



5 February 2018

The Honourable Kenneth Madison Hayne AC QC
Commissioner
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry
by email: FSRCSolicitor@royalcommission.gov.au

Re: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Thank you for your letter dated 20 December 2017 and providing us with the opportunity to respond to the three questions that you have posed based upon the terms of reference.

As you would be aware the Financial Rights Legal Centre is a community legal centre that specialises in helping people understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable people. 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 in NSW, which helps consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took close to 25,000 calls for advice or assistance during the 2016/2017 financial year.

We understand that you have only a very short time to conduct your inquiries and you require a succinct and prompt response. Instead of separating our responses into two different submissions answering Questions 1 & 2 and then Question 3 we have combined responses to all three questions into this one document. We also begin our submissions with some general observations about the financial system in Australia, and a few fundamental concepts and reforms that should be put in place which will relate to all the forms of misconduct and poor conduct mentioned in our responses to your questions.

Please note that we have provided a number of case studies, examples or other evidence drawn from our case work. This is due to space limitations and the need to cover extensive thematic ground. However we can provide more detailed evidence, if requested.

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

Kind Regards,

A handwritten signature in blue ink, appearing to read "Karen Cox", with a flourish at the end.

Karen Cox
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Introduction and General Comments

The last few years have seen a series of high profile scandals hit the banking and finance sector. These media-grabbing scandals have been the extreme symptoms of an underlying malaise that has gripped the entire finance industry – and particularly our large and previously trusted institutions like the banks: a fundamental shift from an individual customer service based industry to a profit-based sales culture which focuses on products and portfolios. As a result, in the last few decades free services like Financial Rights has seen an increase in consumer problems, such as crippling debt, which has driven people into the hands of smaller unscrupulous operators which often fall outside of existing consumer protection regulation. This submission will examine a range of misconduct and poor conduct not meeting community expectations that has occurred over the last 10 years and suggest that while there have been many valuable reforms since 2008, and more are in the pipeline, more could be done to address the root causes of that misconduct and enable a more nimble response from government and regulators to entrenched and emerging issues.

The following fundamental reforms would help to realign our financial institutions with our consumer protection goals:

1. Regulation should define the desired outcomes of financial services regulation as far as possible, as opposed to focusing solely¹ on developing technical rules intended to produce an outcome (for example, that products and services are clearly understood by customers and suitable to their circumstances and objectives);
2. A strong and nimble regulator should be empowered to develop (in consultation with industry and consumers) agreed indicators of whether those outcomes are being met, collect and analyse relevant data, and work with industry to improve outcomes where they fall short²; and
3. The Regulator should be empowered with permanent rule making and intervention powers to promote the desired outcomes where necessary (both in order to motivate industry to engage with the process outlined at point 2 and to allow the regulator to deal with serious or systemic consumer detriment without the need for law reform in every instance).³

The following case study demonstrates the difficulty consumer advocates have faced in the last decade which could be avoided if these three reforms were implemented.

Responsible lending & credit cards – a case study

Unsustainable credit card debt has been a problem in Australia since at least the late 1990's. The introduction of the credit card into the market fundamentally changed attitudes to consumer credit from something you obtained for a specific amount, for a specific purpose and term to an open

¹ This is not to advocate for the removal of all existing rules and prescription. Many technical aspects of the current law are entirely appropriate and are achieving their objective. Others could potentially be repealed once an alternative approach is shown to be more effective.

² See for example Willis, Lauren E., Performance-Based Consumer Law (August 16, 2014) 82 University of Chicago Law Review 1309 (2015).

³ The Parliament could be given an oversight role to prevent over-reach by the regulator.

ended arrangement where people had access to credit “just in case” with no set time limit for paying it back. At around the same time technology was facilitating a shift in credit assessments from an individualised analysis of whether a particular customer would be both able and inclined to pay their loan to broad based statistical models which fed consumer information and loan performance data in and spat out increasingly refined models for predicting the likelihood of repayment. These systems are geared to ensure profit across the portfolio, and will assume an acceptable level of default provided market share and profit are maximised.

The Australian Banking Industry Ombudsman (“ABIO”), the then applicable external dispute resolution scheme released a Bulletin in March 2002 that was critical of the practice of determining a borrower’s ability to pay an increased credit card limit on the basis of their ability to make minimum repayments on the existing account balance. The ABIO argued the ability to pay the minimum repayments was no indication of whether the customer could manage to repay a greater amount of credit.⁴ At the same time Financial Rights (formerly known as the Consumer Credit Legal Centre or CCLC) had reviewed clients’ statements revealing that they had been offered limit increases despite only meeting their minimum payment 50 to 60% of the time, and never making any significant reduction in the total amount outstanding.

Over the years credit card debt and clients presenting with credit card debt related problems continued to rise. In 2005 consumer representatives unsuccessfully sought a commitment from the banks that they would stop offering credit limit increases to customers who were not making significant inroads into repaying their existing debt. For many people credit cards were becoming a long term debt sentence.

In 2008 in the lead up to the Commonwealth taking over the regulation of credit Financial Rights proposed four keys reforms:

1. the banning of unsolicited credit card limit increases;
2. a requirement that eligibility for a credit card be assessed on the basis of a person’s capacity to repay the entire limit available on the card within 3 years (rather than simply meet the minimum repayment amount);
3. a compulsory increase in the minimum repayment required as a percentage of the outstanding debt for all new accounts (minimum repayments were often no more than 2% and sometimes as low as 1.5%); and
4. disclosure on account statements indicating how long it would take the customer to repay the debt if they make only the minimum repayment.

The relevant provisions of the *National Consumer Credit Protection Act* which commenced in 2011 included no credit card specific requirements. There was only a general responsible lending provision (largely because the GFC galvanised the government into action) which would apply to all forms of credit. In 2013 enhancements were introduced that required consumers to opt in to receiving credit limit increase offers but stopped short of banning them, and disclosures now had to be included on account statements indicating both how long it would take the customer to repay

⁴ Australian Banking Industry Ombudsman Bulletin No 33 - March 2002

the debt if they make only the minimum repayment and the amount they would need to pay in order to repay the debt off completely in 2 years.

The Senate Inquiry in relation to credit card interest rates found that:

“While the RBA advised that about 75 to 80 per cent of credit card transactions do not accrue interest, about 65 per cent of the total quantum of credit card debt (or, as noted above, \$33.1 billion) is accruing interest. To clarify, interest paying cardholders 'account for about 30–40 per cent of accounts, about 20–25 per cent of transactions, but close to two-thirds of the outstanding stock of debt'.”⁵

Finally, in 2017 the Government announced further credit card reform initiatives⁶ including:

- Unsolicited credit limits would finally be banned completely;
- Credit providers must assess a consumer’s capacity to pay on repayment of the entire credit limit within a reasonable period to be set by ASIC.⁷

At the same time the independent reviewer of the Code of Banking Practice recommended that the new 2018 Code should contain a commitment to assessing credit card applications on the basis that the customer can afford to pay the entire approved limit within a period.

Statistics released by the Reserve Bank of Australia show that as at June 2016 there were 16.5 million credit cards with outstanding balances of \$52.2 billion.⁸ Sixty-three % of outstanding balances, or almost \$33 billion, was accruing interest. This represents a 25 % increase in balances accruing interest over the past 10 years.⁹ These statistics correspond with the huge increase in household debt. Credit cards top the list of consumer finance products motivating calls to its National Debt Hotline, and have done every year for the past three years.

Over the last ten years banks and other credit card providers have been dragged kicking and screaming along every step of this reform journey. The problems and potential solutions have been apparent for over a decade. This should be a case study of credit card products providing consumers with a means to purchase goods and services that meet their needs, while financial service providers (FSPs) make a reasonable profit. Instead this case study demonstrates that the profitability for FSPs is maximised when consumers are overcommitted to the point where they can meet their minimum repayments but struggle to reduce their debt quickly, if at all. This guarantees a long term income stream for the bank, at relatively high interest rates. It also allows banks to offer the convenience of credit card transacting to majority of their customer base for an effectively subsidised cost. For the large minority of indebted consumers this is the worst possible outcome:

⁵ Final Report of the Senate Economics Committee: Interest rates and informed choice in the Australian credit card market, 16 December 2015 para 2.9

⁶ Treasury, Credit cards: improving consumer outcomes and enhancing competition <https://treasury.gov.au/consultation/credit-cards-improving-consumer-outcomes-and-enhancing-competition-2/>

⁷ There are other important reforms in relation to the charging of interest and the ease of reducing your credit limit or cancelling your card.

⁸ Reserve Bank of Australia, 'Statistical Tables - Credit and Charge Card Statistics C1', 2016, available at: <http://www.rba.gov.au/statistics/tables/index.html#money-credit>

⁹ Ibid.

expensive long term debt. At best this is a poor financial outcome which inhibits people's ability to achieve their financial goals. At worst it creates severe financial stress, impacting on health, productivity and family relationships.

Banks and other credit providers have alternatively denied there is a problem, sought to manage any reform to ensure that the status quo is maintained, or, in more recent times, addressed the extreme cases with laudable hardship processes, whilst continuing to reap the rewards of the high interest and late fees on the remainder of the revolving debt cohort.

Financial Rights notes that the government is currently proposing significant reforms with respect to the offer of credit cards under the *National Consumer Credit Protection Amendment (Credit Cards) Regulations 2017*. These reforms have been introduced to address a number of the more egregious credit card sales practices and responsible lending practices including:

- card issuers did not assess a customer's suitability based on a consumer's ability to repay the credit limit within a reasonable period.
- unsolicited credit limit increase offers;
- retrospectively charging interest on credit card balances;
- not providing consumers with easy, online options to initiate a card cancellation or reduce their credit limit.

We support the credit card reforms before the Parliament¹⁰ as they include changes we have been lobbying for over a decade. However, there is a risk these reforms won't work because, like many other reforms, they are technical requirements prescribed in the hope of achieving a particular outcome, rather than prescribing the desired outcome itself. Such technical reforms are always at risk of being manipulated by financial service providers who make minimal changes in order to "comply" but preserve their current business models as much as possible.

If the fundamental reforms that we describe above were in place, credit card consumer protections would not have taken a decade to be introduced. An empowered and nimble regulator would have been able to work with industry to improve these products so that a more fair and balanced outcome was reached: credit card products provide consumers with a means to purchase goods and services that meets their needs, without incurring enduring debt.

In the following sections as this submission addresses the Royal Commission's Questions, we will return to these fundamental reforms which we strongly argue would transform and improve the entire financial system.

¹⁰ Although we would prefer that capacity to repay be required to be assessed over 3 year rather than "a reasonable period" as defined by ASIC.

Specific Responses to Questions

Financial Rights has in its work with people experiencing financial hardship identified both misconduct and conduct, practices, behaviours and business activities that fall below community standards and expectations. From the design of low value products and bad sales and marketing practices to poor customer service standards and claims handling, we have seen a vast array of poor conduct across the life cycle of a consumer's relationship with a financial services provider.

In developing this response we have grouped together the worst of the practices we've seen and sought to divide them into those that can be considered misconduct (illegal or otherwise) and those practices that fall below community standards and expectations. We have then provided a brief summary addressing each of your questions directly at the end of each thematic areas. The areas we address are: (1) Problematic sales and marketing practices; (2) Conduct undermining financial hardship provisions; (3) Fee charging practices (4) Poor Customer service standards and practices (5) The development and design of poor value financial products

1. Problematic sales and marketing practices

Financial Rights has long held serious concerns with respect to the sales practices and culture of the financial services sector. Much of the misconduct and behaviours in sales of life, general and add-on insurance have been well documented. Problematic sales practices, including the failure of responsible lending, arise too in the credit and lending space leading to poor outcomes for consumers and high levels of household debt. Financial Rights has also identified a particular issue with respect to sales practices targeting Aboriginal communities.

1.a. Insurance sales and marketing practices

Life insurance sales and marketing

A large proportion of the problems raised with the Insurance Law Service focus on:

- the general mis-selling of life insurance products by insurers;
- bad or incorrect advice from advisors and other sales agents at the time of purchase;
- the mis-selling of problem products most particularly funeral insurance;
- the mis-selling of replacement policies by financial advisors leading to issues of non-disclosure or the loss of accrued benefits.¹¹

Consumers buying life insurance will often use a financial adviser to make the arrangements. These financial advisers receive high upfront and ongoing commissions for selling life insurance, even though commissions are banned for all other kinds of personal advice. Commissions however give

¹¹ See case studies detailed at pp. 41-42, Financial Rights, Submission to the Senate Economic References Committee Inquiry into Consumer Protections in the Banking, Insurance and Financial Sector, March 2017 http://financialrights.org.au/wp-content/uploads/2017/03/170307_ConsumerProtections_Sub_FINAL.pdf

an adviser a strong incentive to place consumers in the policy that attracts the biggest payment for them, not necessarily the policy that's best for the client. There is clear evidence that advisers who receive commissions are more likely to recommend inappropriate products for their client and are more likely to switch a client into a new product unnecessarily.

Current remuneration arrangements encourage advisers to sell products rather than provide quality personal advice. Being sold an inappropriate life insurance product causes long-term financial and personal harm to consumers. It means consumers waste money on a product they can't use, and should something go wrong, they or their families are not covered as expected.

Misaligned commissions can also affect sales in direct distribution of insurance products. Most insurers also operate under a "no advice model" where sales staff avoid giving any explanations or guidance as to the product features. This, combined with poor or minimal training, and a sales process designed to meet the insurer's needs rather than the consumer's needs regularly leads to poor consumer outcomes and mis-sold products.

We refer you to the case studies below in relation to funeral insurance.

Life insurance and superannuation

Life insurance products are also bought by Superannuation Trustees as group insurance products where there are an entirely different set of misaligned incentives, problematic practices and poor consumer outcomes.

For example, some consumers simply take up the default superannuation of an employer and tick a box on the form on their first day of work. They may take the form home and consider it overnight. They may not know what to choose, seek out further information and subsequently have information sent out to them. They may not realise they hold a superfund and existing insurance and hold multiple policies. For many, insurance is automatically provided and members are not even aware that they are a beneficiary under the policy.¹² In these circumstances consumers are provided with an opt-out option. For others still, life insurance is an option that is not automatic at all and is made available only if it is sought after explicitly (eg Future Super).

In our experience, this model has led to a large number of consumers being unaware that they have an insurance product via their superannuation and are surprised when they find out – sometimes pleasantly because they need the money, sometimes unpleasantly, given they have paid a significant amount in premiums and fees with no benefit. The Productivity Commission too confirms this impression.¹³ Financial Rights has even heard from callers who claim that they never ticked the box to take up the insurance product.

¹² Under the *Superannuation Industry (Supervision) Act 1993*, all MySuper products are required to provide life and TPD insurance to members, and may choose to provide income protection insurance, by default, as long as '... the cost of the insurance does not inappropriately erode the retirement income of beneficiaries': SIS Act, s. 52(7)(c). MySuper members may elect to opt-out of the insurance cover.

¹³ "many members are unaware whether they have insurance through their superannuation; even those that are aware tend to lack a good understanding of their cover" p. 189 <http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency/report/superannuation-competitiveness-efficiency.pdf>

Superannuation trustees have relied too much on a default model of group insurance and have failed to provide appropriate, easy to understand information to better communicate with consumers at the inception of insurance coverage. This has led to poor consumer outcomes such as account balance erosion, where people have multiple super accounts each with insurance premiums eating away at their accrued values. The Superannuation sector has however failed to address these issues. An Insurance in Superannuation Working Group was established to seek solutions but were ultimately unsuccessful in introducing a mandatory Code with effective standards. Instead due to competition issues and industry disagreement, the sector introduced a voluntary, watered down Code of Practice that will not address the key issues faced by consumers in this space. Financial Rights is not against the inclusion of insurance in superannuation however the insurance and superannuation industries must ensure that this insurance is not junk.

Add-on insurance sales

Exploitative add-on insurance and sales practices by car-dealers, banks and other third party distributors have been an issue for many years highlighted by a string of government inquiries¹⁴ and ASIC investigations and surveillances¹⁵. ASIC's 2011 report into Consumer Credit Insurance (CCI) Sales practices by banks, for example, demonstrated significant use of harassing tactics and high pressure sales approaches including:

- staff persisting with an insurance sales pitch to a consumer who has clearly indicated they do not wish to purchase the product;
- the practice of keeping consumers 'captive' until after the insurance sales pitch has been completed;
- using the insurance cooling-off period as a selling point;
- highlighting the risks of not having insurance if the consumer became sick or unemployed, without providing information about other alternatives such as financial hardship variations; and
- deliberately masking the cost of the insurance in the loan repayment.
- consumers being sold CCI products without their knowledge or consent;
- serious deficiencies in the scripts used for the sale of CCI products.¹⁶

¹⁴ Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into the *Corporations Amendment (Future of Financial Advice) Bill 2011*; and the PJC Inquiry into the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*. Both of these made specific recommendations about the need to monitor the quality of advice about the sale of risk insurance.

¹⁵ ASIC Report 413 *Review of Retail life insurance advice*, October 2014 <http://download.asic.gov.au/media/2012616/rep413-published-9-october-2014.pdf>; ASIC Report 454 *Funeral insurance: A Snapshot*, October 2015 <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-454-funeral-insurance-a-snapshot/>; ASIC Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no*, February 2016; <http://download.asic.gov.au/media/3549387/rep470-published-29-february-2016.pdf>; ASIC Report 471 *The sale of life insurance through car dealers*, February 2016 <http://download.asic.gov.au/media/3549384/rep471-published-29-february-2016.pdf>; ASIC Report 492 *A Market that is failing consumers: The sale of add-on insurance through car dealers* <http://download.asic.gov.au/media/4042960/rep-492-published-12-september-2016-a.pdf> and ASIC Report 498 *Life Insurance claims: An industry review* <http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>

¹⁶ ASIC Report 256: *Consumer Credit Insurance: A review of sales practices by authorised deposit-taking institutions*, October 2011 <http://download.asic.gov.au/media/1343720/rep256-issued-19-October-2011.pdf>

ASIC's most recent *Report 498 into the Life Insurance Industry* found that "problematic sales practices may lead to poor claims outcomes"¹⁷ including policies sold that were manifestly unsuitable and consumers being misled about the cover under the policy.

Reports by ASIC from 2011 and 2013 demonstrate misconduct with CCI sales practices by Australian banks and other financial service providers. Westpac, for example, has been required to repay consumers who have been mis-sold CCI associated with its home lending, and Esanda has agreed to compensate consumers for sales conduct of a broker which included selling add-on products without the knowledge or consent of the consumer.¹⁸

The issues identified by ASIC five years ago however continue to occur. Consumer Action's December 2015 report *Junk Merchants*, details the serious problems of add-on products including their low claim rates, high decline rates and the fact that they are regularly mis-sold.

Case study – Theresa's story

Theresa has held a credit card account with her Bank since 2001. She only just found out that she was paying \$26-27 per month for insurance to cover her if she was retrenched or to cover medical expenses. At the time she signed up to the card she was a student, not working and receiving Centrelink income. The product was totally unsuitable for her since she could not make a claim. Theresa worked casually in 2003 in a bar for a couple of years. She did not commence full time work until 2006. She stopped working in 2012 when she became pregnant. Since then she has been caring for her child. She intends on studying her masters before returning to work. In 2007 she replaced the credit card with two new credit cards. At the time she was not advised that she had the insurance product that she was paying for. Because she was overdrawn one month ago she was advised that one of the charges was for insurance \$27 per month. It was only then that Theresa realised she had the insurance and had paid a total of \$5000 in premiums since 2001.

Like the credit card reform example at the beginning of this submission, for many consumers, add-on CCI is not functioning as a useful and valuable product. For most this product is useless junk that is highly profitable to the insurance companies and the lenders selling it. By selling CCI FSPs are not providing a useful service; instead they are engaging in a legal rip off. Even during recent negotiations over the content of the new 2018 Banking Code of Practice, it became clear that despite conceding there may be a problem (after ASIC released two reports concluding there was) the goal from the banks' perspective was to ensure they could no longer be accused of misleading consumers about the benefits of the product – they were aiming for a type of informed consent, whereas the goal should be to offer products that are useful and beneficial to the consumers who purchase them.

¹⁷ Op Cit. ASIC, para 93

¹⁸ For further information see Consumer Action's *Junk Merchants: How Australians are being sold rubbish insurance and what we can do about it*, December 2015, <http://consumeraction.org.au/Junk%20Merchants%20-%20Consumer%20Action%20Law%20Centre%20December%202015.pdf>

Misleading and aggressive advertising and marketing of insurance products

There are significant issues relating to the advertising and marketing of insurance products and the claims made in these representations. For example, much of the advertising in funeral insurance is based on exploiting anxiety or guilt, or other ethically questionable techniques. Products are promoted to customers in situations where it is evident that the product is worthless or of very low value to that customer. Insurance advertising tends to use terms such as “no cost,” “without cost,” “no additional cost” or “at no extra cost.” Advertising emphasises some aspects of an insurance product, ignoring other critical elements such as failing to make explicit the nature of stepped premiums and level premiums.

These sales practices have led to significant misunderstandings regarding the nature of the products being sold with significant consumer confusion. Combined with the poor sales techniques detailed above, it has led to the situation where somebody can hold 10 funeral insurance plans, a general misapprehension that insurance products (like pet insurance or funeral insurance) are savings plans, that life insurance is for life, that comprehensive insurance covers all scenarios, and that insurance is not a shared risk between insurer and the policyholder.

Aggressive telemarketing, over reliance on cooling off periods for people to read product disclosure statements and the ease of obtaining payment from even very low income earning customers via direct debit combine to have resulted in appalling outcomes as demonstrated by the following recent clients of Financial Rights.¹⁹

Case study – Daniel’s story - C136333

60 year old Daniel is on the Disability Support Pension. He has Bipolar Disorder and an acquired brain injury. He lives alone in community housing. When he contacted Financial Rights he was paying for 11 funeral insurance policies – 5 of which were with the same insurer, 2 with another! \$140 in premiums he could not afford was coming out of his fortnightly benefit payments.

Daniel instructed Financial Rights that the insurer kept ringing him and offering him more insurance, knowing he had existing policies. The products are stepped, meaning the cost will simply increase over time. Daniel’s income will remain substantially the same. With the increase in premiums and the costs of living, it is inevitable Daniel’s policies will lapse before he is able to claim.

Case study – John’s story - C142817

John is a 58 year old indigenous male living in a remote community at the tip of the Cape York Peninsula. He is isolated, doesn’t have any family around him and when he came to us, was receiving only a Centrelink Newstart benefit, he worked casually from time to time. He had paid over \$12,000 in insurance premiums over the past 3 or 4 years when he was referred for assistance. He had 4 policies with 3 separate corporate authorised representatives of the same Australian Financial Services licensee.

¹⁹ The majority of the premiums paid in these cases were refunded after Financial Rights raised disputes with the insurer’s (or lodged disputes in the Financial Ombudsman Service) but our concern is for the systemic sales practices and other clients who have not sought assistance.

As part of investigating whether he had a case for seeking the return of the amounts paid – the recordings were requested and damning: In one instance he was told he was just being called to deliver more information after he completed a survey but he was signed up on the spot. In another he was asked whether he had funeral insurance already and replied “I think so” but the salesperson proceeded to sign him up to another policy anyway. The worst was where he answered the phone and said “I’m not having a good day, I’m in hospital” but the sales rep persists with the hard sell despite his replies being unintelligible most of the time.

Case study – Lynda’s story - C138561

Lynda is an Aboriginal woman on the Aged Pension. She was sold life insurance after she allegedly provided her authority when she completed a survey. She expressed a desire not to leave her children out of pocket for her funeral expenses but she was sold a \$100,000 life policy with stepped premiums. She was attracted by the prospect of being able to provide to her kids a lump sum without comprehending the long term cost and uncertainty. She contacted Financial Rights when the premiums reached \$115 per fortnight and she could not afford to pay them. By that time she had spent over \$8,000 on the policy and could have saved up for her own funeral; instead she was facing losing the lot because she could not longer afford the premiums.

Exploitative mis-selling of products into Aboriginal communities

Unfortunately it has become clear in recent years there are several financial service providers that have been using problematic sales practices to target vulnerable communities such as remote Aboriginal communities.

For instance, certain insurers have been exploiting the importance of funeral ceremonies in Aboriginal culture to sell unsuitable funeral insurance plans.²⁰ Another example involved remote Aboriginal communities have been targeted by payday lending and consumer lease companies through the use of Centrelink’s Centrepay system.²¹ Financial Rights also details the systematic exploitation of Aboriginal people in Alice Springs below with respect to the sale of credit cards and consumer leases at a Large Department Store.

General insurance sales practices

General insurers (like life insurers) sell insurance products under a general advice²² or no advice distribution model. This means that sales staff (be it of the insurer, an authorised seller such as a bank or car dealer or a third party distributor) promote the insurance product but do not tell the

²⁰“Babies among thousands of Aboriginal children signed up to 'shocking' funeral insurance schemes” ABC, consumer affairs reporter Josie Taylor, 21 Nov 2015, available at: <http://www.abc.net.au/news/2015-11-21/aboriginal-babies-being-signed-up-to-shocking-insurance-schemes/6958342>

²¹“Radio Rentals made \$90 million from Centrelink payments last year” ABC, Consumer affairs reporter Josie Taylor, 20 Mar 2015. at: [http://www.abc.net.au/news/2015-03-20/radio-rentals-reaps-\\$90-million-in-centrelink-payments/6333690](http://www.abc.net.au/news/2015-03-20/radio-rentals-reaps-$90-million-in-centrelink-payments/6333690); “Ongoing probe into appliance rental market” Appliance Retailer, 14 September 2015, available at: <https://www.applianceretailer.com.au/2015/09/ongoing-investigation-into-appliance-rental-market/>

²² Section 766B Corporations Act

consumer whether or not it is suitable or meets their needs. This exacerbates the inherent information asymmetry between the consumer and the insurer leading to poor outcomes for consumers who are provided with insufficient or inadequate information to inform their decisions or to engage with the complexities of these products.

Under a no advice or mere general advice model the advertising of insurance products becomes one of, if not the only way consumers are informed about the products that they are purchasing. Combined with the fact that insurance products tend to be those products where their performance or quality is not apparent until well after the point of sale (ie. at claims time) this leaves a significant amount of room for insurers to behave and market in a way that misleads consumers and prevents consumers from making the right choices about products that suit their needs.

A no advice model also leads to an over-reliance on disclosure to provide the information that consumers need to engage with in order to make the correct choices. Disclosure is largely sold as a key consumer protection on the assumption that if you just tell the consumer what they need to know then they can make decisions for themselves.²³ It was seen as a way to address the information asymmetry between consumers and insurers inherent in the insurance sector and the financial services sector more broadly. This is now commonly recognised as a failure.²⁴

Financial Rights commonly hear consumers complaining they have been caught by “the fine print”. In some instances the fine print is incomprehensible.

Disclosure is failing in its intent to suitably inform the consumer. Disclosure documents are overly complex, long and ineffective in empowering consumers to make informed choices at the point of sale. Consumers largely do not engage with these documents.²⁵ Disclosure has morphed away from promoting consumer understanding and towards insurers simply complying with the rules, managing liability, and reducing claims outcomes.

Case study- Barry’s story - C155930

In February 2017 Barry purchased return overseas travel tickets to depart Australia on 14 October 2017, and thus became eligible for complimentary travel insurance through his credit card. Early in the morning on 12 October 2017, he went to the emergency department at Hospital. Later that same morning, his wife contacted the Insurer to tell them he had been hospitalised. He was admitted later that day, and was eventually discharged on 20 October 2017 with a principal diagnosis of pneumonia. His Doctor advised that he was not fit to fly. His wife, on his behalf, made a claim for unexpected

²³ There is a mandated disclosure regime for financial products is contained in Chapter 7 of the Corporations Act 2001, the PDS regime for General Insurance under Part 7.9 of the Corporations Act, Key Fact Sheets under the Insurance Contracts Amendment Act 2012.

²⁴ See ICA, *Too Long; Didn't Read: Enhancing General Insurance Disclosure: Report to the Effective Disclosure Taskforce to Insurance Council Board* <http://www.insurancecouncil.com.au/assets/Effective%20Disclosure%20Report.pdf> and ICA, *Consumer Research on General Insurance Product Disclosures, Research findings Report, February 2017* http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf

²⁵ ICA, *Consumer Research on General Insurance Product Disclosures, Research findings Report, February 2017* http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf and also ASIC commissioned Susan Bell Research into consumer experiences with purchasing home building and contents insurance, including the use of insurer disclosure material found that only 20% of consumers who took out a new policy or considered switching their policy said that they read the PDS: Susan Bell Research (October 2014), *Insuring your home: Consumers’ experiences buying home insurance*, ASIC Report 416.

cancellation of travel pursuant to “Benefit 3: Unexpected cancellation of travel arrangements and other unexpected expenses of my policy (pages 39-42 of the PDS).” All medical records requested by the Insurer were provided.

The Insurer in rejecting the claim relied solely on the general exclusion wording:

any condition, including but not limited to mental disorder, anxiety, alcoholism, drug addiction or pregnancy and/ or any physical, medical or dental condition, for which investigation (whether or not a diagnosis has been made), treatment or advice is received, or medication prescribed or taken, after you obtained your return overseas travel ticket, but prior to the commencement of your journey;

Financial Rights assisted in drafting a dispute with the Insurer arguing that if the Insurer’s interpretation is correct, it means that, contrary to what is suggested by the wording of Benefit 3, there are in fact no circumstances in which the Insurer would provide cover for cancellation expenses where the cardholder became ill after purchasing their ticket but before departure. Even where the cancellation was caused by an illness which was entirely unexpected and not in any way related to any medical condition or condition for which there had been medical investigations etc. prior to purchase of tickets, the Insurer would not provide cover. That is, the cover purportedly provided by Benefit 3 where the reason for cancellation was either of the two matters quoted above would be completely illusory.

A general or no advice model also leads to significant underinsurance in the market. This is because consumers having difficulty in engaging with insurance for example estimating rebuild costs, the lack of access to effective tools to estimate rebuild costs; consumers fail to change rebuild values with rising prices; and home building policies are difficult and complex to compare, including sub-limits and optional extras Insurers also rely heavily on disclosure of the sub-limits. This is inadequate, as disclosure by PDS alone is insufficient in fully informing a consumer as to limitation of cover.

The no advice model leads to the misbehaviour described above with respect to authorised and third party distributors who promote products to customers in situations where it is evident that the product is worthless or of very low value to that customer; and engage in high pressure sales practices, practices based on exploiting anxiety or guilt, or other ethically or legally questionable selling techniques. Reverse competition – where insurers compete in the distribution market with offers to car dealers of high and distorted commissions - and other sales incentives are direct results of the structure of the general and no advice models.

Summary: Problematic insurance sales and marketing practices

Question 1 - Misconduct

- Advisers have failed to comply with the laws relating to appropriate advice and prioritising the needs of the client.²⁶
- Exploitative mis-selling of add-on insurance products²⁷

²⁶ ASIC Report 413 *Review of retail life insurance advice* (REP 413), available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/>

Question 2 – Conduct, practices, behaviours or activities below community standards

- Bad, incorrect or self-interested advice from advisors and other distributors leading to:
 - a. the sale of problematic or low value products such as funeral insurance;²⁸
 - b. the mis-selling of replacement policies by advisors leading to issues of non-disclosure or the loss of accrued benefits;
 - c. the use of high pressure and other misleading sales techniques designed to boost profits, not serve consumer need.
- Automatic insurance sales in superannuation and subsequent account erosion.
- The use of exploitative advertising techniques that play on anxiety or guilt, use inappropriate terms and imagery that undermine understanding, contradict key product characteristics, detract from the prominence of important statements and generally mislead customers.
- Automated renewals without clearly informing consumers of the feature.
- The use of complex, long and ineffective disclosure documents to simply comply with the rules, manage liability, and reduce claims outcomes.

Question 3(a) – Attribution to broader cultural or governance practices

- The use of high upfront and ongoing commissions for advisors misaligning incentives;
- The reliance on the general or “no advice” model in insurance sales.
- Not recording the sales process and maintaining these records for an appropriate length of time.
- A reliance on automatic renewals as a sales model.
- An over-reliance on disclosure placing the onus on the consumer to engage with and understand the insurance.
- The use opt-out default life insurance sales practices in superannuation

Question 3(b) – Attribution to other practices (i.e. remuneration)

- No effective oversight over authorised distributors and other third parties.

Question 3(c) – Effective mechanisms for redress available

- Insurance policyholders have access to free dispute resolution through an industry funded ombudsman (either FOS or the CIO) or the SCT in superannuation, where they can seek redress.
- There are however few options for redress in mis-sold junk insurance products given a large segment of the consumer base are unaware that they even have the product. When they do they simply cancel rather than seek redress for the mis-selling in the first place. FOS is an option but under-utilised one. Consumer Action has established a DemandaRefund.com

²⁷ ASIC Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492) available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-492-a-market-that-is-failing-consumers-the-sale-of-add-on-insurance-through-car-dealers/>

²⁸ ASIC. Report 454 *Funeral insurance: A snapshot* <http://download.asic.gov.au/media/3393361/rep454-published-29-october-2015.pdf>

website. Consumers are often reliant on long-delayed, intermittent enforcement action from an under-resourced ASIC.

- While responsible lending laws exist in credit an equivalent suitability regime in insurance does not exist.

1.b. Credit and lending sales practices

Banks and credit providers have responsible lending obligations to ensure that any credit granted to customers must not be unsuitable and the customer can afford to repay without substantial hardship. However a number of poor sales and marketing practices, including failures to fully comply with the letter and/or spirit of these obligations, have led to significantly increased levels of household debt and financial hardship.

Credit card sales

Credit cards have been a key source of problems for consumers for over a decade, as we have discussed in the case study in the introduction to this submission. Financial Rights notes that the government is currently proposing significant reforms with respect to the offer of credit cards designed to address a number of the worst credit card sales practices and responsible lending practices including. There are however other exploitative practices that continue to occur.

The offer of “honeymoon” interest rates where promotional interest rates are used to induce consumers to enter into credit card contracts who are unable to repay the debt once the promotional period is over, incurring large interest charges. Credit card issuers of low interest honeymoon periods take advantage of consumers with low levels of financial literacy, who do not understand or consider the actual impact of interest rates until it is too late.²⁹ Further, while banks are able to offer honeymoon interest period credit cards to lure in vulnerable consumers, there is little incentive for these banks to reduce credit card interest rates in order to become more competitive.³⁰

In our experience consumers take up balance transfer offers with the intention of saving some money and paying off as much as possible during the interest free period (and therefore pay little or no attention to the rate the card reverts to at the end of the period). Quite often this is unrealistic in the first place given their capacity to pay, or they keep using the card and do not make any inroad into the debt. Worse, in many cases the previous account (that they transferred the balance from) is kept open and they use it, resulting in even higher debt levels.

²⁹ Ian McAuley, ‘Behavioural Economics and Public Policy: Some Insights’ (2013) 4 *International Journal of Behavioural Accounting and Finance* 1, 22.

³⁰ *Ibid.*

Another phenomenon that Financial Rights has increasingly seen is the packaging of mortgages with a mandatory credit card, for example, the ANZ Break Free Home Loan Package.³¹ While this is not strictly speaking an unsolicited credit limit offer – it is worse – it is the mandatory provision of a credit card to have access to a particular home loan. This practice is inconsistent with the requirements and objectives of the responsible lending provisions.

There is a significant issue with respect to the sale of credit cards and other financing by point of sale retailers, this space includes non-bank lenders as well as bank lenders.

Case study – Large Department Store systemic mis-selling³²

Financial Rights last year acted on behalf of a large number of Aboriginal clients in the Northern Territory following the sale of goods at a Large Department Store via credit card and consumer lease contracts initiated in the store. The salesperson told our clients the goods were cheap, they could pick out anything in the store and it would be sent to them. The sales person did not ask what their income and expenses were and completed the application forms, usually for both a consumer contract and a credit card, without the clients understanding what was happening. All the application forms were filled out by the salesperson and were all completely incorrect. The credit and consumer lease providers involved (both non-bank lenders in this instance) subsequently approved the credit cards without verifying the information, or properly assessing the affordability and suitability of the card. The average spend by these consumers was \$12,500. Some of them had only entered the shop to browse or purchase a very low value item.

The sale of credit cards and other credit forms of credit by these distributors, raises serious questions about the continued exemption of point-of-sale retailers from the *National Credit Act*. These distributors:

- are not required to meet any entry standards and ASIC is also unable to exclude vendor introducers from the credit market (even if they engage in conduct that is incompetent or dishonest);
- select, recommend or propose credit products without having to conduct an assessment as to whether the product is suitable for the consumer, or meets their financial requirements or objectives; and
- there are limitations on the ability of consumers to access remedies for the conduct of vendor introducers, including lodging their disputes with a recognised external dispute resolution scheme.

Irresponsible lending via motor vehicle dealerships

A significant part of the lending sector's sales and distribution model is via third party intermediaries such as mortgage brokers (dealt with in more detail below) and motor vehicle dealerships. When consumers buy a motor vehicle at a dealership, many require finance. In doing so

³¹ <https://www.anz.com.au/personal/home-loans/your-loan/breakfree-package/>

³² C148716, C139043, C138999, C138324, C138085, C144889, C138850, C149250, C148247, C150556, C150562, C149254, C150560

they enquire with the dealer directly or the dealer raises the matter and brokers the loan as part of the sales process. Consumers end up having very little contact or no contact at all with the lender during this process. Indeed, there is very little oversight by lenders over the entire dealer sales processes – mainly because they contract themselves out of any responsibility: see for example Sachin’s story below and the application terms included.

Motor vehicle dealers are paid commissions on loan sales, which fundamentally misalign the incentives in selling financial products, with the best interests of the consumer not considered. Financial Rights has also seen high levels of motor vehicle finance churn, where consumers with older cars still on finance, or with balloon payments are being upgraded or refinanced with increased finance. We suspect that dealers develop strategies to promote car upgrades and refinancing given commission structures incentivise increased financing sales.

Add to this the sale of poor value insurance products such as CCI, gap, tyre and rim and extended warranties, sold under their own commission based sales structures and you have a market designed to put profits over positive consumer outcomes.

This has inevitably led to significant issues with respect to lenders and dealers not meeting their responsible lending obligations under the National Credit Act. There have subsequently been a number of instances of serious misconduct identified by ASIC.³³

Despite these enforcement measures in individual cases, there remain few moves by the banking sector to address the fundamental structural problems in outsourcing their obligations and use of commission-based incentives driving poor outcomes in this sector. ASIC has begun a process of developing solutions but are, as suggested at the beginning of this submission, hampered by a lack of resources and power required to resolve the issues.

Case study – Sachin’s story – C138654

Sachin works full time in IT, earns \$3,500 per month and boards in a house. The rent is reasonable, and below market rent. He has a car on finance which he just purchased. However, a few weeks after the purchase the car breaks down. He does some online research and becomes concerned that he has bought a lemon. He goes to a dealership, as he wants to trade in his car and purchase a more reliable one.

Sachin’s ‘lemon car’ had a trade-in of \$23,000 value. His finance over the car was \$43,000. The new car price is \$30,000, plus extras including stamp duty, origination fees and some add on insurance. The new loan is for \$63,000 over his new \$30,000 car. The payments are \$645.87 per fortnight. He agrees

³³ ASIC, *Media Release, 17-410MR Volkswagen Financial Services Australia pays \$216,000 penalty for misleading advertising*, 28 November 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-410mr-volkswagen-financial-services-australia-pays-216-000-penalty-for-misleading-advertising/>.

¹³ ASIC, *Media Release, 16-417MR ASIC action sees BMW Finance pay \$77 million in Australia’s largest consumer credit remediation program*, 6 December 2016, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-417mr-asic-action-sees-bmw-finance-pay-77-million-in-australias-largest-consumer-credit-remediation-program/>

¹⁴ ASIC, *Media Release, 18-013MR ASIC acts against ANZ for breaching responsible lending laws in its former Esanda car finance business*, 18 January 2018, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-013mr-asic-acts-against-anz-for-breaching-responsible-lending-laws-in-its-former-esanda-car-finance-business/>

and gives the dealership all of his details. The dealership get him to sign the application form:

I/we the Applicants for finance

- *Declare that the details in this application are true and correct and are not by omission, or otherwise misleading.*
- *Acknowledge that the dealer named in this application (the "Dealer") is not acting as my agent in relation to my application for finance from [Bank] and is not authorized to negotiate in relation to the loan contract on my behalf.*
- *Acknowledge the Dealer may perform some activities under the National Consumer Credit Protection Act on behalf of [Bank] as its agent, except in undertaking customer identification or providing documents as legally required.*
- *Am/Are liable to pay the Origination fee shown in the Loan Agreement to the Dealer for reimbursement of its administrative costs in the amount of \$770.00 inclusive of GST.*
- *Authorise the Origination Fee to be included in the Loan Agreement and for [Bank] to make the payment on my/our behalf to the Dealer.*
- *Have requested my total monthly household expenses be reduced when assessing this loan as my spouse/de facto contributes to these expenses, is in permanent (not casual) employment and has a net monthly income as detailed above.*
- *Have chosen to finance one or more insurance products and confirm the agent for the insurance company (Dealer) has explained the benefits, exclusions and cost of the products) and the impact and cost of including the premium in the amount financed.*
- *Have selected a balloon repayment (larger final repayment). I understand I will be required to make this final payment on the final repayment date.*

Sachin signs the contract, not really understanding he has just signed an application form that indicates that he has a de-facto who shares his household expenses, a feature the dealer added in without his knowledge. Sachin doesn't have a spouse. His expenses are all paid for him by him. The loan repayments represent 50 % of his income.

Sachin struggles to make the payments. Shortly after he is required to leave his residence and needs to rent elsewhere. He struggles to make the payments and he surrenders the vehicle. The shortfall after the sale of the vehicle is approximately \$42,000.

He raises a dispute with the lender with the assistance of Financial Rights. After some investigation they agree to put him in the position prior to the loan being granted, reducing the debt to \$20,000. Sachin still is unable to afford the debt and he has no car.

Case study –Harriet's story – C140565

In November 2016 Harriet refinanced her car loan through her Bank and traded in an old car for another car with a purchase price of about \$36,000. The amount financed was \$52,000 and the total amount repayable over the term of the loan was to be about \$80,000. The repayments under the loan were approx. \$950 per month.

Harriet has been receiving the Parenting Payment from Centrelink since 2014 and worked in various casual jobs since that time. At the time of obtaining the loan, she was working in a casual position which commenced one month before. She defaulted on the first two repayments in December 2016 and January 2017 and made one repayment in February 2017. We raised a dispute with IDR on the basis of irresponsible lending due to:

- No enquiries were made about what she could afford or what she wanted to spend
- Numerous errors on the finance application form relating to the value of her assets

- Omission of debts and regular repayments she was making at the time including payments to a Consumer Lease Company, a Debt Collector and payments to relatives
- Clear failure to verify her financial situation.

The bank after some time settled and sold the car and relieved her of paying any shortfall.

Case study –Terrence’s story – C138847

Terrence identifies as Aboriginal and he instructs us he has never had a car loan. In early 2016 he saw an advertisement on TV about a car sale over the following weekend at a Car Dealer. He called and informed them that he would come in the next day to inspect a vehicle.

When he attended the car yard he was taken to a vehicle already selected by a member of staff to test drive (a 4WD). The purchase price of the car was \$32,990. After they returned from the test drive he was shown various documents to review and sign. He drove away with that vehicle that very same day.

He told Financial Rights that he had wanted to purchase a small hatchback for between \$15,000 to \$20,000. He was working as a wardsman at a hospital at the time and needed a small car just to commute between home and work.

He attended the car yard again three days later where he took in his payslips and signed further documents including the Loan Agreement. The loan was to be provided by a Bank for an amount of approx. \$35,000 (which included insurance and fees).

Terrence had indicated to staff at the Car Dealer that he could afford repayments of \$200/fortnight. But the loan repayments to the Bank were almost double this at approx. \$775/month. Over 60 months it would total approx. \$46,000.

Terrence was also homeless at the time, temporarily staying with his niece. Terrence defaulted on his repayments 3 months later in June 2016. When he came to us in November 2016, we raised responsible lending and unjust contract with the Bank.

Terrence surrendered his car and in April 2017, the Bank agreed to release him from all liability.

Mortgage brokers

Financial Rights is concerned with the inherent conflict of interest in the broker remuneration model and the poor practices identified by *ASIC Report 493 Review of interest-only home loans: Mortgage brokers’ inquiries into consumers* including:

- Brokers only providing general information, rather than tailored information on specific products and loan features;
- Poor record keeping;
- Poor provision of loan choice explanation.

ASIC Report 445: Review of interest only home loans also identified key failures in relation to ensuring such loans were affordable and met the borrower’s objectives and requirements, with a greater proportion of interest-only home loans being sold through third party or broker channels than directly. Interest-only loans cost more over the life of the loan and leave consumers more vulnerable to hardship and market movements because they do not acquire any equity during the

interest free period.³⁴ In 2015, prior to recent intervention by APRA, interest only loans represented 45% of new loans approved by banks.

In 2015 CHOICE magazine conducted a shadow shop of mortgage brokers³⁵ and found three key problems:

- Clients were not well-informed about the size or nature of the commissions that brokers receive.
- The quality of some broker recommendations was poor and some brokers encouraged consumers to pursue risky borrowing strategies.
Mortgage brokers help arrange credit for the largest purchase most people make, a house. Yet, brokers are only required to arrange a 'not unsuitable' loan, not a "suitable loan" and certainly not the best available loan. There is no obligation to act in the customer's best interests.

A key objective in the enactment of the *National Credit Act* was to address predatory lending in the home loan market. Brokers which charged large up-front fees (financed under the loan) featured regularly in blatant equity stripping cases. As a result commissions were not a significant focus in the national reform process, with disclosure being the only requirement imposed. Disclosure alone is clearly insufficient to address the inherent conflicts of interest in the market. Financial Rights received many calls from people who were not aware that if they switched lenders within the first few years of the loan the broker retained a right to "clawback" the lost trailing commission.

The *National Credit Act* subjects brokers and lenders to more or less the same standards in relation to responsible lending, that being that credit providers should not provide loans, and brokers should not recommend loans, which are "unsuitable". A loan will be found to be unsuitable if it does not meet the consumer's requirements and objectives, or if it appears based on reasonable enquiries and verification that the consumer will not be able to repay the loan without substantial hardship. While this may be an appropriate standard to hold a lender to, it is hard to argue that it is an appropriate benchmark for a mortgage broker who purports to give independent advice and match consumers with the most suitable products from a range of lenders.

Case study – Margot's story - C138746

Margot and her daughter entered into a joint loan with a Bank for \$248,000 in 2013. The loan had a 30 year term. Margot was on the disability support pension (DSP) at the time the loan was taken out, and would be 92 by the end of its term. The purpose of the loan was the purchase of an investment property, but the only security for the loan was Margot's home. The funds were not used to purchase an investment property in joint names. Margot's daughter did buy an investment property, but it was in her name only. She made off with the proceeds of the loan, made virtually no repayments, hid the default notices and other documents from Margot, and has since disappeared. The Bank obtained

³⁴ The report noted that Interest Only loans sold through direct channels were also problematic in many cases.

³⁵ CHOICE, Mortgage broker investigation, 6 May 2015 <https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop>

default judgment and an order for possession of Margot's home.

The loan was arranged by a Mortgage Broker. The Broker purported to submit the application on behalf of both Margot and her daughter, but no one from Broker had ever met or spoken to Margot. Margot did not even know the Broker was involved in the loan until documents were produced by the Bank when a dispute was raised following the order for possession. The signatures on the application form purporting to be Margot's are not her signature. No inquiries were made about Margot's expenses; a combined Household Expenditure Measure (HEM) figure for Margot and her daughter was the only expense information used in Broker's application. Needless to say, the Broker made no inquiries about Margot's requirements and objectives. In particular, despite the fact that Broker was arranging a 30-year loan for an investment property to a 62-year old on the DSP, secured only by a mortgage over her home, no exit strategy was put in place, leaving Margot extremely vulnerable to losing her home (particularly given the transaction involved a transfer of a 10% ownership interest in that home to her daughter).

Case study – Haadi's story - C137141

Haadi had a mortgage with his wife and had refinanced it a few times to pay a number of his debts. Haadi runs his own business and engaged the services of an accountancy firm to complete his tax returns. Haadi received demands from the Australian Tax Office of accrued taxation and fines where they were threatening to garnish his wages and commence recovery action. His tax accountant negotiated a lump sum reduction of the debt but Haadi could not afford to make the payment within the required time frame. His accountant indicated that "he knew a broker who could help" get him a loan to refinance his mortgage.

Haadi met with the Mortgage Broker and recalls being told by the Broker that he was going to "put the best picture forward" in order to obtain a loan. The application form was completed by the Mortgage Broker. Haadi's gross income was listed as \$120,000 as he believed that he did earn that amount as gross income and that he would earn that much in the following 12 months. Haadi's accountant wrote a letter in support of the application where they confirmed that Haadi's stated gross income of \$120,000 was accurate. Haadi expected to have a contract for service for the following 12 months and expected that he would have a gross income of \$120,000 per annum. Haadi's taxable income for the financial year immediately prior to taking out this loan was approximately \$28,000. The Mortgage Broker assessed that a refinance was suitable based on the accountant's letter of support and Haadi's explanation as to his debt issues. There was no evidence that any proper enquiries or verification was made as to Haadi's real financial situation as required by the National Credit Act.

The mortgage was refinanced into Haadi's name only with a further amount of \$50,000 borrowed on top of the existing balance of the mortgage. Haadi lived with his wife (who was a stay at home mum) and their 4 dependent children. At the time of the application, Haadi advised the mortgage broker that he had 4 dependent children, a wife who does not work, council rates owing where they had applied for judgment against him and a default on his credit file for a phone bill. Haadi struggled to make the payments because the work contract he had expected did not eventuate with the same level of income he had before. Haadi missed the payments under the loan a number of times and repossession action was commenced against him with judgment obtained. Haadi eventually had to sell his family home.

We also note that while we are often able to settle individual cases where there has been a failure of responsible lending, we see no evidence that lenders systemically monitor their broker networks to identify and rectify concerning trends in poor product distribution.³⁶

Case study – Jessica’s story - C112109

Jessica was seeking a consolidation loan as she was having difficulty managing her financial situation. Jessica had lost her job and started receiving Centrelink benefits. This put her in further financial stress. One of her big concerns was a mortgage she had on a property that she had inherited.

Jessica had approached Mortgage Broker 1 to discuss her situation and that she was requiring a consolidation loan to pay her personal debts while she was trying to obtain a full time job. She was advised by them that they could not assist her but they could get her in contact with someone who could and arranged a meeting with Mortgage Broker2.

Jessica was advised by the broker that he could organise a loan but the only way he could do that was to give her a business loan. Jessica told the broker that she was not running a business and never had. He assured her that he could sort everything out and that the loan would be secured on her house but it was a way to protect her house. The broker knew that the consolidation loan Jessica was seeking was to pay for personal debts. Jessica was made to sign a Business Purpose Declaration for a loan of \$40,000 with a brokerage fee of \$25,000 which would be financed by the loan.

Jessica did not end up landing the full-time job she was hoping for and could not pay back the loan. The lender commenced proceedings against Jessica to take possession of the security property.

Case study – Britta’s story - C159878

Britta had an existing home loan with a bank for the property she resides in. In December 2016 she applied for a loan through Mortgage Broker to purchase an investment property (a knockdown rebuild). The Mortgage Broker ended up giving her multiple loans for each property, some with interest rates as high as 20%. The loan set up was so confusing that she still doesn’t understand it and so couldn’t explain the structure in detail. She thinks at least parts of the loan may be business loans. Her mortgage repayments are currently about \$20k+ a month.

She has now finished renovating and found a purchaser for the property, but there is going to be a shortfall. Mortgage Broker is delaying settlement, and has told her that they will not agree to settle unless she signs up for an unsecured loan for the shortfall with an interest rate of 16%. They are proposing that the loan of \$100k would be distributed \$70k to another Mortgage Broker and \$30k to go back to her to help her meet her loan repayments.

The exclusion of business and investment lending³⁷ from the regulatory regime for credit is a concern in itself, but it also enables some of the conduct above to take place with little scrutiny or opportunity for redress. In Jessica’s case the only option for defending a case brought by the broker and lender was in the Supreme Court, as neither party was required to be licensed or a member of external disputes resolution scheme.

³⁶ See: ASIC, Report 516 Review of mortgage broker remuneration, March 2017, <http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf>

³⁷ Except investment in residential property, which is regulated by the National Credit Act.

The use of benchmarking by credit providers as part of their affordability assessments

To determine whether a credit contract or consumer lease is 'not unsuitable', in accordance with their responsible lending obligations, credit providers must make 'reasonable inquiries' about the particular consumer's financial situation and the consumer's requirements and objectives in relation to the credit contract or consumer lease. Credit providers are also required to take 'reasonable steps to verify' the consumer's financial situation.

Benchmarks are used by some credit providers to determine whether a credit contract or consumer lease is likely to cause substantial hardship to a consumer. Although useful, the use of benchmarks should not be a replacement for making inquiries about a particular consumer's current income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses.

Many credit providers however have used benchmarks to estimate living expenses and rental costs by reference to a prescribed percentage of their income (for example 15% and 25% respectively) in circumstances where their actual expenses are more than this. As a result of this conduct, ASIC has for example required Cash Converters to refund \$10.8m to online borrowers. ASIC found systemic use of benchmarks in its 2015 Review of interest-only loans.³⁸ More recently ASIC released its report into Mortgage Broker remuneration which found that a significant number of loans across several lenders stated that the consumer expenses were equal to the benchmark, suggesting that inquiries were not occurring properly.³⁹ ASIC initiated a civil action against Westpac for allegedly using benchmarks to assess loan repayments instead of actual expenses of consumers.⁴⁰

Summary: Credit and lending sales and marketing practices

Question 1 - Misconduct

- Credit providers have mis-used benchmarks where their actual expenses should have been used.
- Breaches of responsible lending laws by motor vehicle dealers selling finance on behalf of lenders.
- Breaches of responsible lending laws in credit cards, personal loans and home lending by using benchmarks instead of actual expenses, pushing inappropriate interest only loan;
- Brokers signing consumers up to business loans when they are clearly not in business.

Question 2 – Conduct, practices, behaviours or activities below community standards

- The use of honeymoon rates as a promotional tool.

³⁸ "in over 20% of files reviewed, lenders had not considered the borrower's actual living expenses when approving the loan, but relied instead on expense benchmarks." p. 9, ASIC, Report 445 – Review of interest-only loans, August 2015, <http://download.asic.gov.au/media/3329474/rep445-published-20-august-2015.pdf>

³⁹ Para. 61, page 15, ASIC Report 516 Review of mortgage broker remuneration <http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf>

⁴⁰ Beau Donnelly, Corporate regulator eyes Westpac over lending practices, SMH, <http://www.smh.com.au/business/banking-and-finance/corporate-regulator-eyes-westpac-over-lending-practices-20170301-guocvv.html>

- Mandatory bundling of credit cards with new home loans.
- Assessing the ability to repay credit cards using the minimum repayment.
- No oversight of third party sellers including mortgage brokers.
- Poor broker advice encouraging risky borrowing strategies, and not acting in the customer's best interests.
- Targeting of vulnerable communities.

Question 3(a) – Attribution to broader cultural or governance practices

- Outsourcing financing sales and consumer credit obligations to third parties outside of the sector.
- A system wide lack of oversight of third party financing sales, including contracting out of legal responsibilities.
- The use of benchmarks is lazy, cost-cutting exercise and boosts the sale of credit.

Question 3(b) – Attribution to other practices (i.e. remuneration)

- Point-of-sale retailers are exempted from the *National Credit Act* and are therefore not required to meet any entry standards, select, recommend or propose credit products without having to conduct a suitability assessment.
- Broker remuneration model including commissions driving misaligned sales incentives.

Question 3(c) – Effective mechanisms for redress available

- Consumers of credit products have access to free dispute resolution through an industry funded ombudsman (either FOS or the CIO) where they can seek redress.
- Consumers are limited in their ability to access remedies for the conduct of point of sale credit sales, including lodging a dispute with EDR.

2. Exacerbating financial hardship

Financial hardship in insurance

Unlike credit, there are no legislative or regulatory requirements for the insurance sector to meet with respect to dealing with the financial hardship of their customers, outside of compliance with the ASIC/ACCC Debt Collection Guideline. The general insurance industry does have some self-imposed non-mandatory standards under the General Insurance Code of Practice as does the life insurance industry under its own newly introduced Code of Practice.

Despite the existence of these standards the sector's approach to financial hardship is problematic leading to conduct which would not meet community expectations.

Requiring excess payments up front

Firstly, insurers generally require that insureds pay their excess upfront before a claim can be lodged, processed or approved. This requirement fails to take into account an insured's financial hardship, which could potentially render them unable to pay their excess. It is unreasonable in such circumstances to require the payment of excess before a claim is lodged, processed or approved. This prevents many consumers from accessing the benefit of insurance they have paid for and would otherwise be entitled to rely on solely because they are unable to afford the excess at the time the insurer requires it to be paid.

Case study- James' story - C143059

James is insured. His car is hit in from behind by Mark's car. Mark tells him he is insured and provides him the claim details. Mark and James keep in contact in the claims process. Mark tells James that he is having trouble paying the excess. He has the cash, but his insurer says they need him to pay it by credit card. James is frustrated. He rings Marks insurer and offers to pay the excess and get the cash from Mark. Marks insurer refuses. James feels like he is stuck in the middle.

James does not want to claim on his insurer as due his age he is concerned of the impact on future premiums. He is also concerned that his insurer will not cover hire car costs and he will not be able to choose the repairer. The repairer they use are not very good and he has heard lots of horror stories.

James decides to pursue the 3rd party himself and engages his local smash repair company who gives him a courtesy car. He thinks they hire lawyers to recover against the other party. It took many months to resolve. James was very happy with the smash repair service and not the service of the insurers involved.

Case Study Lacey's story – CLSIS 137975

Lacey is on DSP and lives in a remote town. She was in a minor motor vehicle accident and insured. She needs a car. She has paid for a hire car benefit with her insurer however her Insurer has told her that they have an exclusive hire car agreement with a specific Car Hire Company only, the nearest one being 100 kms away from her. The 3 hire car companies close to her have no agreement with her insurer. Lacey's solution is that she pays for the hire car herself and they will reimburse her. The problem is she is on DSP and has no money to pay for the hire car. In addition, her Insurer has said her \$600 excess is payable and without paying it she cannot get her car back from the repairer's. Lacey has saved \$400 and will try and get remainder \$200 by next week. She needs a hire car for when her car is scheduled to go in for repairs. She also needs a car for health and family reasons. There is only 2/3 buses per day in her area

An insurer should not be able to refuse to pay a legitimate claim by reason only of the insured's inability to pay excess under section 54(3) of the *Insurance Contracts Act 1984* because no part of the loss that gave rise to the claim was caused by the insured's inability to pay the excess. Also refusing to pay a claim on the basis of non payment of excess is, in our view, a breach of the *Insurance Contracts Act 1984* duty of utmost good faith (Sections 13 and 14(1) of the *Insurance Contracts Act*.) We also note that the case of *Calliden Insurance Limited v Chrisholm* [2009] NSWCA

398 confirmed that a failure to pay the excess upfront should not be a bar to claiming under an insurance policy. Further FOS has stated that “consumers experiencing financial difficulty may be unable to pay a policy excess. This should not mean the claim cannot progress.”⁴¹

Failure to provide the option to pay premiums fortnightly (including by Centrepay)

Secondly the insurance industry has failed to provide the option for customers to pay their premiums fortnightly or to work with the Government and the Department of Human Services to enable Centrepay to be used as an option for the payment of premiums. This lack of willingness to provide basic payment options has led to significant financial exclusion for people on low incomes, and puts these people at significant risk of under-insurance. Even people who are employed often report having their insurance cancelled, or being constantly at risk of cancellation, because their monthly deductions do not line up with their fortnightly salary payments, making cancellation a risk for anyone who expends their entire salary most pay periods.

Insurers argue that payment systems are not capable of receiving fortnightly payments without costly upgrades. There are also additional ongoing costs to insurers that lead them to not wanting to provide this basic option to consumers – ie. Centrepay requires payments to be at least \$10 per fortnight and many policies for low income consumers would cost less than this amount. Further Centrepay charges businesses a standard fee per transaction, but does not offer discounts based on a high volume of transactions. At \$10 per fortnight minimum the profit margins for insurers are therefore less than higher payments.

The Rise of Debt Management Firms

The financial services sector has seen a proliferation of consumer complaints against new financial businesses known as Debt Management Firms who prey on and exploit the most financially vulnerable consumers in Australia. This is arguably a direct result of some of the practices outlined above, most relevantly failures of responsible lending in the credit market leading to high levels of household debt.

Debt management firms target people in financial hardship or with listings on their credit reports. These businesses claim they can assist people by reducing debts or repayments, ‘repairing’ credit reports, advising and arranging debt agreements, and managing budgets. More frequently the promises do not live up to reality and many people end up in a worse financial position, after having paid the high set up and ongoing fees charged by these businesses.

These businesses have a number of common elements including:

- targeting consumers experiencing financial stress, particularly low-income Australians;
- they fail to provide clear explanations of fees and charges during the initial contact with consumers
- they charge high up-front and on-going fees for ‘services’ and

⁴¹ A guide to insurance excesses. <https://www.fos.org.au/custom/files/docs/a-guide-to-insurance-excesses.pdf>

- they suggest high cost 'solutions' to debt problems that are not in the consumer's best interests, potentially leaving them in a worse financial position than before, even when there is a free dispute resolution service available to the consumer.

Debt management firms operate under a business model that is inherently unfair. They depend on a class of consumers that cannot access, or are not aware of, alternative services to meet their needs, and they are based on charging ongoing fees to consumers who are often ill placed to afford them and the fees are significantly disproportionate to the cost of providing the service.

Debt management firms can charge large fees and cause significant consumer detriment, but consumers have limited access to justice. Although the fees charged by some providers are very high and disproportionate to the service provided, this may not itself be unlawful. They are also extracting a significant amount of money from people in financial difficulty to the detriment of both the clients and their creditors. Debt Agreements, for example, which are heavily promoted on television, radio and online as a solution for people struggling with debts, have increased in year on year terms for ten consecutive quarters and as of December 2017 represented 46.2% of all personal insolvency activity.⁴² In 2015 (the last year reported on the AFSA website) Debt Agreements Administrators received 23% of the total amount paid towards Debt Agreements in that period, amounting to over fifty two million dollars.

Importantly, none of the above businesses (apart from Debt Agreement Administrators) are subject to specific regulation of their activities.

The businesses currently do not currently fall within the meaning of 'financial services' or 'financial products' as defined the ASIC Act or the relevant provisions of the *Corporation Act*. This means they cannot be licensed by ASIC, are not required to be members of EDR schemes, are not required to provide any information on their activities nor are subject to regular audits. Even if they were to be licenced the laws currently in place do not necessarily address the business models that these firms use.

These businesses do however fall within the consumer protection provisions of the ACL but the ACL protections have so far proven to be inadequate to protect vulnerable consumers. There are also significant difficulties in applying the consumer guarantees to new and emerging services such as those provided by debt management firms. For example, how does a consumer or regulator know whether a new and emerging service is "fit for any specified purpose" when there is nothing to compare that new service to and there are no standards set for what is essentially a useless service.

Some of the activities of debt management firms may or may not be regulated by the *National Credit Act*, the *Bankruptcy Act* and the *Privacy Act*. What is clear however is that there is no uniform regulatory framework applying to the activities of debt management firms in Australia and they are not required to hold a credit or AFS licence administered by ASIC.

There are also significant complexities and difficulties for consumers (be it individually or collectively) to pursue any action against any debt management firms or any other new and emerging financial businesses. Firstly it is difficult to work out whether a business needs to be

⁴² <https://www.afsa.gov.au/statistics/quarterly-statistics-commentary>

licenced as an Australian Financial Services Licensee, secondly actually pursuing this requires Supreme Court action which is costly and complex and thirdly the rescission provisions under s. 925A of the *Corporations Act* and the interpretation they have been given by the courts have proven difficult for consumers to get their fees returned or receive declaratory relief.

Exacerbating financial hardship

Question 1 – Misconduct

- Insurers have required that insureds pay their excess upfront before a claim can be lodged, processed or approved in breach of the law.
- Debt Management Firms target consumers experiencing financial stress, failing to provide explanations of fees, charging unreasonably high fees and not addressing consumer needs.

Question 2 – Conduct, practices, behaviours or activities below community standards

- Insurers have failed to work with Centrepay to be used as an option for premium payments.

Question 3(a) – Attribution to broader cultural or governance practices

- Credit providers avoid the NCC through indulgences and mis-report RHI in order to maintain their ability to undertake enforcement measures.
- Insurers unwillingness to spend money to upgrade payment systems or pay additional ongoing costs to provide appropriate options to lower income consumers

Question 3(b) – Attribution to other practices (i.e. remuneration)

- Debt management firms have emerged as a form of regulatory gaming as they eke out a space that avoid falling within the meaning of ‘financial services’ or ‘financial products’ as defined the *ASIC Act* or the relevant provisions of the *Corporation Act*.

Question 3(c) – Effective mechanisms for redress available

- Since DMFs do not have to have a licence and therefore do not need to be a part of an EDR scheme. Consumers therefore have great difficulty in pursuing any action against any DMFs or any other new and emerging financial businesses. Pursuing a DMF requires Supreme Court action which is costly and complex. The rescission provisions under s. 925A of the *Corporations Act* and the interpretation they have been given by the courts have proven difficult for consumers to get their fees returned or receive declaratory relief.
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3. Fee charging practices

Financial service providers have a right to cover the costs of doing business like every company in Australia. However, Financial Rights has been long concerned with the almost universal practice of user pays fee charging that is regressive by nature, has a harsh, disproportionate and punitive impact upon lower income consumers and is often hidden from consumers.

The multiple types of fees charged vary widely across the financial services sector and seemingly multiply every day. They include:

- bank monthly account fees,
- ATM fees
- credit card surcharge fees
- credit card annual fees
- superannuation account fees
- small amount credit contract fees
- default fees
- late fees
- overdrawn fees
- inward dishonour and honour fees
- paper billing fees, and more.

Fees add up – particularly for those who can least afford them. For many struggling families, fees can mean the difference between eating and not eating. Financial Rights is aware of late payment fees ranging from \$9 to \$40. A \$40 default fee for a consumer on Newstart earning \$263 a week equates to approximately 15% of their weekly income. The same fee for someone earning an average annual salary of \$80,000 only pays 2.6% of their weekly income on a default fee.

These fees not only deplete low earning consumers' incomes but also affect whether debits made from their account for things like rent or electricity can proceed or be rejected, as there is less money in the account to pay them. Penalty fees have little deterrence value where the consumer's problem is not poor management but insufficient funds and simply drive consumers faster down the path of financial hardship and pain.

Case study – Anne's story – C127520

Anne is living in a women's refuge in South Australia. She was from Pipalyatjara in the APY lands. English is Anne's second language, her first language is Pitjantjatjara. She is a single mother, and suffers from depression and anxiety. In 2015 she entered into a contract for funeral insurance. The direct debits were \$34 per fortnight. The Insurer made 17 dishonoured direct debits. After the School Kids Bonus was deposited the Insurer deducted \$590. She had incurred approximately \$250 in fees from her bank for the dishonours. Financial Rights raised a dispute with the insurer and sought the refund of the premiums taken. They were refunded on a goodwill basis.

Financial Rights also sought a refund of the dishonour fees from her Bank. We argued the Bank:

1. applied its policies and/or its discretion inconsistently in allowing Anne's account to become overdrawn by direct debit entries in a way that amounts to maladministration;
2. used Anne's protected Australian Government payments to clear these unarranged overdrafts, including at times taking more than 10 % of these payments contrary to the Department of Human Services Code of Operation; and
3. failed to cancel direct debits by an Insurer from our Anne's account after being advised that Anne did not authorise these payments, contrary to the PDS and its obligations under the

Code of Banking Practice (Code).

The Bank refunded on a goodwill basis without admission approximately \$250 being the dishonour fees accrued.⁴³

While ASIC has identified a number of instances of misconduct where fees have been either purposefully or inadvertently overcharged⁴⁴ much of the problem of user pay fee charging is not its legality or otherwise but the fact that it is business practice that is falling well below community standards and expectations.

And the situation only seems to be getting worse. Bank fees continue to rise with fees growing at 2.8% – faster than the consumer price index.⁴⁵ Fees have been rising fastest on credit cards, with a 5.9% growth in fees in 2014. Australians paid nearly \$12 billion in bank fees in 2014. In that year the average household paid \$468 in bank fees.

This seems to be set to continue following the High Court’s decision upholding a decision that the ANZ was entitled to charge late payment fees which included a range of indirect costs, such as bad debt provisioning, increase in regulatory capital provision and the shared costs of running collections (even though no actual collections may have occurred).⁴⁶

Credit card late fees as high as \$35 are disproportionate, bear no resemblance to what a late payment actually costs a bank and penalises those who can least afford it. Fees purporting to cover the actual loss suffered by the bank are a form of double dipping given the fact that credit card interest rates are set at very high levels in order to reflect the risks and costs involved in unsecured debt.

The consumers carrying debt from month to month (63% of outstanding balances accrue interest) pay high interest and effectively cross-subsidise all other card holders who pay off their accounts regularly and incur almost no interest. Within the 63% of card holders who incur interest there is a sub-group that carry significant balances, far higher than the average balance. The overwhelming majority of people carrying significant credit card debt do so because they do not have the means to pay it down quickly or at all. For people who are overstretched, late fees only make the task of

⁴³ In cases where consumers, or their advocates, complain about the application of fees in particular circumstances the banks are often quite willing to reverse them. While this is appreciated it is hardly systemic or fair to those who do not have the time or skills to complain.

⁴⁴ 16-027MR Payday lender penalised for overcharging consumers, 9 February 2016 “ASIC identified that Fair Go Finance charged establishment fees of more than twice the 20% maximum allowed.” <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-027mr-payday-lender-penalised-for-overcharging-consumers/>; 16-167MR On-line lender to refund \$35,000 after over-charging consumers, 30 May 2016 “applying fees and charges to MACCs in the range of 56% to 68%, which are in excess of the permitted annual cost rate of 48%; <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-167mr-on-line-lender-to-refund-35-000-after-over-charging-consumers/>; ASIC, 17-249MR MyState refunds more than \$230,000 of over-charged fees and interest, Wednesday 26 July 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-249mr-mystate-refunds-more-than-230-000-of-over-charged-fees-and-interest/> “This was due to errors in MyState’s manual administration processes, including failures to link loans and offset accounts, and failures to deal with offset accounts when loans were switched or discharged.”

⁴⁵ Kelsey Wilkins, *Banking Fees in Australia* <http://www.rba.gov.au/publications/bulletin/2015/jun/pdf/bu-0615-5.pdf>

⁴⁶ *Paciocco v Australian and New Zealand Banking Group Limited* [2016] HCA 28 <http://eresources.hcourt.gov.au/showCase/2016/HCA/28>

repayment more difficult. Banks already charge high interest, make considerable profits, and have other enforcement options apart from late fees.

Internet and phone banking have increased the potential for banks to offer innovative services for managing their finances. This is to be encouraged. However, such services also come at a cost and those costs are not clearly disclosed. For example, a customer is invited to set up dishonour alerts.⁴⁷ The customer clicks on the feature and receives a long paragraph of information in addition to a couple of obvious boxes to tick about which account and what form of notification. If the consumer does not read the terms and conditions carefully, they can easily miss the warning about the honour fee. Further, the amount is not disclosed. Equally, when the alert is received there is no mention of the fact that the fee will be charged to the account. Without careful checking of statements or internet transaction details such fees can be missed and continue to be incurred without the consumer's knowledge.

Summary: Fee charging

Question 1 – Misconduct

- Overcharging of fees by lenders above mandated levels

Question 2 – Conduct, practices, behaviours or activities below community standards

- Financial service providers charging an increasingly large variety of fees, over and above cost recovery levels and in a manner that is regressive and punitive in nature.
- Double dipping by credit card providers who charge late fees when interest rates are set at high levels to reflect the higher risks and costs involved in unsecured debt.
- Disclosure practices that hide fees and costs, inadvertently or otherwise.

Question 3(a) – Attribution to cultural or governance practices

- A user pays fee charging culture that is ultimately regressive and impacts upon the most financially vulnerable.
- Inadvertent overcharging of fees above mandated levels due to system or other administrative errors.
- Fees are not being clearly disclosed both when a person opts into a service and when they incur the fee. Financial service providers are relying on consumers' lack of engagement with terms and conditions to get away with the excessive charging of fees.
- Business practices that develop fee structures that are not transparent and charge well over what would meet cost recovery levels, where there are no laws, regulations or industry standards.

Question 3(b) – Attribution to other practices (i.e. remuneration)

- User pays fee charging approach being used by industry to boost profit margin

⁴⁷ See example from St George internet banking detailed at p. 104, Financial Rights, Submission to the Senate Economic References Committee Inquiry into Consumer Protections in the Banking, Insurance and Financial Sector, March 2017 http://financialrights.org.au/wp-content/uploads/2017/03/170307_ConsumerProtections_Sub_FINAL.pdf

Question 3(c) – Effective mechanisms for redress available

- Some refund and waiver policies available for the charging of fees to receive a paper bill, including a recently announced decision by the ABA to waive fees for those who do not have access to electronic statements under the new Banking Code of Practice.⁴⁸
 - Little likelihood of consumer action given the relatively small amounts, distributed nature of the charging and there is usually a mountain of other problems faced by vulnerable consumers.
 - There is no ability to negotiate these fees upfront.
-

4. Poor customer service standards and practices

Inability to cancel recurring transactions via credit card systems

While banks have been working to improve this area of misconduct, and have recently committed to a set of standards for cancelling direct debits under the Banking Code of Practice and via the *Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms* there remains significant difficulties with respect to cancelling recurring transactions via the Visa, MasterCard and all other credit card systems.

Consumers commonly establish recurring transactions and standing authorities with third party merchants to pay regular bills, such as insurance, utility bills or fitness club memberships. We note recurring payments on credit cards are increasingly common and is encouraged by banks through the establishment of loyalty schemes. However, very few consumers would be aware that if they wish to cancel direct debits from their credit card, they must contact each merchant individually. Problems can arise when a merchant does not act on an instruction to cancel a regular payment. These problems can also arise when a consumer closes their credit card account but does not arrange with third party merchants to cancel regular payments. In this case, a consumer is generally responsible for establishing and cancelling authorities directly with the relevant merchant. They will also be responsible for any transactions debited to the credit card account, even after the account has been closed.

Many transaction accounts are now accessed via scheme debit cards, greatly increasing the percentage of transactions that may be affected by this limitation. Although consumers can sometimes avoid this problem by providing their account details rather than their card details, this is not always possible, and most consumers are not aware of the different implications for cancellation in any event.

The same problems flow for consumers on low incomes when they cannot cancel a debit set up on a card as for a transaction account. Despite the importance of this consumer right and banks'

⁴⁸ ABA, Customers set to benefit from new Banking Code, Media Release, 20 December 2017 <https://www.bankers.asn.au/media/media-releases/media-release-2017/customers-set-to-benefit-from-new-banking-code>

corresponding obligations under the Banking Code of Practice, non-compliance with the requirement to cancel direct debits has been common and, most importantly, remains ongoing. In 2017 a compliance report found that over half of banks still give non-compliant responses to customer enquiries about cancelling a direct debit to a transaction account.⁴⁹ Additionally, all cardholders face a number of barriers if they wish to switch credit cards and one of the most significant barriers to switching is cancelling recurring direct debit transactions that are set up from a consumer's credit card. Currently, recurrent payments made from a credit card are much more difficult to cancel than payments from a transaction account, and credit card recurrent payments can continue to be made even after the card itself is cancelled.

There should be no difference in treatment between credit card accounts and other accounts. In our view, a consumer should be able to instruct their bank to cancel a credit recurring payment authority, as they can with a transaction account direct debit authority. Further, upon cancellation or closure of a credit card account, a bank should take steps to cancel all regular transactions and other standing authorities.

There should also be no cost to the consumer for cancelling an instruction to debit their own credit or charge card account. Currently consumers can write to the merchant and then complain to the bank, and if necessary FOS, if the merchant does not act on their instructions as the payment is then unauthorised. This is a lengthy, cumbersome process, but it is at least free. Any replacement system should not set consumers backwards.

Even direct debits on transactions accounts are not always easy to cancel, despite there being a clear obligation on banking staff to do so at the request of the customer since the 2003 version of the Code of Banking Practice. Callers to Financial Rights report this problem regularly, and even our staff solicitors have met resistance when trying to cancel direct debits on a consumer's behalf. This issue has been the subject of three reports by the Code Compliance Monitoring Committee, and while the latest report in 2017 showed a marked improvement over 2008 when 80% of staff answered relevant questions incorrectly, 54% of banking staff still gave incorrect responses to questions about the cancellation of direct debits.⁵⁰

Poor insurance claims handling practices

One important part of insurance claims handling process of insurers is the conduct of investigations. Insurers primarily initiate investigations to confirm the circumstances and details of a claim to ensure that there is an insurable event under the policy and sometimes seek to check the veracity of statements or accuracy of information provided to them at the time the policy was taken out or at the time of renewal. Insurers are also on the look out for evidence of fraud. Investigations usually involve the engagement of third party private investigators and the undertaking of surveillance.

⁴⁹ Banking Code Compliance Monitoring Committee Report: Improving banks' compliance with direct debit cancellation obligations. October 2017 <https://www.fos.org.au/custom/files/docs/ccmc-report-improving-banks-compliance-with-direct-debit-cancellation-obligations-october-2017.pdf>

⁵⁰ <http://www.ccmc.org.au/cms/wp-content/uploads/2017/10/CCMC-Report-Improving-banks%E2%80%99-compliance-with-direct-debit-cancellation-obligations-October-2017.pdf>

In 2016 Financial Rights released a report into insurance investigations in Australia titled: *Guilty Until Proven Innocent*.⁵¹ The report found major misconduct and conduct not meeting community standards with the investigations process. Consumers reported:

- being subject to incredibly long interviews up to five hours, sometimes repeated over months;
- being bullied, harassed and intimidated by investigators;
- being “treated like a criminal” and that the investigator had prejudged their guilt with little or no basis, putting forward theories that bore scant resemblance to reality;
- being grilled with repetitive and seemingly irrelevant questions about highly personal and sensitive issues like past relationships and medical conditions;
- that investigators threatened to reject claims and or initiate serious repercussions (such as the reporting of relatives to immigration) if consumers did not act in the way the investigator demanded;
- racial profiling;
- failure to provide people with poor English skills access to appropriate interpreters and failure to provide consumers with mental health problems the use of a support person;
- being given little or no explanation of the investigation process;
- being asked to sign documents that are not explained, asked to hand over personal and sensitive documents without warning and with no reasons given, and have had their neighbours, family, friends and business associates or clients questioned without the policyholder being notified.

Financial Rights found that the onerous demands placed on consumers by an investigation led many to withdraw their claim, again not due to any admission of fraudulent behaviour but simply because the process is too burdensome or invasive for many consumers to bear.

Case Study Khilaal’s story – C142742

In November 2016, Khilaal and his wife, both of Lebanese decent, found their car stolen from their carport. Hours later it was identified by police burnt out. Khilaal made a claim on their comprehensive insurance only to have it denied on the basis they had not proven a loss & had not dealt with the insurer in utmost good faith.

Khilaal and his wife had held 6 insurance policies with this Insurer for over 5 years, fully paid up. When the claim was denied, their Insurer cancelled all the policies. Khilaal and his wife repeatedly requested the evidence relied on by the Insurer to deny the claim. It wasn't until the Financial Rights became involved and lodged a complaint with FOS that the Insurer produced any of the documents.

Upon review of the evidence relied on by the Insurer to refuse the claim, it is clear the Insurer had no basis for denying the claim. Among other things, Khilaal and his wife had no financial motive, no criminal record and had never lodged a claim before. Khilaal and his wife also endured hours of questioning & provided all documents requested by the Insurer.

⁵¹ <http://financialrights.org.au/wp-content/uploads/2016/03/Guilty-until-proven-innocent.pdf>

We were extremely concerned about the Insurer's investigation practices, particularly: 1. apparent racial profiling; 2. refusing to produce evidence relied on to deny a claim in breach of the General Insurance Code of Conduct; and 3. its investigation methods and reasoning. Since applying to FOS, the Insurer has settled with Khilaal and his wife and Financial Rights has made a complaint about the Insurer's investigation and practices to ASIC.

While Financial Rights found that some internal insurer standards governing investigations do exist, there was no transparency since they are hidden from consumers and the public eye, and there were no industry wide standards included in the self regulatory General Insurance Code of Practice. Nor are there any substantial laws in place to regulate the conduct of insurance investigations or investigators.

Subsequent to the release of the Report, misconduct was investigated and confirmed by the General Insurance Code Governance Committee (**CGC**) in its 2017 Own Motion Inquiry on Investigations of Claims and Outsourced Service.⁵²

Financial Rights notes that the Financial Services Council's (**FSC's**) launched a Life Insurance Code of Practice in late 2016 and included (at 8.11 and 8.12) minimum standards for the conduct of interviews and surveillance, to address a lot of the concerns raised by Financial Rights. The Insurance Council of Australia (**ICA**) has recently proposed to include a mandatory set of standards in the General Insurance Code of Practice⁵³ which covers many but not all issues raised by Financial Rights and the CGC.

Our report however also found that the state of private investigator licensing in Australia is a mess.⁵⁴ There is vast variability across jurisdictions in the content and coverage of licensing schemes, training methods and quality control, and a multiplicity of associations and self regulatory codes. This is confusing to consumers. It is not clear there is any uniform competency or accountability standards for private investigators across Australia. This mess is at least in part acknowledged by the industry itself.⁵⁵ The Australian Law Reform Commission (**ALRC**) recommended in its 2008 Report on Privacy Law and Practice that the Federal Governments through the Council of Australian Governments consider developing uniform private investigator regulations. As a part of this there should be a uniform enforceable code of conduct that supersedes the mess of ineffective and unsubstantial self-regulatory codes that currently exists. This was never followed up by Government.

⁵² <https://www.fos.org.au/custom/files/docs/gicgc-omi-on-investigation-of-claims-outsourced-services-may-2017.pdf>

⁵³ Insurance Council of Australia, Interim Report of the Review of the General Insurance Code of Practice, November 2017 http://codeofpracticereview.com.au/assets/interim%20report/02112017_Interim_Report.pdf

⁵⁴ For full details of this mess see pp. 70-76, *Guilty Until Proven Innocent*

⁵⁵ ALRC Report on *Privacy Law and Practice*, 2008, para. 44.76

Poor customer service standards and practices

Question 1 – Misconduct

- Misconduct relating to insurance investigations including bullying, harassment, threats and racial profiling.

Question 2 – Conduct, practices, behaviours or activities below community standards

- Banks do not provide the tools required to cancel recurring transactions via payment networks.
- Poor conduct and behaviour relating to insurance investigations including overlong interviews, repetitive and insensitive interview tactics, failure to provide necessary support or information.

Question 3(a) – Attribution to broader cultural or governance practices

- Structural issues, costs and liabilities relating to the varied responsibilities of payment networks, banks and vendors provides an ability to shift blame on to other parties for not acting in the interest of the consumer.
- A guilty until proven innocent approach to investigations and claims handling to decrease costs involving constructive claims withdrawal tactics such as delays, drip feeding of requests and the wearing down of claimants.
- The lack of rigorous fraud data and the use of dubious quantitative fraud data to justify an aggressive approach to claims and investigations

Question 3(b) – Attribution to other practices (i.e. remuneration)

- The outsourcing of insurance investigations to a largely unregulated private investigator sector and subsequent a lack of oversight.

Question 3(c) – Effective mechanisms for redress available

- Currently in order to cancel recurring transactions on a credit card consumers can write to the merchant and then complain to the bank, and if necessary FOS, if the merchant does not act on their instructions as the payment is then unauthorised. This is a lengthy, cumbersome process, but it is at least free.
- With no industry wide investigation standards in insurance including in the self regulatory General Insurance Code of Practice and no substantial laws in place to regulate the conduct of insurance investigations or investigators, there is significant difficulty in seeking redress or access to justice.

5. The development and design of poor value financial products

Poorly designed financial products and services

Innovation in financial products and services is critical for the health of the financial services sector and for satisfying evolving consumer demand. New business models, products and services emerge and drive competition paving the way for improved outcomes for consumers. However the financial services sector continues to design and develop products and services that serve the interests of financial service providers and their commercial incentives rather than actual consumer demand and need.

Financial Rights regularly has to deal with the poor and detrimental results which arise out of the sale of poorly designed products - particularly in the insurance space. Some of the key poor-value products include:

- *Add-on insurance products:* These include:
 - CCI (discussed in Section 1 above , including Theresa's story),
 - Gap insurance: designed to cover any amount left to pay on the consumer's car loan once a comprehensive car insurance policy has paid out
 - Tyre and Rim Insurance: covers damage to a motor vehicle's tyres and rims (which are often not covered by comprehensive car insurance
 - Mechanical Breakdown insurance
 - Extended Warranties.

These products tend to receive fewer claims than other classes of insurance, insurers tend to decline more claim than others and often mis-sold with many consumers unaware that they even hold the insurance product. They are also often sold on finance, with interest charges further inflating their cost.

- *Funeral Insurance:*⁵⁶ The problems with funeral insurance are multiple. Premiums increase steeply with age, with the structure of the policies creating the very real possibility that a consumer would pay significantly more in premiums than the policy is worth. Consumers also drop the policy because of a lack of affordability before they ever get to claim. While approximately 50% of consumers with funeral insurance are aged between 50-74, 50% of indigenous consumers with funeral insurance are under 20.⁵⁷ Young people are extremely unlikely to need to rely on funeral insurance. This is also a product where the value proposition decreases for consumers the longer they have the policy, with sales to young indigenous consumers indicating significant issues with the distribution of products. In addition to funeral insurance companies preying on communities, they are fundamentally poor value when compared with funeral bonds, pre-paid funeral options, some life insurance products or simple savings. Consumers often do not understand key features of the product

⁵⁶ see ASIC Report 454, Funeral Insurance: A Snapshot, 29 October 2015 <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-454-funeral-insurance-a-snapshot/>

⁵⁷ Ibid.

including in particular, the increasing premiums, or that they will lose the benefit of the policy and all amounts paid if they stop paying at any time before they die. Unfair sales tactics and unfair pressure are also placed on vulnerable consumers, exploiting genuine concerns for the financial future of their families in the name of increasing sales. See *Daniel John, Lynda and Anne's stories above*.

- Debt Management Firms: These including budgeting services, credit repair services and debt negotiation and consolidation services⁵⁸ as discussed in Section 3 above.

The sale of most of these products and services does not involve any actual misconduct, but the results of using these products regularly fall below community standards and expectations for financial products and services. They over-promise and under-deliver, often to the most desperate and vulnerable Australians.

Unsuitable insurance products and the standard cover regime

As noted by the recent Senate Inquiry

“Adequate insurance cover is integral to protecting consumers’ most valuable assets and to maintaining and protecting the living standards of all Australians and the economy overall. As seen in the wake of a number of natural catastrophes, unsuitable financial products, including insurance, can have significant and devastating impacts on people’s lives. To that end, accessibility, transparency, affordability and competition are crucially important features of a well-functioning general insurance market.”

One of the key frustrations and problems faced by consumers with respect to choosing an insurance product is the fundamental inability to properly understand and compare products.

The *Insurance Contracts Act* under sections 35 and 37 provide for standard cover in certain types of common general insurance but they also allow insurers to contract out of these provisions so long as they clearly disclose this fact in writing. In practice, all insurers contract out of the provisions, rendering them ineffective and pointless.

The standard cover regime was originally enacted as a response to the Law Reform Commission’s 1982 Report on Insurance Contracts.⁵⁹ The Law Reform Commission argued that:

*difficulties caused by lack of information available to insureds are made worse by the wide of terms of insurance contracts offered by different insurers and the unusual terms which sometimes appear in them. In order to alleviate these difficulties, standard cover should be introduced ...*⁶⁰

The Law Reform Commission continued to state that:

⁵⁸ ASIC Report 465 “Paying to get out of debt or clear your record: the promise of debt management firms”, available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-465-paying-to-get-out-of-debt-or-clear-your-record-the-promise-of-debt-management-firms/>

⁵⁹ <http://www.alrc.gov.au/report-20>

⁶⁰ p.xxvi <http://www.alrc.gov.au/report-20>

Policies contain numerous terms which affect in unexpected ways the cover offered. In a few cases, the insured's attention is drawn to the relevant limitation at the time when cover is arranged. In the vast majority of cases, however, nothing is said. The insured's ignorance remains undisturbed until he makes a claim. The market is at present distorted by the fact that purchaser discrimination is limited to matters like price, little or no account being able to be taken of differences in the nature of the products being sold.⁶¹

The original vision for standard cover was one in which:

An insurer should be free to market policies which offer less than the standard cover. If it chooses to do so, it should have to draw the insured's attention to that fact and to the nature of the relevant diminution in cover. If it fails to do so, the contractual terms should be overridden to the extent to which they provide cover which is less than the standard.

The problem with the implementation of this vision is that, as alluded to above, Section 35 includes a “get out of jail” clause stating that the standard cover regime:

does not have effect where the insurer proves that, before the contract was entered into, the insurer clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise).

In other words, insurers don't have to “draw the insured's attention” to the fact that they are providing less than standard cover – they just provide it in the PDS and contract. We note the recently released research by the ICA that found that only between 19% and 26% (depending on the type of general insurance) used the PDS in their pre-purchase decision making and even fewer (3%-7%) used it as their main source of information. Further, while many consumers believed they were aware of the terms of their policy, actual tested comprehension levels were low in comparison to confidence levels.⁶² In short, insurer's can offer less than standard cover simply by telling their customers in a document few read and even less understand.

This systematic avoidance by the insurance industry of the spirit and intent of the standard cover regime through their over-reliance on Section 35 has led to systemic poor consumer outcomes for consumers through the sale of unsuitable products.

We note that the Government has stated in repose to the *Senate Economics References Committee report: Australia's general insurance industry: sapping consumers of the will to compare* that there is merit in further reviewing the standard cover regime with particular regard to the efficacy of current disclosure requirements. In the meantime insurers continue to avoid the rigours of an effective standard cover regime and consumers will continue to be purchasing unsuitable insurance products.

⁶¹ pp.44-45 <http://www.alrc.gov.au/report-20>

⁶² Consumer Research on General Insurance Product Disclosures Research findings report, February 2017, available at http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf

Blanket mental health exclusions leading to systemic discrimination

Insurers include blanket mental health exclusions in insurance products and rely on those exclusions to refuse to pay a claim in circumstances where the applicant for insurance had no history of a past or current mental health condition when applying for insurance but developed a mental health condition after purchasing the policy.

Additionally, when an applicant for insurance discloses a past or current mental health condition when applying for insurance, the insurer:

- refuses to offer insurance; or
- offers insurance with a broad mental health exclusion, in circumstances where a more limited mental health exclusion would have been reasonable; or
- offers insurance without a mental health exclusion but with an unreasonably high premium.

These blanket mental health exclusions are discriminatory as they do not meet the requirements of the *Disability Discrimination Act 1992 (DDA)*. The DDA prohibits insurers from discriminating against a person on the basis of their mental health condition, including past, present, future and imputed mental health conditions unless the discrimination is:

- a. based on actuarial or statistical data that is reasonable for the insurance provider to rely on; and
- b. reasonable having regard to that data and all 'other relevant factors'.

If there is no statistical or actuarial data available or reasonably obtainable to assess the risk, an insurer may justify its discrimination by relying solely on all 'other relevant factors'. These may include the circumstances of the individual, medical opinions, opinions from other professional groups, actuarial opinions and commercial judgment.

The DDA also contains a general defence, which may be available to insurance providers where not discriminating would cause them unjustifiable hardship. All relevant circumstances of a particular case are to be taken into account in determining whether a hardship imposed on the insurance provider is unjustifiable. These circumstances include:

- a. any benefits that might accrue to the customer with a disability or any other person if cover was provided;
- b. the effect of the disability of the person; and
- c. any costs or other disadvantages of providing cover, bearing in mind the financial circumstances of the insurance provider.

Almost identical provisions exist under State and Territory anti-discrimination legislation.

Blanket mental health exclusions are common in the Australian insurance market – particularly the travel insurance market. However the case law⁶³ is clear that insurers must comply with section 46 before including a blanket mental health exclusion. In reality insurers continue to use blanket mental health exclusions despite no demonstrated statistical or actuarial data to support their

⁶³ *QBE Travel Insurance v Bassanelli* [2004] FCA 396; *Ingram v QBE Insurance (Australia) Ltd (Human Rights)* [2015] VCAT 193, Financial Ombudsman Service Case No. 428128 March 2017.

decision to include the exclusion in their policy. In other cases, the statistical or actuarial data upon which they rely may be out-of-date, general in nature and not directly applicable to the person or insurance product involved, based on an insufficient sample size or not directed towards insurance risk or incidence data.

In some cases, it is not known what, if any, actuarial and statistical data insurance companies rely on to assess the insurance risks of people experiencing mental illness, with insurers not revealing this information on the basis of it being commercial-in-confidence.

This systemic approach to blanket mental health has led to perverse and discriminatory outcomes for large number of consumers.⁶⁴

There are a number of avenues in which appeals relating to insurance company decisions regarding applications and claims can be made. The DDA, for example, allows people to lodge complaints with the Human Rights tribunal where they believe that the insurance company in question has not properly substantiated their decision with actuarial or statistical data, or other reasonable grounds. However this has not led to systemic change. According to Mental Health Australia:

“Many of the complaints brought against insurance companies are resolved through conciliation processes. While conciliation processes are generally considered to be far more supportive of a complainant’s needs, very few disputes resolved through conciliation have resulted in admissions of liability or the setting of firm legal precedents when insurance companies do get things wrong.⁶⁵ This can be problematic to people living with mental illness when considering the possibility of appealing a decision. Moreover, a complaint driven process, as is articulated in the DDA, can also inadvertently disadvantage complainants as the process is often considered complicated and intimidating to individuals unfamiliar with complaint systems.⁶⁶ An emphasis on preventative monitoring and evaluation of discrimination in the insurance and superannuation industries would offer a complementary mechanism for addressing possible discrimination against people with mental illness, without creating additional stress and worry for them.

Because of this, industry continues to discriminate counter to both the spirit and intent of the DDA, with no proactive preventative measures, little regulatory oversight and enforcement or incentive to act appropriately and within the law. The General Insurance Code of Practice has yet to include any clauses relating to the treatment of mental health. The ICA are however proposing to include a non-mandatory Mental Health Guidance in its current review of the Code. Even with this weak proposal there will still be no compulsion placed upon insurers to act appropriately and within the law.

⁶⁴ PIAC, beyondblue and the Mental Health Council of Australia have gathered significant case studies and evidence in this regard, including, for example, Survey Mental Health Council of Australia and beyondblue, *Mental Health Discrimination and Insurance: A Survey of Consumer Experiences 2011* (2011) <https://mhaustralia.org/publication/mental-health-discrimination-and-insurance-survey-consumer-experiences-2011>

⁶⁵ G. Innes (2000). Disability Discrimination and insurance: Speech to Australian Life Underwriters Association and Claims Association conference. http://www.humanrights.gov.au/disability_rights/speeches/2000/underwrite.htm.

⁶⁶ WA Office of Mental Health (2003). Submission to the Productivity Commission Review of the DDA 1992. http://www.pc.gov.au/_data/assets/pdf_file/0005/41774/sub094.pdf

Lack of standard definitions for medical terms and other common terms in insurance

Recently there have been a series of high profile cases involving life insurance companies denying claims on the basis of definitional gaming and out of date terminology. These include claims denied because a stem cell treatment used the patient's own cells rather than someone else's,⁶⁷ because insurers were relying on an outdated medical definition of a heart attack⁶⁸ and because insurers were relying on an outdated medical understanding of arthritis treatments.⁶⁹

The most common concerns with medical definitions that Financial Rights sees are firstly, that there are varied definitions used by insurers, which make it difficult for consumers to compare policies and understand exactly what cover is extended to them under their policy. Secondly, not all insurers provide cover for particular events. Thirdly, where certain medical events are excluded or limited, consumers may be unaware of this. Financial Rights has provided examples of these in other submissions.⁷⁰

Case study- Melanie's story - C144046

Melanie was diagnosed with a brain tumour and her doctor removed the tumour. She made a claim on her trauma premiere policy that she had with Life Insurer. The insurance was arranged by an advisor.

The Insurer rejected the claim because of the way the tumour was removed. It was removed through the nose and not by a craniotomy. The policy wording covers a craniotomy. Melanie's policy is 11 years old and the medical definitions are out of date. Today 98 % of brain tumours are removed through the nose and there is no need to make a patient undergo a craniotomy.

As a result of the tumour she now suffers from Cushing's Disease which is caused by a change in Melanie's hormone levels. It is a severe case because the tumour was undiagnosed for so long. Melanie was a self employed personal accountant. She had regular clients that she did work for at home. Now she cannot work and she is being supported financially by her family. Her father is paying her mortgage and making her car repayments.

Financial Rights obtained from her specialist a report confirming that the medical definitions are out of date (i.e. impossible to meet the definition). The insurer reviewed the matter and decided to pay the claim outside of the policy terms. They are taking steps to calculate any premium refund.

We note that the newly developed Life Insurance Code has included a clause that promises three-yearly reviews of defined medical events by a 'relevant' medical specialist to ensure the definitions remain current: clause 3.2. The FSC also included in the Life Code standard definitions for three medical events: cancer (excluding early stage cancers); severe heart attack (measured by specific

⁶⁷ <http://www.abc.net.au/news/2015-11-25/sick-mother-denied-transplant-over-technicality-in-policy/6970656>

⁶⁸ <http://www.abc.net.au/news/2016-03-05/comminsure-denying-heart-attack-claims/7218818>

⁶⁹ <http://www.smh.com.au/business/banking-and-finance/arthritis-sufferers-denied-payouts-due-to-antiquated-medical-js-20160311-gngu5q.html>

⁷⁰ For e.g. Submission to the Senate Inquiry into Consumer Protections in the Banking, Insurance and Financial Sector http://financialrights.org.au/wp-content/uploads/2017/03/170307_ConsumerProtections_Sub_FINAL.pdf

tests) and stroke (resulting in permanent impairment). While we commend the FSC for taking these steps, Financial Rights continues to have serious concerns with respect to the design of these definitions, clauses and guidelines and subsequently the seriousness in which the FSC and life insurers are approaching the issue of medical definitions.

Apart from the fact that the FSC has only included three medical events, central to our concern is that the 'relevant' medical specialist under the draft guidelines does not have to be *independent* of the insurers. Who is a "relevant" medical specialist is entirely at the discretion of insurers and the FSC. This fundamentally undermines the appearance of impartiality and raises questions as to the validity of the draft and any review into medical definitions, in the eyes of consumers.

The Code also guarantee updates to medical definitions but for 'on sale' policies only—this is likely to leave gaps for many people whose policies are no longer 'on sale'.⁷¹

With respect to General Insurance there is only one standard definition used. The Government intervened in the insurance market to ensure that there is one standard term that applies to all home and contents policies: the definition of flood. Following the floods of 2011 and subsequent lack of coverage for many home owner policyholders, flood cover is now included in home and contents insurance policies, with a common definition, but consumers have the choice to "opt out".

In Financial Rights experience many consumers are opting out, or simply finding it impossible to find cover at an affordable price. Financial Rights gets regular calls from consumers who are unhappy with the premium being asked in relation to their flood cover. Complaints include:

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

Some callers are being refused insurance completely:

We are concerned that events similar to 2011 are likely to occur again, with significant numbers of properties uninsured for flood as a result of customers being unable to afford appropriate cover in the private market, being refused cover, or opting out of cover without appreciating the full extent of their risk. The market solution is not currently working. All indicators currently point to a likely increase in natural disaster events. These events are inevitably going to cost the government significant amounts of money.

Then there are the other definitions of commonly understood natural disaster events such as bushfire, earthquake, hurricane or man-made disasters such as terrorism that continue to vary significantly across the market. It is simply a matter of time until a similar spate of issues as

⁷¹ For further information see our joint submission to the FSC's consultation on their draft Minimum Standard Medical Definitions, http://financialrights.org.au/wp-content/uploads/2016/11/161111_FSCDraftMedicalDefinitions_Submission_FINAL.pdf

occurred with the flood definition will arise causing significant harm. These variations will be largely unclear and unknown to consumers, with insurers ultimately benefitting from the sale of products that will not be able to be claimed upon.

Claims denials based on unfair contract terms

Financial Rights regularly comes across unfair contract terms in insurance causing a significant imbalance in the parties' rights and obligations arising under the contract. These terms are not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term, and they cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

Financial Rights and Consumer Action have collected a large array of example terms that would potential meet the definition of a unfair contract term.⁷²

Unfair terms are usually hidden away in the fine print of an insurance contract or product disclosure statement and are rarely read or understood by a consumer when selecting coverage. See Barry's Story above.

However the the unfair contract terms regime under the Australian Consumer Law does not apply to insurance contracts. The *Insurance Contracts Act 1984* (Cth) does not include protections against unfair contract terms and excludes any Commonwealth, state or territory laws regarding contractual 'unfairness' from applying to contracts of insurance regulated under that Act, such as the unfair contract terms provisions in the ACL and ASIC Act.

The insurance has long argued for a unique status be applied to insurance with respect to unfair contract terms, largely arguing that the duty of utmost good faith protects consumer interests. Clearly this has not provided the protection asserted given the continued preponderance of unfair terms.

We note that the Government will be releasing proposals in early 2018 to implement the Australian Consumer law recommendation to apply unfair contract terms to insurance.⁷³ We welcome this development and emphasise that this problem requires a legislative solution. We also acknowledge that the ICA have recently taken the step to develop a possible approach to applying UCT to insurance contracts, however Consumer Representatives are concerned that this model could carve out a very significant portion of contract terms from the unfair contract terms test and potential review.

⁷² For e.g. Submission to the Senate Inquiry into Consumer Protections in the Banking, Insurance and Financial Sector http://financialrights.org.au/wp-content/uploads/2017/03/170307_ConsumerProtections_Sub_FINAL.pdf

⁷³ Australian Government response to the Senate Economics References Committee report: Australia's general insurance industry: sapping consumers of the will to compare, December 2017 <https://static.treasury.gov.au/uploads/sites/1/2017/12/p2017-t248756.pdf>

The development and design of poor value financial products

Question 1 – Misconduct

- The use of blanket mental health exclusions in insurance products in a discriminatory manner counter to the requirements of the *Disability Discrimination Act 1992*.
- The use of unfair contract terms in insurance contracts.

Question 2 – Conduct, practices, behaviours or activities below community standards

- The design and sale of unsuitable and generally worthless financial products such as add-on insurances, funeral insurances, and debt management services.
- Targeting of inappropriate markets such as young Indigenous people for funeral insurance.
- Avoidance of the spirit and intent of the standard cover regime.
- Claims denials on the basis of definitional gaming and out of date terminology.

Question 3(a) – Attribution to broader cultural or governance practices

- Insurers have over-relied on s. 35 of the *Insurance Contracts Act* to avoid the spirit of the standard cover regime.
- There is scant enforcement, regulatory oversight or incentive to act appropriately and within the confines of the *Disability Discrimination Act*.
- Insurers have developed an outsourced distribution model where there is a lack of oversight of distributors, contrary to the AFSL regime where insurers can outsource functions, but not their responsibilities as a licensee.

Question 3(b) – Attribution to other practices (i.e. remuneration)

- Competition laws prevent broad consideration of standard definitions in addition to the lack of any regulatory or self-regulatory imperative to develop standard definitions.
- Reliance on duty of utmost good faith as a consumer protection against unfair contract terms.
- The wide-spread use of product sales commissions and product based payments inevitably distort sales-staff behaviour, placing the imperative to make a sale above considerations of appropriateness for the consumer.
- The use of pressure selling techniques as a result of the above distortions.
- All insurers sell add-on products under general advice or no advice distribution models, where sales staff can promote the product but cannot tell the consumer whether or not it is suitable or meets their needs. This has led to the prioritisation of profit and business growth over meeting the genuine needs of the community.

Question 3(c) – Effective mechanisms for redress available

- While complaints can be brought against insurers under the DDA, most complaints are resolved through conciliation, resulting in few admissions of liability and subsequent legal precedents.

- The duty of utmost good faith has in practice failed to prevent the development of unfair contract terms, and failed as an effective and accessible tool for consumer redress.
 - Recent ASIC enforcement action has begun to reign in the worst excesses of add-on insurance sales, but many consumers are either unaware that they may have an add-on insurance and don't complaint, or do know understand that they can ask for a re-fund.
 - The lack of an unfair contract term regime in insurance has led to an inability to seek redress for claim denials on the basis of an out of date or inappropriate definition or term.
-

6. General comments on redress

Current government policy is that consumers should be compensated where there is loss or damage due to breaches of financial services or credit laws. This is implemented through the requirements in financial services legislation that requires licensed businesses to have arrangements for compensating consumers.⁷⁴ The law requires that this is generally satisfied through the holding of adequate Professional Indemnity (PI) insurance cover.

Dispute Resolution

Financial Rights is very supportive of the move to a new one-stop shop external dispute resolution (EDR) scheme that implements the considered recommendations of the Review of the Financial System External Dispute Resolution and Complaints Framework (Ramsay Review). The proposed Australian Financial Complaints Authority (AFCA) can build on the success of the existing EDR framework, and extend the benefits of EDR to superannuation customers for the first time.

Australians need a free, fair, fast and effective service to help resolve disputes against financial firms. Whether it is stopping the unwarranted repossession of the family home or challenging an insurer's decision to deny an income protection claim, these disputes can be incredibly stressful and adversely impact upon lives until resolved. Once established, AFCA should remove inconsistency and confusion in dispute resolution, and make it easier to resolve complaints with banks, insurers, super funds and others financial institutions.

Industry ombudsman schemes have been a hallmark of consumer protection, and it is good that the AFCA legislation adopts the principles of the schemes, including accessibility, independence and fairness, as the general considerations for scheme authorisation. We also support the mandatory requirements in the Bill, which confirm that accessing AFCA will be free of charge for complainants, and that its determinations will be binding on financial firms.

⁷⁴ section 48, *National Consumer Credit Protection Act 2009*; section 912B, *Corporations Act 2001*

The Regulator

ASIC has been a very effective regulator in the consumer credit and insurance spaces. It has been very active in the seven years since taking over this role from the State governments in 2010 and has taken some well targeted activities to address areas of likely consumer detriment.

In recent years ASIC has taken a lot of action against financial service providers which are actively engaging in misconduct and entered into numerous enforceable undertakings. ASIC also engages in a great deal of surveillance and investigation activities, regularly publishing its findings on specific practices and products such as add-on insurance products or newly emerging debt management firms.

However, even though we are very supportive of ASIC as the national regulator for financial services, we believe that more could be done to empower ASIC to be nimble and fast acting when it becomes clear that consumer detriment is taking place or certain groups of consumers are at risk.

Better Regulation

The suitability of financial products has begun to displace disclosure in regulatory theory and practice. The FSI review, for example, recognised the limitations of disclosure and recommended a move to design and distribution obligations which sought to better match products with their target customers, rather than place the onus entirely on consumers of those products to read and comprehend the benefits and risks of such products, and how they measure up to their needs and objectives, based on mandated disclosure (a big ask in theory and a proven failure in practice).

We strongly support the proposed legislation introducing Design and Distribution Obligations (“DDOs”) and Product Intervention Powers for ASIC although we believe it is unnecessarily confined. Credit, for example, has not been included and there are other carve outs and limitations⁷⁵.

It appears that the approach that is currently being pursued with regards to these new powers is predicated on the principle that you can have individual suitability tests, such as responsible lending in credit, and you can have a product based suitability test such as is proposed in the design and distribution obligations, but you don’t need both. We argue otherwise.

The reason given for excluding credit is that there is already an individual product suitability test in the form of the responsible lending obligations under the *National Consumer Credit Protection Act*. While consumers can raise disputes and seek remedies under the responsible lending laws, there is no mechanism to determine whether products are being widely marketed to an unsuitable consumer group, or to determine whether any particular credit products systemically lead to poor consumer outcomes. Recent measures introduced to tackle the growing numbers of interest-only loans in the home loan market were driven by APRA and concerns about market wide stability⁷⁶ but

⁷⁵ Product intervention orders can only be introduced for a maximum of 18 months

⁷⁶ See for example Media Release, 31 March 2017, APRA announces further measures to reinforce sound residential mortgage lending practices, available at <http://www.apra.gov.au/MediaReleases/Pages/mediareleases.aspx?ys=2017&ye=2017&pg=2>

there are other credit products that are arguably unsuitable in a systemic way that are not of sufficient value to warrant prudential interest.

Pay day lending has notoriously produced very poor outcomes for many consumers leading to specific regulation in 2013 and further reforms currently in the pipeline, which we strongly support. Product design and distribution laws, and product intervention powers however may have enabled these issues to be dealt with sooner, more effectively and without the need for further specific legislation. The same could be said for the problems in the credit card market outlined above.

While insurance products will be covered by the DDOs this is also insufficient. The sale of funeral insurance or life insurance policies with stepped premiums to people on long term Centrelink benefits with little prospect of improvement in their financial circumstances is clearly unsuitable, as they are likely to be priced out of the product prior to obtaining any benefit. DDOs may reduce the number of people affected by this problem but they provide no remedy for those who may slip through the net. At the moment the only way to address this issue is to argue that the person was in some way misled or subject to pressure sale tactics, whereas the product was clearly unsuitable from the outset.

In recent times ASIC has enhanced its data analysis capabilities and has a number of potentially informative projects in the pipeline.⁷⁷ Properly designed data collection and analysis can effectively identify important market issues, possibly bringing to light consumer issues that are otherwise undetected, but also importantly distinguishing between products that are “mis-sold” and products that have little intrinsic value at all (because they produce real benefits for very few consumers, if any⁷⁸). What is required is for ASIC to be empowered to act on the information so identified.

Regulation in the credit space in particular is detailed, prescriptive and notoriously avoided. The level of detail and prescription lends itself to casting the net very narrowly in terms of the entities and products which are captured, which in turn generates the potential for avoidance.

Regulating for outcomes has the potential to avoid this trap, with a broad based principles approach allowing for general application across a range of products and services without the need to set clearly the type of narrowly defined boundaries and definitions that facilitate technical avoidance and require a new set of laws for every emerging trend. In short:

1. Regulation should define the desired outcomes of financial services regulation as far as possible, as opposed to focusing solely⁷⁹ on developing technical rules intended to produce an outcome (for example, that products and services are clearly understood by customers and suitable to their circumstances and objectives);
2. A strong and nimble regulator should be empowered to develop (in consultation with industry and consumers) agreed indicators of whether those outcomes are being met,

⁷⁷ For example a credit card project, and proposed data collection in relation to effectiveness of CCI reforms.

⁷⁸ For example, where claims ratios for insurance products are so low as to suggest the product has little intrinsic value for consumers. We note that some US states set minimum claims ratios for insurance products.

⁷⁹ This is not to advocate for the removal of all existing rules and prescription. Many technical aspects of the current law are entirely appropriate and are achieving their objective. Others could potentially be repealed once an alternative approach is shown to be more effective.

collect and analyse relevant data, and work with industry to improve outcomes where they fall short⁸⁰; and

3. The Regulator should be empowered with permanent rule making and intervention powers to promote the desired outcomes where necessary (both in order to motivate industry to engage with the process outlined at point 2 and to allow the regulator to deal with serious or systemic consumer detriment without the need for law reform in every instance).⁸¹

Last Resort Compensation Scheme

Although there are some opportunities for consumer redress through industry funded ombudsmen schemes and PI cover, it is clear that the current compensation arrangements for consumers of financial services are inadequate and are not achieving the policy objective. In 2015 FOS publicly announced that between 1 January 2010 and 31 March 2015, 126 of its Determinations remained unpaid. The value of the outstanding amounts at that time was \$12,862,911.70 plus interest (adjusting for interest and inflation, the present day value of these uncompensated losses is over \$22 million).⁸² Unpaid determinations represent 24.47% of all determinations issued in the Investments, Life Insurance and Superannuation area. An unknown number of additional consumers suffer loss that is likely to have been caused by misconduct but do not pursue a claim in a court or EDR forum.

A last resort compensation scheme is the only way to ensure that consumers who suffer loss from misconduct are compensated. It is effectively the missing piece of the financial services regulatory architecture.

Any last resort compensation scheme would only be called on in a minority of cases—those where loss flows from proven misconduct by a licensee, the licensee then cannot meet the claim and the consumer cannot be compensated by recourse to PI insurance arrangements.

Ideally, the scheme would only make compensation payments on the basis that the claimant assigns their rights against the licensee to the scheme. This would enable the scheme to pursue recoveries against directors and managers where possible—the scheme would have an incentive to do this. Second, claiming against the scheme could trigger enforcement investigations against any relevant directors or managers that were involved in misconduct. ASIC’s banning power could be used to prevent the possibility of businesses “phoenixing”.

There are options that could be considered other than a last resort compensation scheme. For example, the Government could seek to specify mandatory levels of PI insurance cover to ensure it covered the risk of uncompensated loss. Another alternative is to require licensees to have more stringent capital adequacy requirements that could be called upon. Both these options are likely to impose significant costs on industry. Moreover, it is not clear that a private PI insurance market would be willing to provide this level of cover—there has been failure in other private last resort

⁸⁰ See for example Willis, Lauren E., Performance-Based Consumer Law (August 16, 2014) 82 University of Chicago Law Review 1309 (2015).

⁸¹ The Parliament could be given an oversight role to prevent over-reach by the regulator.

⁸² For further information, see Financial Ombudsman Service Circular Issue 21, April 2015: <http://www.fos.org.au/the-circular-21-home/fof-news/unpaid-determinations-update.jsp>

insurance markets, for example, home building warranty insurance in a number of states where private providers have opted not to provide cover due to uncertainty in pricing for the risk. In comparison, a last-resort compensation scheme can operate as an industry-wide insurance mechanism: a comparatively low cost arrangement that can provide cover for a small risk that, if eventuates, will have substantial impacts on an individuals and families.

A last resort compensation scheme can also enable other elements of the compensation system—EDR and PI insurance—to work more effectively. If it is established, consumers will have confidence that taking their complaint to EDR will not result in uncompensated loss.