5 February 2018

# Misconduct in the Banking, Superannuation and Financial Services Industry

## Submission to the Royal Commission

## ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns

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# INTRODUCTION

CHOICE would like to thank the Royal Commission for its invitation to make a submission on misconduct in the banking, superannuation and financial services industry.

The financial services industry plays an essential role in the lives of Australians, from providing for day-to-day transactions, to helping save for a home, to providing for a comfortable retirement. The importance of this industry means it must be held to the highest standards. However, CHOICE research found a mere 30% of Australians trust the banks.[1] Finding the sources of this trust deficit and addressing them is a vital role for the Commission.

In looking at issues across the financial services sector, one overriding problem emerges – there are lengthy and unnecessary delays to solutions to help consumers. There are delays as financial services providers deny any problem is occurring, as we saw with financial advice issues where banks spent years insisting problems only occurred due to a "few bad apples" rather than the incentives they had put in place to encourage advisers to sell products at all costs. And there are excessive delays as industries pursue ineffective self-regulatory options. These self-regulatory initiatives either fail to deliver anything, like we have recently seen with the Insurance in Superannuation Working Group, or they address only those issues which industry feel comfortable tackling, not the root cause of problems.

While waiting for solutions, people suffer heavy losses, such as having to sell their family home, relationship breakdown or illness due to the financial stress they are placed under.

Self-regulation as a first response in the financial services sector has demonstrably failed, leading people to suffer significant loss. It is time for a re-think on how we can best rapidly respond to issues as they are identified.

The leading example is the years it took and the human suffering caused by industry's failure to standardise a single term within insurance contracts. The industry's failed attempt to come up with a standard definition for 'flood' directly led to human suffering and loss of homes during the devastating Queensland floods of 2010-11. After years of industry delay, government action was eventually required to define a single word.

[1] The January 2018 CHOICE Consumer Pulse survey was designed and analysed by CHOICE with fieldwork by The ORU conducted with 1029 Australian households between 3 and 15 January 2018. Final data has been weighted to ensure it is representative of the Australian population based on ABS Census data from 2016.

The solution can be found in fast acting regulators who are properly empowered to identify and act upon problems as they arise. Examples can be seen in the Australian Prudential Regulation Authority's (APRA) powers to quickly intervene in the home loans market to cap interest-only loans when these loans pose a financial stability risk.

Examples can also be seen outside of the financial sector in essential services such as telecommunications. The Australian Communications and Media Authority (ACMA) has the power to make binding standards on industry. These standards can be relatively quickly made to serve the public interest and protect consumers from suffering harm.

Importantly, these powers require regulators to work with industry and consumers to develop appropriate solutions. As the examples below highlight, a regulatory response from a fast-acting independent umpire is essential for dealing with increasing complexity within the financial services sector.

To assist the Commission, CHOICE has undertaken a survey of over 2,800 Australians, who offered to share their experiences of the financial services industry.[2] We have included these stories so that people could share in their own words their experience of where the sector has failed. In some cases, the failures identified are so poor that they may breach existing law and constitute misconduct. Most are examples of financial service providers falling well short of community standards and expectations. It is in these cases that we see the special need for attention and legislative reform.

The examples highlighted in this submission are indicative of an industry that has lost touch with the public. From those who have lost their home due to poor financial advice, to those who have had the pain suffered by a disability compounded by a restrictive insurance policy, the cost of inadequate consumer protections too often falls on those least able to cope.

Other people shared stories of conduct that causes less devastating individual impacts, such as excessive fees or ever-increasing insurance premiums. For the individuals involved, these practices result in unaffordable increases in living expenses or the erosion of vital retirement savings.

[2] CHOICE, 2018, 'Royal Commission survey' , data was collated 10 January – 5 February, 2018, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their priorities for the Royal Commission and experiences where a financial service provider had not met the respondents standards or expectations, n=2,820

The calling of a Royal Commission also provides a significant opportunity for the Commission to use its evidence-gathering powers to unearth or better understand the causes of poor practice in the sector. To assist the Commission CHOICE has produced targeted lists of evidence that if requested, should provide valuable insights into the underlying causes of poor practice in financial services.

## Recommendation summary

- Where there is evidence of consumer harm that self-regulation as a first response be abandoned and replaced with properly empowered regulators.
- That an industry funded compensation scheme of last resort be established.

## Summary of information requests

**Information that should be requested from insurers:**

- What, if any, research the company conducted to determine if customers genuinely understand the benefits and limitations of the insurance products they purchase?
- Similarly, what research has the company conducted to determine which products and sales methods will attract more customers?
- Information about how premium prices are calculated, the evidence used to make these decisions and how consumers are informed about how data is used. Specifically:
    - What are the factors used to set premium pricing (e.g. colour of your car)?
    - What data does the company use to underpin these decisions?
    - Where is data used to set premium prices sourced? Is there data collected on individual consumers outside of the sign up and claim process and how is it used? Specifically, is data from social media activity, loyalty programs (grocery, airline or other loyalty programs) or online browsing used by the insurer?
    - How are premium levels calculated for existing customers compared to new customers?
    - How are factors in premium pricing communicated to consumers? How are consumers informed about what data is used to set premium prices and where it was sourced?
- Information about claims handling practices that could contribute to poor customer experiences. Specifically:

  - What are the policies and guidelines that govern private investigator and third-party claims assessor behaviour in assessing claims?
  - What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for claims assessors and independent advisors?
  - What are the average and maximum claims timeframes for each policy? What is the average and maximum time for a complaint to be resolved through Internal Dispute Resolution (IDR)?
  - What are the claims ratios (successful vs unsuccessful) for policies and add-ons? For example, what is the claims ratio for add-on pet cover with home insurance or add-on consumer credit insurance?

**Information that should be requested from life insurers**

- What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for claims assessors and independent advisors (e.g. doctors)?
- Is data collected on individual consumers outside of the sign up and claim process and how is it used? What do consumers know about its use?
- What data is relied upon to assess the level of risk associated with various mental health conditions?
- What data is relied upon to assess mitigating factors in placing mental health restrictions on a policy?

**Information that should be requested from superannuation funds**

- What is the level of erosion of member funds due to fees and insurance?
- What evidence is there that insurance products are appropriate for different cohorts of members (e.g. members on low incomes, women, older members, members without beneficiaries)? What consideration did superannuation trustees give to the suitability of insurance for different cohorts when establishing current arrangements?

**Information that should be requested from financial services providers about financial advice**

- What is the number and percentage of consumers on legacy commission structures?

**Information that should be requested about home lending from banks, aggregators or brokers about home lending**

- Questions about mortgage brokers and commission payments to encourage sales:
  - Do banks that own mortgage broking businesses provide any additional incentives for brokers in those businesses to recommend the parent company's

loans? Are any KPIs or other performance measures used to encourage or require a certain volume of loans be directed to the parent company?
    - What service does a consumer receive from a mortgage broker over the life of a loan? What measures are in place to ensure that the consumer receives this service? How does this correlate with trail payments made over the life of the loan?
    - How have banks adjusted commission payments to brokers over the last three years? What consideration was given to likely consumer outcomes because of these commission restructures?
- Questions about interest-only loans:
    - What steps do lenders take to ensure customers understand interest-only loans? Is consumer understanding of key terms measured?
    - What is the rate of default in raw number and percentage terms on interest-only loans?
    - What steps do lenders take to inform customers of an upcoming switch to principal and interest repayments for interest-only loans?
    - What assessment takes place of a customer's ability to repay principal and interest once an interest-only period expires for an interest-only loan?
- Questions about Lenders Mortgage Insurance:
    - How often do lenders claim on LMI?
    - How is premium pricing for LMI determined, including typical profit margins and expected losses recouped from borrowers?
    - What steps do lenders take to ensure customers understand LMI?
    - On what basis does a lender offer LMI from one insurer as opposed to another (e.g. are there incentives like commissions or profit sharing in place)?
    - What barriers to switching are associated with moving a home loan with LMI?
- Questions about guarantor loans:
    - What are lenders' modelled impacts on family homes at different interest rate rises (e.g. 1-6% rate rise)?
    - What is the percentage of guarantor loans that default?
    - What steps do lenders take to ensure customers understand guarantor loans?

**Information that should be requested from lenders about personal loans**

- What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for staff recommending credit cards over lower cost options?
- Information on the credit assessment processes. For example, how often are Household Expenditure Measures (HEMs) solely relied upon to estimate a borrower's living expenses? In what circumstances do lenders use HEMs? Are they used for people on

social security payments? Are they used when actual expenses are known or should reasonably be known?

**Information that should be requested from banks about fees**

- What is the breakdown of the cost to business of commonly charged fees?
- What percentage of customers with a credit card are paying late fees? What measures have financial services providers put in place to help customers avoid fees?

# General Insurance

Consumer protections in the general insurance space have been too focused on disclosure to inform consumers of detailed policy rules. These protections are extremely limited and frequently lead to insurers failing to live up to community expectations. Consumers are presented with long and complex terms and conditions and expected to understand them. When consumers go to claim on their policy, they are frequently faced with loopholes or exceptions that mean they don't receive the support they expected from their insurance policy.

Behavioural finance shows that existing product disclosure regimes are inadequate. Traditionally the role of disclosure was based on a theory that consumers are rational agents who will make welfare maximising decisions if provided with full information.[3] While this theory has long been questioned, policy and regulation have been slow to catch up. Traditional models assume economic agents, such as consumers, have an infinite capacity to take in and process information; are neutral as to how it is presented; can anticipate and take the future into account; care only about self-maximising; and treat gains the same as losses.[4] In contrast, behavioural economics recognises that consumers have limits on the amount of information they can take in; are affected by presentation; tend to be poor at anticipating the future; care about people and fairness; and are more concerned about losses than gains.[5] These are known as 'behavioural biases'.

The impacts of behavioural biases are compounded in general insurance because the nature of the product means it is usually only relied upon in the future, if at all. This makes it difficult for a consumer to adequately assess their needs against the product offering. In addition, the presentation of terms in the form of lengthy Product Disclosure Statements (PDS) requires high levels of time and comprehension to come to grasp with the detail of a policy. For many, reading

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[3] Johnston, K., Tether, C., Tomlinson, A., 2015, 'Financial Product Disclosure: Insights from behavioural economics', Ministry of Business, Innovation & Employment, p.iii
[4] Office of Fair Trading, 2010, 'What does Behavioural Economics mean for Competition Policy?', March 2010, p. 5
[5] Office of Fair Trading, 2010, 'What does Behavioural Economics mean for Competition Policy?', March 2010, p. 5

beyond the exclusions on the key fact sheet or cover page will be the limit to their ability to engage with long product disclosures.

> In one instance Budget Direct wrote off my car after it had been in an accident, then did not honour my claim as the person driving my car was under the age of 40!? She was 38. This policy clause was buried in small print way down in my contract not stated on the cover page with all the usual exclusions. #680

A good disclosure process can also be defeated if key definitions are not standardised. This is particularly the case in insurance where a definition, potentially hidden a hundred pages deep in a PDS, can radically alter the value of a policy. This weakness was recognised in the moves to standardise the definition of a 'flood' in insurance contracts.

## Flood cover – two decades of inaction exacerbates consumer harm

The story behind the standardisation of the term 'flood' is one of industry delay and piecemeal self-regulatory efforts. It demonstrates that consumers are harmed not just through an initial failure from industry to live up to community expectations, but the harm continues and is exacerbated as ineffective industry efforts and opposition to reform delays meaningful solutions.

As the timeline below shows, issues with flood cover in insurance were evident from 1996. Industry took years to recognise the problem and even longer to propose a solution. Eventually, the Federal Government stepped in to legislate a simple, consistent definition of 'flood'. Because of delays, multiple communities were left without flood cover between 1996 and 2014 when reform was finally implemented. [6]

[6] For further information on issues covered in the timeline see: 1. Coffs Harbour flood impact: http://www.abc.net.au/news/2009-04-13/flood-insurance-decision-brings-relief/1648554 and http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;db=CHAMBER;id=chamber%2Fhansardr%2F1996-12-02%2F0124;query=Id%3A%22chamber%2Fhansardr%2F1996-12-02%2F0163%22 2. Wollongong floods: http://www.legalaid.qld.gov.au/files/assets/public/publications/work-and-money/storm-insurance_content.pdf and http://www.insurancenews.com.au/analysis/10-years-on-flood-cover-remains-elusive 3. ASIC report on flood cover http://asic.gov.au/about-asic/media-centre/speeches/key-regulatory-developments-and-issues/ 4. The Natural Disaster Insurance Review and consultation on legislation to introduce a standard definition http://www.ndir.gov.au/content/commissionedpapers/2011/Flood_Insurance_Aus.doc and https://static.treasury.gov.au/uploads/sites/1/2017/06/explanatory_statement.pdf 5. March 2008, Insurance Council of Australia Limited, Authorisation A91086, available at https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/insurance-council-of-australia-limited-authorisation-a91086

**Industry inaction on flood insurance**

**1996 Coffs Harbour** floods: there is public outcry as insurers deny claims as damage was caused by "stormwater" not "flood

**1998 Industry review recognises issues:** Issues with disclosure about flood cover were raised and recognised in a review of the General Insurance Code of Practice. Industry promises more clarity and better disclosure.

**1998 Katherine floods:** the community is devastated as people insured with TIO were covered for the damage but people with other insurers were not.

**1998 Wollongong floods:** insurers deny claims because damage caused by "stormwater" not flood. Public campaigning sees some insurers reverse their decision.

**2000 regulator calls for action:** an ASIC report finds issues with the sale and disclosure of flood cover in insurance. The report recommends that industry improve disclosure and sales practices.

**2007 Hunter and Central Coast floods**: many insurance claims were rejected because damage was caused by a "sea surge" rather than a "flood"

**2008 Industry proposes a voluntary and ineffective solution:** The ICA asks the ACCC to approve a voluntary definition of flood. Consumer groups argue that the definition would make flood cover more confusing and cause more issues. The ACCC rejects the ICA's proposal.

**2010/11 Major flooding in Queensland, Northern NSW and Victoria:** again, many insurance claims were rejected.

**2012 law reform:** The Federal Government amends the Insurance Contracts Regulations 1985 to include a standard definition of flood.

**2012 Industry calls for further delays** Industry submissions to government call for a minimum two-year period before the new law will take effect.

**2014 implementation:** New legislation finally applies. Flood cover is standardised.

The insurance industry could have taken more effective action at multiple points to improve issues with flood cover. It chose not to. For example, the ACCC rejected the Insurance Council of Australia's 2008 proposal for a voluntary standard definition of 'inland flood'.[7] The ACCC found the industry's proposed definition failed the net public benefit test because it introduced terms untested at law and terms that did not match up with how a consumer might understand them. Most damning of all the industry was only proposing voluntary adoption of the standard definition. The ACCC provided direction on how the standard definition of flood could be improved in order to pass the net public benefit test. However, the industry chose to walk away from the proposal rather than seek meaningful reform.

In many respects this is unsurprising; commercial operators can be aggressively focused on competing for customers and increasing profit in the short term rather than working to lift standards for consumers across the board. Frequently these two motivations directly conflict. In some circumstances consumers do benefit from competition, especially where it drives product innovation, improves quality and keeps prices low. However, where behavioural biases limit a consumer's capacity to adequately assess quality, such as when they are overloaded with information, competition fails.

UK research into how consumers understand insurance products highlights this limitation.[8] People with high levels of engagement tend to use comparison tools as one source of information to 'narrow the field' and are likely to ask follow-up questions of an insurer to ensure they offer the right level of cover. By contrast, those with lower levels of engagement tend to be overly focused on headline price, believing all types of cover to be essentially the same.

As a result, a great number of people are sold into inappropriate insurance products. For this time-poor demographic, simply providing more or better information is unlikely to solve the problem. It should be the role of regulators to identify these problems and intervene. A reliance on self-regulation in these circumstances misunderstands the role of commercial operators to vigorously compete and deliver for their shareholders.

The human toll of self-regulation was evident in the summer of 2010-11 when Queensland was hit with a series of natural disasters which caused flooding resulting in the loss of life and

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[7] 20 March 2008, Insurance Council of Australia Limited, Authorisation A91086, available at https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/insurance-council-of-australia-limited-authorisation-a91086
[8] Atticus, 2014, 'Price comparison website: consumer market research', prepared for the Financial Conduct Authority.

damage estimated at $2.38 billion.[9] The tragedy was compounded when people discovered the insurance, which they had been diligently paying for years in the event of such a disaster, failed to cover them. The culprit was hidden away in the fine print of their insurance contracts.

Allowing industry to develop its own definitions of flood had led to a series of carve outs and restrictions in some policies which left consumers without cover. The lack of a standard definition for a flood meant people in the same street impacted by the same flood received completely different outcomes when making a claim.

### Selma's story[10]

The downstairs of our home became un-liveable as water rushed through downstairs. We woke to find our 2 children asleep and their beds surrounded by water.

CGU refused to cover us. We had flood cover, but apparently not storm water cover.

We lived halfway down a hill in Yarraman, QLD. A metre of water came through, the school below us was also affected, as well as surrounding house, but we still weren't covered (others were).

Quotes ranged from $40,000 - $140,000 to fix it.

CGU said it was our poor drainage that made the water come through. Yet everyone else around us had similar damage and they were covered.

It took them 8 months to decide that they wouldn't cover us! 8 months while I was pregnant and had 2 children without bedrooms!!

It financially ruined us and 7 years later we are only just starting to get back on track.

After the failure and delay by industry to develop a standard definition, it fell upon taxpayers through a flood levy to pick up the pieces and pay for the lost homes of Australians who thought they were insured.[11] In 2012 the Federal Government amended the *Insurance Contracts*

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[9] 8 March 2012, Carbone D and Hanson J, 'Top 10 Worst Floods in Australia', Australian Geographic, available at http://www.australiangeographic.com.au/topics/history-culture/2012/03/floods-10-of-the-deadliest-in-australian-history/

[10] All names changed to protect privacy

[11] 27 January 2011, Levy M, 'Levy to pay for $5.6b bill', Sydney Morning Herald, available at http://www.smh.com.au/business/levy-to-pay-for-56b-flood-bill-20110127-1a64x.html

*Regulations 1985* to finally include a standard definition of flood. After industry protests about implementation difficulties, the full force of the amendment did not take effect until 2014. All told this was nearly two decades of delay and inaction from the insurance sector. Self-regulation as a first response has demonstrably failed, leading people to suffer significant loss. It is time for a re-think on how we can best rapidly respond to issues as they are identified.

Despite legislative reform eventually coming to solve the lack of a standard definition for flood, there remain a slew of terms which have different definitions depending on the policy. For example, home insurers use different definitions for 'actions of the sea'. ANZ excludes loss or damage caused by "actions by the sea" however it does not define a tsunami as an action by the sea and will in fact cover loss or damage caused by a tsunami.[12] By contrast Coles considers a tsunami to be an act of the sea and excludes damage or loss "caused by high tide, tidal wave, tsunami or other actions of the sea."[13] These kind of inconsistent definitions greatly increase the time taken to compare policies and in many cases consumers are likely to be misled to think they have cover when in fact they do not.

## General insurance – lack of loyalty to existing customers

The CHOICE survey prepared for the Commission found a lack of loyalty to existing customers was the most common problem identified in general insurance (71.3%).[14] Respondents complained of regular yearly premium hikes that punished those who remained loyal to their insurer. Many found approaching their existing insurer as a new customer resulted in being offered much cheaper premiums.

### Fabricio's story

I hate it when you stay with an insurance company and there is no customer loyalty, premiums go up year on year forcing you to shop around.

### Sera's story

It's almost impossible to decipher and compare products terms of coverage and claims. The process is so difficult that we end up choosing a policy based on guesswork. I hate dealing with these companies. On top of that they crow about their discounts and benefits, when every year

[12] ANZ Home Insurance PDS, available at: https://www.wealth.anz.com/content/dam/anzwealth/pdfs/insurance/ANZ-Home-Insurance-PDS.pdf
[13] Coles Home Insurance PDS, available at: http://financialservices.coles.com.au/insurance/about-our-insurance/important-information#PDS
[14] CHOICE survey of the people who had an experience with a general insurer which did not meet the person's standards or expectations, n=543

policy premiums increase, so much that any so called benefits are quickly eclipsed for loyal customers.

Johann

Premiums for insurance renewals are higher than if I cold call an insurer. Renewals are designed to rip off those who do not check the prices.

Len

Premium rises each year when it's cheaper to sign up as a new customer.

The evidence from one case study showed a consumer so fearful of large premium hikes they were avoiding making a claim.

Sybille's story

I have had home and contents insurance for over 20 years but if I claim for storm damage to my home I will be hit with a massive premium hike, so instead I'm sleeping in a bedroom with mouldy walls, carpet and floor.

## General insurance – lack of transparency about price

It would be easy to say that consumers can simply shop around each year to get the best deal, but this ignores two main limitations in consumer decision making. Firstly, as already mentioned, people have limitations on the amount of information they can understand about a product. This is not aided by a lack of standard terms or terms that do not align with common usage or understanding.

Secondly, people have limitations on the amount of time they can dedicate to finding a new insurance policy each year. Across the multitude of insurance products renewed on an annual basis, such as home, contents and car, it could take days to properly analyse the cost versus the included value of each product on the market. Even with the help of comparison services, such as those provided by CHOICE, we can only hope to narrow the field. There are complex arrays of individual factors that make up a premium price, many of which are not transparent.

For example, a recent media report showed that one insurer was using information about the level of education obtained by a person to set car insurance premiums.[15] Those who had finished schooling in year ten were being charged higher premiums than those who had completed high school or gone on to tertiary study.

Insurers are exempt from anti-discrimination protections where they can show the discrimination is reasonable and based on actuarial or statistical data that shows a special degree of risk.

The problem is this data often goes untested and is not publicly available. Consumers are left completely in the dark about the factors that make up their premium price and are therefore unaware which insurers may be discriminating against them for factors outside their control.

### Agatha's story

On renewing my car insurance several years ago, I was asked if I had ever been a bankrupt - I had not been asked this question before - I had been a bankrupt so I ticked "yes". By this time I was out of my bankruptcy and I had never been late or missed a payment to the car insurers before, during or after my bankruptcy. My premium went up by a huge amount, so I declined to accept the new arrangement and found a new provider. A rep from the company rang me asking me why I didn't renew - I told her and she offered me a lower rate but it was still considerably more than I'd paid previously. She was very nice (not at all pushy) and not at all surprised when I declined to pay even 1 cent more simply for being honest. So this company had had my business for 10+ years and I'd never missed a payment to them or made a claim, yet they decided to try and punish me anyway - bad decision!

### Linnie's story

My car and contents insurance premiums keep increasing year after year, despite crime rates in my suburb being level with or lower than the state average and my car decreasing in value each year on my policy. How is this possible. When I question it with them they always make up some ridiculous reason. When I threaten to go with another insurer, they can suddenly offer me a much better price. This sort of practice shouldn't be allowed to happen.

[15]The report found Progressive Direct customers who had left school in year 10 were charge up to 14% more for car insurance premiums compared to those who had gone on to tertiary studies: http://www.heraldsun.com.au/business/car-insurance-pricesetting-based-on-a-persons-education-level-is-discriminatory-watchdog-says/news-story/66f9bab1b7ddd61312d058f8ec162dee

## General insurance – no transparency about the reasons behind premium increases

Consumers are also left without any ability to qualify information provided or gain an understanding as to why some disclosures increase premium costs. It is understandable that if some activity has a causal relationship to risk there may be an impact on premium prices. However, insurers are not transparent about these risk factors, their impact or accepting of a person's individual circumstances that may mitigate this risk. Without transparency consumers may find it more difficult to shop around or avoid insurers that are discriminating against them.

As the following case studies demonstrate, a lack of transparency leads to some people being charged significantly more for insurance, making it unaffordable or in some cases simply denying access to insurance altogether.

### Nora's story

Travel insurance - when can you ever get coverage for pre-existing conditions? I have never managed this, no matter how long since the injury or how low the risk of recurrence.

### Sharlene's story

We had an investment property in Central Queensland (on the coast and on a hill) but the area was lumped with Rockhampton and after the floods, the premium rocketed from $900 to $3,500 (QBE) because of our postcode even though our property could never flood. Some insurers wouldn't even cover that postcode. We eventually found alternative cover for around $1,300pa but that kept going up so we sold the property in the end. Insurers were completely inflexible even though we'd never had a claim, our property was unharmed during a cyclone and was incapable of flooding.

## General insurance - information request

Given the evidence of practices associated with general insurance falling below community standards and expectations, we see this as an important area of further exploration for the Royal Commission. We can see the Commission's understanding of the poor practice in general insurance could be strengthened by requesting the following evidence from insurers:

- What, if any, research the company conducted to determine if customers genuinely understand the benefits and limitations of the insurance products they purchase?

- Similarly, what research has the company conducted to determine which products and sales methods will attract more customers?
- Information about how premium prices are calculated, the evidence used to make these decisions and how consumers are informed about how data is used. Specifically:
    - What are the factors used to set premium pricing (e.g. colour of your car)?
    - What data does the company use to underpin these decisions?
    - Where is data used to set premium prices sourced? Is there data collected on individual consumers outside of the sign up and claim process and how is it used? Specifically, is data from social media activity, loyalty programs (grocery, airline or other loyalty programs) or online browsing used by the insurer?
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- Information about claims handling practices that could contribute to poor customer experiences. Specifically:
    - What are the policies and guidelines that govern private investigator and third-party claims assessor behaviour in assessing claims?
    - What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for claims assessors and independent advisors?
    - What are the average and maximum claims timeframes for each policy? What is the average and maximum time for a complaint to be resolved through Internal Dispute Resolution (IDR)?
    - What are the claims ratios (successful vs unsuccessful) for policies and add-ons? For example, what is the claims ratio for add-on pet cover with home insurance or add-on consumer credit insurance?

# Life insurance

Life insurance (including disability insurance) is a product that gives people comfort at some of the most challenging times in their lives. Given the inherent vulnerability of people when they come to claim against a policy, this sector has a special responsibility and should be held to the highest standards. In contrast, the evidence shows an insurance sector that is failing in its duty to put consumers' interests first.

Recent scandals have demonstrated that when a consumer claims on life insurance there can be a big gap between the quality and coverage that is expected and what is actually delivered.

This appears to be, in part, because it is extremely difficult for consumers to understand and compare insurance policies either on quality measures or price. Consumers also can't trust that an insurer will treat them fairly, especially if they need to make a claim. Finally, poor system design means that many people hold unsuitable or multiple insurance policies without realising. Issues with product quality need to be addressed through better regulation, fairness, disclosure and system design.

While disclosure alone cannot remedy all problems, there are a number of lessons from other sectors where it has been more successfully applied and subsequently improved consumer outcomes. A more thorough application of the learning from behavioural economics and a move away from a reliance on the PDS is central to overcoming this challenge.

Again industry self-regulation in the form of the Life Insurance Code of Practice and attempts to develop a code for life insurance in superannuation has fallen short of expectations. Efforts to date have not gone far enough in targeting key concerns around enforceability, compliance monitoring, sales practices, product design and lengthy delays in claims processes.

The current exemption from a prohibition on unfair contract terms that the insurance sector enjoys further compounds consumer harm. Consumers are being exploited by fine print terms hidden away more than one hundred pages deep into a PDS. Central to restoring confidence in this sector will involve giving assurance to consumers that products reflect their expectations and that they won't be denied claims on the basis of fine print technicalities.

Despite reform efforts, conflicted remuneration remains a problem in this sector. Serious responses need to recognise that banning conflicted remuneration is the only real solution to a problem which is causing demonstrated harm to consumers.

In the CHOICE survey prepared for the Commission, confusing policy terms was the most common issue for people who had experienced problems with their life insurance (63.2%).[16] It is not until a person comes to claim that the full implications of confusing or restrictive policy terms are brought into sharp focus, often with dire financial impacts on the people and families affected.

[16] CHOICE survey of the people who had an experience with a life insurer which did not meet the person's standards or expectations, n=171

### Sandro's story

The claim was made by my son, he had two policy's with comsure and to hear the title of the insurance policies you would believe them to be income protection. So when my son fell from his off road motorcycle and injured his foot he thought he was covered. Initially he was told that he could not make a claim on either policy. I persisted and eventually was told that because they had not received his claim form that they could not consider his claim. We eventually got all the medical and financial information that we could muster. But even now they maintain that because my son was not bed ridden they still might turn down the claim. In my opinion insurance should be described for what it is and not restricted by fine print and technical clauses. If you are disabled from working then the insurance should cover your incapacity to work weather you are bed ridden or not.

### Norton's story

Like with other forms of insurance, these insurers are probably worse in finding loopholes to avoid paying. I have not had to make a claim, but looking at policies there is no clarity on what information needs to be provided, proof and so on that would mean a guarantee that a future claim will not be denied. Again, the power is with the insurer. The terms and conditions are so complex, legalistic and biased toward the insurer, etc that there is no certainty for customers.

## Life insurance claims

More than a third of respondents to the CHOICE survey prepared for the Commission had experienced a problem with the life insurance claims process (35.1%).[17] Issues ranged from conflicting claims assessments to serious delays in processing claims.

It is clear from these claims experiences that consumers are often in the dark about the fine print exclusions and the subtle variations between policies which could be the difference between a claim being paid or not. Many were confused by the fact they were paid out under one policy and denied under another for the same incident.

Insurers often claim they are operating in a competitive market where consumer demand drives this need for policy differentiation. What is clear from the case studies is people are completely unaware of these fine print variations and it is often not until claim time that they discover to their detriment that they have no or limited cover.

[17] CHOICE survey of the people who had an experience with a life insurer which did not meet the person's standards or expectations, n=171

Again, the lack of standardisation in insurance policies has created a nearly impossible market for the average consumer to navigate, leading to denial of claims and severe financial hardship.

### Alexander's story

I became very ill in 2011, had to take medical leave, returned to work on a part time basis, and then after 6 months returned to full time work. After 12 months it was apparent my health was suffering, and I was not able to manage my role effectively. At the beginning of 2013, with agreement from my employer, I left work on medical grounds and went on to TTD, funded by my employer's superannuation policy (with PLUM, part of NAB). For the next 2 years while receiving TTD payments, I had a series of medical tests which were both at the instigation of my treating doctor, and also at the instigation of PLUM.

In 2015, at the conclusion of the 2 years TTD, I progressed the claim to TPD, and PLUM accepted this claim later in that year.

As I had my own self-managed super fund in addition to the company superannuation, I also had a TPD policy with CommInsure. I also made the TPD claim against this policy, and after further medical tests, CommInsure rejected my claim on the grounds that the policy provided that any ability to return to work, even if part-time, in a lesser position than that in which I had been employed, or even unpaid charity work, meant that the policy would not be satisfied for acceptance. The CommInsure Policy was very generally worded; by comparison the PLUM policy made the terms of acceptance very clear and seemed to be even more restrictive than the CommInsure interpretation. Subsequently I made a complaint to CBA regarding the denial of policy; the denial was investigated and the outcome was the denial was upheld, and I was told the acceptance of the claim by another company (PLUM) had no bearing on the CommInsure decision. The investigation was a waste of time, and I cannot be certain it was actually conducted - the communication of findings was sparse at best.

In 2016 we took a major decision with our life, selling our property in Melbourne and moving over 300kms to the country to be able to maximise the difference between sale and purchase prices, in order to build our retirement funds. The downside was moving from a circle of friends who had supported me during my illness, and from our children, who were settled in Melbourne. This would not have been the case if CommInsure had accepted the claim at the time it was made.

Late in 2017 I had turned my thoughts back to this matter, and was starting to investigate if the

Financial Ombudsman was able to take up my case, when I received a call from CommInsure.

They had again reviewed my claim - they would not explain why, although I believe the sale of CommInsure to AIA may have been a factor, as well as the impending enquiry - and were now accepting my claim. When I queried why the change, one of the startling admissions was that given PLUM had accepted my claim they really didn't have a good reason to deny it.

So thanks to CommInsure, I had a stressful time after the claim was not accepted, and that was a decision they made without good reason as subsequently proved; my wife and I went through the distressing time of selling our house and moving away from family and friends, which is not a decision that can be easily reversed even with the acceptance of the claim; and all the dealings I had with CommInsure left me with the impression they had little or no interest in my health or well-being, but every interest in denying a claim to further the banks interests. I have no kind words to say on their behalf, they have caused stress and upheaval in our lives without any justification.

There are also reports of insurers substituting their own claims assessment for that of the treating specialist. In the case below it was only after gaining legal representation that the person was able to have the claim upheld. Forcing consumers to seek a legal remedy in these cases adds significant cost and can significantly diminish the value of a payment.

### Heng's story

I have a back problem that has had 3 ops on it I have been deemed never to return to work by both my specialists and GP so lodge the claim forms only to be sent to another doctor that said he believes I can go back to work so in the end I had to end up using shine lawyers to step in after 14 months of shine dealing with them and me paying for my independent medicals they finally approved the claim and gave me back my income protection that was cut off in October 2015 as well as pay the TPD. But this is the same company that released my super under the grounds of TPD. The company was ANZ.

## Life insurance and mental health conditions

The life insurance sector's treatment of mental health in yet another story of inaction and delay in the face of serious consumer harm. Mental health advocates, such as the Public Interest Advocacy Centre (PIAC) have been representing people since 2012 who have been discriminated against by insurers on the basis of a mental health condition.[18] The life insurers are well aware of the problems, but have only attempted piecemeal fixes, failing to address systemic failures to offer insurance based on a genuine assessment of the risk profile of the person seeking insurance.

Life insurers' treatment of pre-existing mental health conditions, no matter how minor, is cause for concern. As the following case studies highlight, people who had sought help for minor stress or depression were only able to gain restricted cover. In one case the person now fears seeking further medical treatment in case this voids insurance altogether.

### Davina's story

I had income protection quoted, but because I had visited a doctor for stress they put in a huge amount of conditional limitations. This effectively has resulted in me not seeking medical help as I do not want it put on my medical file - or my insurance is void!

### Emma's story

I have very mild depression but ended up with policy refusals and the few that would take me have put blanket mental health exclusions down for stuff I've never had, like alcoholism/drug use (I never drink and have never taken drugs) or schizophrenia.

### Isobel's story

I also had seen an osteo using my health insurance extras for some massages, and ended up with a full muscular-skeletal exclusion even though I have no condition at all. I had just used it for the discount.

## Life insurance – information request

Given the evidence of practices associated with life insurance falling well below community standards and expectations we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the problems in the life insurance sector could be strengthened by requesting evidence from insurers as to:

- What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for claims assessors and independent advisors (e.g. doctors)?

[18] 24 February 2017, PIAC, 'Time to end mental health insurance discrimination', available at https://www.piac.asn.au/2017/02/24/time-to-end-mental-health-insurance-discrimination/

- Is data collected on individual consumers outside of the sign up and claim process and how is it used? What do consumers know about its use?
- What data is relied upon to assess the level of risk associated with various mental health conditions?
- What data is relied upon to assess mitigating factors in placing mental health restrictions on a policy?

# Superannuation

We understand superannuation is already subject to a significant inquiry by the Productivity Commission. However, there are a number of examples of poor practice which bear repeating here. The overwhelming majority of people who had experienced concerns with their superannuation have seen their balance eroded due to fees and insurance (74.9%).[19]

The industry response to this problem is illustrative of CHOICE's concerns about how the financial services sector consistently fails to adequately self-regulate. The industry had been inundated with scandals of people having retirement savings eroded by bundled expensive and often inappropriate insurance offers.

At worst, the industry's own research showed low income women have 44% of retirement savings eroded due to insurance.[20] This is from a sector already required to act in the best interests of members as a part of its trustee duties. In the face of this egregious level of account erosion the industry sought to self-regulate through the development of a code of practice. The difference between what was promised and what was finally delivered was exasperating.

Participants from all six industry lobby groups and a number of life insurers and superannuation funds were represented. CHOICE also participated to give feedback on the consumer perspective throughout the process. The goal was to produce a binding and enforceable piece of self-regulation. The aim was to give direction to funds on how to design insurance products which met the best interest duty and put an end to erosion of retirement savings.

After over a year the end result was an unenforceable code with poor industry buy-in and limited consumer protections that was widely criticised by consumer representatives and the Federal Government.[21]

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[19] CHOICE survey of the people who had an experience with superannuation which did not meet the person's standards or expectations, n=291
[20] KPMG, 2017, 'Review of default group insurance in superannuation'.
[21] Adele Ferguson, 2017, *Australian Financial Review, 17/12/2017, available at:* http://www.afr.com/business/insurance/afr17adele-life--20171217-h05zfl

It now appears that these problems will only be resolved through legislation, adding further time to the reform process. Meanwhile, people's retirement savings continue to be eroded, some to zero as the case studies below illustrate.

CHOICE's first-hand experience of industry's attempt at self-regulation painted a picture of a sector incapable of reaching agreement on meaningful reform. Even industry participants who attempted to raise the level of consumer protection were forced to settle for the lowest common denominator, as wide industry buy-in is essential for self-regulation to work.

As shown, these types of crisis points are frequently reached in the financial services sector. Industry self-regulation is almost always seen as the first response. Yet these responses are lengthy processes that fail to adequately protect consumers in a complete or lasting way. Disappointingly, we continue to return to the well in the hope that the next time meaningful reform will come.

### Jordan's story

Our children starting in the workforce ended up with multiple super funds. They always had extra unwanted insurance. Some funds of a couple of thousand dollars have disappeared in fees and insurance charges. No long term benefits for young people starting in the workforce. Obligatory super for young people only benefits the providers.

### Walter's story

Changed jobs a few times and casual employment with no knowledge of super funds. Only heard from them as they closed the fund due to fees and unknown insurance eroded the balance. The funds did not contact me to say fund had been deposited on my behalf because they knew they could rip off all the money.

### Irma's story

I am most concerned that the industry fund HESTA is charging mentally and physically disabled people for sick and accident policies. The client has no idea what they are buying and in most cases the premium is for a minimum benefit of $800 per month when the people in sheltered workshops earn around $2 per hour and very few if any would be paid $800 per month. When it comes to making a claim the insurer then says they will pay a great deal less than the $800 per month benefit. This practice is illegal and morally reprehensible. Most of the people in a sheltered workshop would not be able to go through the complex procedure of making a claim and in the meantime, HESTA is basically scamming these individuals and say that the process of sorting out this mess is not financially viable. It is a disgrace that they are allowed to continue this practice and cheat the most vulnerable in our community. Something needs to be done to stop this blatant gouging.

Geraldine's story

Being a casual worker with varied hours of work per week, I've found that I'm paying more in fees & insurance than what is being put into my super.

## Superannuation information request

Given the evidence of practices in the superannuation sector falling well below community standards and expectations, we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the problems in superannuation could be strengthened by requesting evidence from funds as to:

- What is the level of erosion of member funds due to fees and insurance?
- What evidence is there that insurance products are appropriate for different cohorts of members (e.g. members on low incomes, women, older members, members without beneficiaries)? What consideration did superannuation trustees give to the suitability of insurance for different cohorts when establishing current arrangements?

# Financial advice

The story of financial advice reform is another story of industry inaction and delay. CHOICE has been calling for this sector to be cleaned up as far back as 1990.[22] Over the decades since, we have conducted a series of 'shadow shops' to assess the quality of advice. Each study has found extremely high rates of poor advice and selling that ignores the best interests of people seeking help.

After decades of industry inaction, the Federal Government took on the call for widespread reform in the wake of the catastrophic effects of major financial advice scandals around the time of the Global Financial Crisis in 2008. Collapses and scandals involving Opes Prime, Storm Financial, Timbercorp/Great Southern, Bridgecorp, Fincorp, Trio/Astarra, Westpoint and

[22] 31 March 2015, Kollmorgen A, 'Financial reforms long overdue', CHOICE, available at https://www.choice.com.au/money/financial-planning-and-investing/financial-planning/articles/fofa-financial-adviser-reform

Commonwealth Financial Planning affected over 120,000 Australians, resulting in billions of dollars of lost savings.[23]

Despite the inarguable need for the FoFA reforms the industry actively opposed them, instead devoting significant effort to delaying and watering down aspects of FoFA. These delays saw the problems highlighted in the 2009 Inquiry into Financial Products and Services in Australia only addressed years later in 2013.[24] There was also a strong industry push to significantly water down the gains in 2014 through a series of amendments, which were eventually defeated.[25] This is all despite decades of evidence from the regulator and consumer organisations that financial advice was not meeting community expectations and standards.[26]

CHOICE remains concerned about the lack of protection caused by the number of carve outs in FoFA. For example, the protections do not apply retrospectively, nor does the best interest duty apply to important sources of financial advice, such as mortgage brokers. Given recent evidence, we are also concerned about the extremely low levels of compliance with the FoFA reforms within the banking financial advice sector.

The FoFA reforms were based on clear evidence that conflicted remuneration was leading to poor outcomes for consumers; chiefly it created a best interest duty imposed a ban on trailing and up-front commissions and similar payments as of July 2013.[27] However, as a compromise to industry, the reforms allowed existing commission arrangements to remain. Therefore, there are likely a great many people still in high cost, low performing legacy products that were recommended based on conflicted advice. On average, one third of financial advice licensees' total income in 2014 came from grandfathered benefits. This income tends to be a greater proportion of the revenue of large licensees like the big four banks.[28] To put this into perspective, in 2014 Commonwealth Bank financial planning businesses made a total income of

[23] Losses from Opes Prime, Storm Financial, Timbercorp/Great Southern, Bridgecorp, Fincorp, Trio/Astarra, Westpoint and Commonwealth Financial Planning sourced from figures in ASIC (2014), Submission to the Financial System Inquiry, pp. 192-193 and Industry Super Australia (2014), Exposure Draft: Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, ISA Submission, pp. 37-38.

[24] November 2009, Parliamentary Joint Committee on Corporations and Financial Service, 'Inquiry into Financial Products and Services in Australia', available at http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf

[25] 24 November 2014, Walker J, 'FOFA fiasco: no quick fix for the advice industry', The Conversation, available at http://theconversation.com/fofa-fiasco-no-quick-fix-for-the-advice-industry-34486

[26] ASIC, 2003, Report 18 Survey on the quality of financial planning advice, pp5-6; 31 March 2015, Kollmorgen A, 'FoFA financial adviser reforms: will they put an end to conflicted advice?', CHOICE, available at https://www.choice.com.au/money/financial-planning-and-investing/financial-planning/articles/fofa-financial-adviser-reform

[27] See https://futureofadvice.treasury.gov.au/Content/Content.aspx?doc=home.htm

[28] ASIC (2014), *Report 407: Review of the financial advice industry's implementation of the FOFA reforms*, p. 31. Note, this figure is based on a limited sample of 48 licensees but it is the only publicly available data on grandfathered income.

$829 million.[29] A third of this income equates to $273.6 million. Action is needed to address this ongoing harm – the longer it continues, the more consumers will lose for fees for no service.

In the CHOICE survey the vast majority of people who had experienced problems with financial advice identified poor advice as an issue (78%).[30] Despite the FoFA reforms, poor advice remains a chronic issue in this sector. A recent ASIC investigation found that in a staggering 75% of the advice files, financial advisers did not comply with the duty to act in the best interests of their clients.[31] Further, 10% of the advice was likely to leave the customer in a significantly worse financial position.

Some of the poor advice highlighted in the report related to banks switching customers into a new superannuation platform which resulted in inferior insurance arrangements. An example of the dire impact of this type of switching can be seen in the case study below.

### Earle's story

When rolling over super to BT via St George Bank, I told them I had difficulty retaining employment due to a permanent wrist injury & other injuries. I had just started a new job but was told to leave after 4 days as I got re-injured. I then only worked in another job for 15 days & have never worked again. Then when I tried to claim TPD, I was told I was not able to due to my pre-existing injuries. So, St George had not disclosed to me at the time of rolling over my super that pre-existing conditions affect TPD claims. My other super fund, PSS Commonwealth Govt fund, also refused to pay TPD as they said my injury occurred after I had left the Commonwealth public service.

The same report also pointed to potential conflicts of interest in the vertically integrated models of the big banks. The research showed that despite 'in-house' products making up a small percentage of Approved Products Lists (APL) from which advisors recommend a product, there was a strong weighting towards 'in-house' products in the final advice received by a person.

The CHOICE survey prepared for the Commission found high commissions (51.2%), aggressive or pushy sales tactics (47.3%) and poor customer service (45%) were common concerns for

[29] See Commonwealth Bank (2014), Annual Report 2014 p. 15. NB: Colonial First State income incorporates all income from financial planning businesses at CBA.
[30] CHOICE survey of the people who had an experience with financial advice which did not meet the person's standards or expectations, n=518
[31] 24 January 2018, ASIC, 'ASIC reports on how large financial institutions manage conflicts of interest in financial advice', available at http://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-019mr-asic-reports-on-how-large-financial-institutions-manage-conflicts-of-interest-in-financial-advice/

people.[32] In line with the findings of the ASIC report mentioned above, the following case studies point to bank staff 'up-selling' or 'cross selling' products. In many cases these products were not properly explained or were potentially inappropriate to a person's needs.

### Angelica's story

I was purchasing life insurance, and my broker advised that obtaining it through a new Superannuation account was the most cost-effective way of obtaining it. Costs were no better than using my current super account, and broker forgot to arrange for my current premiums to cease from my existing super account, so I paid twice. Same broker: failed to explain the implications of decisions I was making on (very expensive) IP insurance, resulting in likelihood of a claim being paid out at a far lower rate or not at all. Another broker was aggressive and condescending when I asked for information to be clarified and provided in more detail. Brokers on the whole work for who will pay them the highest commissions, not for the client. I would rather pay a broker a fee and have them receive NO commissions than pay nothing but know that they are not working for me. And it is almost IMPOSSIBLE to find an impartial broker.

### Fleur's story

Sat with a planner at ANZ was sold a suite of products that are worthless she filled out the paperwork herself based on information I provided she filled out the paperwork incorrectly I was keen to have my income insured as I was the only breadwinner for a family of 6. Planners should not be allowed to work for the banks and say they are independent but only sell the products from the bank they work for. Planners should not be allowed to fill out important paperwork for clients. Planners should allow customers time to make sure the paperwork is correct before signing. Planners should not push customers to sign important paperwork while only showing them the sign here page

I have become sick and permanently disabled. I had insurance but due to planner incompetence I have no income, no insurance it remains to be seen if my TPD insurance claim will be approved but as we stand today ANZ's planner has destroyed a family of 6 for a commission and a sale it's a disgusting state to be in when we trusted the planner and ANZ.

### Leesa's story

My elderly father was convinced by his bank (when they also provided him with a terrible deal by pressuring him to paying off his credit card by turning it into a reverse mortgage on his fully owned home) to change from APIA to Commonwealth Bank's insurance. The premiums were

[32] CHOICE survey of the people who had an experience with financial advice which did not meet the person's standards or expectations, n= 518

expensive, the policy was restrictive and difficult to understand and any time he has attempted to make a claim they have found every excuse not to pay out.

### Carleton's story

In the context of a mortgage application (new or refinancing) being pressured into another appointment that the bank represented was part of the application process and financial advice. It eventuated the appointment was a pushy and pressured sales pitch for insurance. The application was still being processed and both inferred that the add-on products (personal insurances and other lines of credit) were 'compulsory' to ensure the mortgage would be approved.

### Helga's story

My financial adviser failed to reinstate my income protection insurance when I returned to work after unpaid maternity leave. Later I developed a disability and am now struggling to find a way to support my family. I've been unable to find any support through my disability insurance provider. My financial planner left the practice and we only found out when the principal contacted us to come in for an annual review.  We had been trying to get a return call or email for moths at that stage. We stupidly paid the retainer after the annual review appointment and then didn't hear from the principal in response to our enquiries. 3 months later we heard the business had folded but we are still receiving occasional newsletters from him. Very frustrating to have wasted that money and time, particularly as we really need good financial planning at this point. We recently engaged another financial planner.  Hope this one is better.

## Financial advice information request

Given the evidence of poor practice in the financial advice sector falling well below community standards and expectations, we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the problems in financial advice could be strengthened by requesting evidence from financial services entities as to:

- What is the number and percentage of consumers on legacy commission structures?

# Housing and lending

## Mortgage brokers – failure to meet consumer expectations

CHOICE is concerned that some consumers do not get the service they expect when they visit a mortgage broker. Advertisements for brokers claim that they will find customers the right loan, provide tailored advice or get a great loan for the client. However, their actual obligation to clients is quite low – brokers have to help arrange a 'not unsuitable' loan. We believe this standard needs to be lifted, especially as mortgage brokers are involved with a growing share of the home lending market.

### Kamal's story

Broker applied for loan with false information which I later corrected with the bank before I signed the legal documents. Insurance protection was included unbeknown to me and once I learned about it, it was too late to change.

We note that it is unlikely that the Royal Commission will get a great volume of case studies about poor behaviour of mortgage brokers. We believe this is the case for two reasons. First, the impact of poor quality recommendations about home loan products are less likely to be evident in a low-interest rate environment. Much like the Global Financial Crisis in 2009 led to a market downturn which exposed the fact that many customers were in riskier investment products than they thought their adviser had placed them in, we would expect that any major change to the housing market will reveal poor recommendations from mortgage brokers.

Secondly, it is extremely difficult for consumers, who are not experts in the credit products mortgage brokers are advising on, to assess the quality of the recommendations they have received. Instead, consumers tend to use proxies to assess quality, like the friendliness and responsiveness of the broker. This mirrors ASIC findings about financial advice. A 2012 ASIC shadow shop of retirement advice found that 39% of advice was poor (failed to meet requirements of the law at the time), 58% was adequate (met requirements of the law) and 3% was good (complied with the law, met clients' needs, improved their situation and clearly explained recommendations). Many people had trouble objectively assessing the quality of financial advice. 86% of participants felt they had received good quality advice, and 81% said they trusted the advice they received from their adviser ‘a lot’, even though only 3% received objectively good advice.[33]

ASIC’s research into consumer perceptions of brokers revealed that there’s a mismatch between what consumers think they are getting when they see a broker and what they receive.

| Consumer perception | Reality |
|---|---|
| **Brokers will arrange a better deal** than if a consumer approaches a lender directly: 25% of all consumers and 58% of consumers with experience of or plans to use a broker thought that brokers would offer a better deal than a bank.[34] | Brokers do not get their clients better priced loans.[35] |
| **Brokers look at a wide range of loans to get consumers a better deal.** The main reasons people said they would use a broker is to access a wider range of home loans (32% overall and 40% with experience or intention to use a broker) and to get a better interest rate or deal (27 overall, 35% with experience or intention to use a broker). | Brokers send 80% of borrowers to four preferred lenders.[36] |
| **A broker puts the customers’ needs first** 86% of people with experience or intention to use a broker thought that brokers would put customer needs first all (27%) or some of the time (59%).[37] | Legally, a broker is only obliged to arrange a ‘not unsuitable’ loan. Commissions and other payments means it’s highly likely a broker will recommend a loan or investment strategy that does not put customer needs first. Brokers don’t have to act in the best interests of the client. |
| **Brokers get paid the same amount regardless of the loan arranged** 36% of people with experience or intention to use a | Most brokers are paid varying commissions for loans arranged in addition to volume-based payments, campaign commissions |

33 ASIC (2012) Report 279: shadow shopping study of retirement advice, p. 8, 54.
34 Asic review, para 906.
35 Finding six: interest rates are not different between distribution channels, Ibid, p. 15.
36 Ibid, para 86.
37 Ibid, para 913.

| | |
|---|---|
| broker mistakenly believe that brokers get paid the same regardless of the loan[38] | and soft dollar benefits. |

The standards that brokers have to meet don't match consumer expectations. They also don't align with the expectations placed on other professionals providing advice on money matters. A comparison of the obligations under the NCCP Act[39] compared to the required behaviour for financial advisers under the Corporations Act shows that brokers are being held to a relatively low standard.

| **Financial advisers must…** | **Mortgage brokers must…** |
|---|---|
| Be licensed or work for or be an authorised representative of a financial services licensee. | Be licensed or work for or be a credit representative of a credit licensee. [40] |
| Gather detailed information to understand the financial situation of their client as well as their goals. | Make reasonable inquiries into client's requirements and financial situation, focusing on a client's ability to meet repayments (income and expenditure) and that the loan is not unsuitable for their requirements and objectives.[41] |
| Act in the client's best interests. | Make a preliminary assessment about whether a loan would be "not unsuitable" (the client can afford to pay the loan without substantial hardship and the loan meets their requirements and objectives) [42] |
| Disclose how they are paid but there are many restrictions on remuneration models known to cause consumer harm, like commissions. | Disclose how they are paid, although practically this may occur at the end of the loan arrangement process when it is too late to affect the client's decision. [43] |
| Be members of an external dispute resolution | Be members of an external dispute resolution |

[38] Ibid, para 916
[39] Section 8 of the Act defines the process of credit assistance as where a person suggests a consumer apply for, increase or remain in a particular credit contract or assists the consumer with an application or increase. Section 9 defines instances where a person 'acts as an intermediary' between credit providers and consumers. Both terms include the primary roles of a mortgage broker. For clarity, this paper uses the term 'mortgage broker' where the legislation refers to 'credit assistance providers' or 'intermediary'.
[40] S 26 of the NCCP Act and Regulation 22, http://www.comlaw.gov.au/Details/C2014C00411/Html/Text#_Toc393444815
[41] s 117 of the NCCP Act.
[42] s 115, 123, 138 and 146 of the NCCP Act. and ASIC Regulatory Guide 209.91.
[43] s 113, 114, 121, 136, 137 and 144 of the NCCP Act.

| | |
|---|---|
| service (such as CIO or FOS). | service (such as CIO or FOS). |
| Most financial advisers are currently required to have Diploma level qualifications.[44] However, standards are being lifted to require a degree, compliance with a code of ethics, a professional year for new advisers and an industry-wide exam. | Mortgage brokers are only required to have Certificate IV level qualifications.[45] |

## Mortgage brokers – indications of improper financial advice

In July 2016, CHOICE asked a nationally representative sample of Australians if they had seen a mortgage broker in the last six years. We asked those people who had seen a broker about their experience.[46] We note that the sample size of this research is relatively small: 280 people had seen a broker in the last six years, the majority (170) had seen a broker in the last two years. Given this, these findings should be taken as an indication of likely behaviour from brokers but not representative percentages of the activity.

The results are concerning. Many people appear to have been given limited information. About a third of people said a broker did not tell them how they were paid. We are also worried about the nature of the information provided by mortgage brokers to consumers. Some brokers appear to have a financial advice-style relationship with their clients – they were discussing non-property investments (24%), long-term investment strategies (33%) and helping people make financial decisions linked to superannuation (20%) and retirement (30%).

Unless a broker is also a qualified financial adviser they should only be arranging a loan for consumers; they are not able to provide financial advice on or related to other financial products. We encourage the Royal Commission to explore whether mortgage brokers are providing unlicensed financial advice, particularly in relation to superannuation and retirement.

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44 ASIC RG146
45 RG206.8 http://download.asic.gov.au/media/4112044/rg206-published-15-december-2016.pdf
46 This question was asked as part of CHOICE's Consumer Pulse study. Consumer Pulse is a study conducted by CHOICE among a sample of 1025 respondents aged 18-75 years. The sample is a nationally representative of the Australian population, based on the 2011 ABS Census data. The study was conducted via an online self-complete survey in partnership with The ORU. The ORU is an ISO 20252 / ISO 26362 accredited panel provider and full AMSRO member. Fieldwork was undertaken from 21 to 29 July 2016.

## Mortgage brokers – commissions and conflicts may be driving poor recommendations

In 2015, CHOICE conducted a shadow shopping exercise where we sent five customers looking for a home loan to three brokers each (15 brokers in total). We found:

- Risky borrowing suggestions – one broker advised a home owner who wanted to refinance her home loan and is in an unsecure employment situation to use the equity in her home to invest in new property or go on a holiday. Another broker advised a couple to borrow $1 million against their home when they only needed $600,000 to buy an investment property.
- Recommendations weren't always based on quality – one broker pushed his own company's product even while acknowledging that other lenders offered a cheaper loan.
- Poor disclosure - only two of the fifteen brokers explained unprompted that they received commissions and which lenders they dealt with.
- Little discussion of long-term risk - no broker had a conversation about capacity to pay should interest rates rise.

This shadow shop indicates that there are problems for consumers, likely stemming from broker commission arrangements or institutional ownership. Research from ASIC further indicates that commissions brokers are receiving are affecting the quality of recommendations some consumers are receiving.

ASIC found that current upfront and trail commission arrangements create two kinds of conflicts of interest. First, because brokers are paid by percentage-based commissions, a conflict arises as the broker earns more if the client borrows more. ASIC calls this a "product-strategy conflict" and recognises that "a broker could recommend a loan that is larger than the consumer needs or can afford to maximise their commission payment."[47] It is particularly concerning that in some cases brokers earn more if they recommend risky products, like interest-only loans, that maximise the amount the customer can borrow. Overall, ASIC found that loans provided through brokers were larger than those from direct online or direct with lender channels and loans arranged through a broker had a higher loan-to-value ratio.

The second kind of conflict ASIC identified was lender-choice conflict, where a broker is incentivised to recommend a loan that may not be the best option for the customer because they will get a higher commission. There was a 0.68% difference between commissions with

[47] ASIC report, p.10.

one aggregator – that could mean broker receives up to $3,400 more for arranging an average loan with a certain lender.[48] Again, ASIC identified some commission structures that indicated that broker remuneration incentivised riskier borrowing strategies. For example, one lender paid higher commissions for loans with higher credit risks which attracted higher interest rates.[49]

CHOICE encourages the Commission to examine the impact of commissions that brokers receive on the quality of consumer outcomes. In particular, trail commissions deserve special scrutiny. Trail commission payments offer no clear benefit to consumers but significant benefits to the brokers, aggregators and lenders. For consumers, there is some implication that trail accounts for service delivered by the broker over the life of a loan. It is incredibly unclear what service is being delivered – any assessment about whether other options are better suited to a client during the life of a loan could be covered through one-off fees based on time actually spent assisting the client rather than the opaque high-costs of trail commissions.

ASIC has found that aggregators can be paid over $2,200 per year through a trail commission for a single loan, although the average annual amount is likely closer to $750.[50] The only work required for this payment is to not switch the customer to another product. Trail also offers benefits to the lender as it positively incentivises brokers to keep clients in current loans. Trail commissions introduce competition issues as they discourage brokers from switching clients to other options. Some industry members may argue that trail incentivises brokers to recommend quality loans to lenders where the client won't default, however this is a basic requirement under the NCCP and should be covered by responsible lending obligations.

Trail commissions are most perverse in businesses established to buy and sell mortgage loan books (the trail payments).[51] The consumer gets no benefit and the possibility of additional service is likely removed when these sales occur. The buyer gets great benefits: ongoing income for no work and, as implied through industry press, the possibility of making the list more valuable through selling additional products from insurance to SMSFs.[52] The price for these books is exceptional. In a quick online search, we found one book sold for $39,000 for delivering expected trail income of $1630 a month plus GST.[53] This money is coming from just 19 clients on the Northern Beaches in Sydney, meaning each client accounts for an average of over $85 a month in payments or $1,029 a year. While it could be argued that the consumer

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[48] Ibid, para 379.
[49] Ibid, para 419(d)
[50] ASIC (2017), Report 516: Review of mortgage broker remuneration, paras 465-466.
[51] For example http://www.trailbookbuyers.com.au/
[52] See http://www.afr.com/real-estate/residential/vic/mortgage-broker-billiondollar-windfall--as-loan-book-prices-soar-20150415-1mlfu7
[53] Example sourced from http://www.xcllusive.com.au/Sold-Businesses/222-Mortgage-Loan-Book-For-Sale.html , screenshots available if required.

doesn't directly pay for these trail payments, that it's a payment from the lender for arranging the loan this ignores the fact that trail contributes to overall lender costs which are inevitably passed on to the consumer.

Another area of conflicts that deserves scrutiny is how lender ownership of a broking business influences the recommendations made. NAB has full ownership of three large aggregators: Finance & Systems Technology, Professional Lenders Association Network and Choice Aggregation Services. These aggregators account for approximately 30% of all brokers in Australia. NAB owned-aggregators directed 22% of home loans to NAB-branded or white-labelled loans even though NAB's overall home loan market share is 13.2%. Similarly, CBA has a controlling ownership stake (80%) in Aussie Home Loans. CBA received 37.3% of Aussie Home Loans; its overall market share is 20.9%. Consumers were more likely to walk away with a white-labelled NAB or CBA loan from an affiliated network, meaning that they would not easily be able to tell that there was a conflict of interest.[54]
Banks, brokers, aggregators and other industry representatives, in consultation with consumer groups, have worked on a self-regulatory response to issues with conflicted remuneration driving poor broker recommendations.[55] This is set to be implemented from 2018 onwards. While the industry response deals with some issues, such as volume-based payments, it does not remove commissions, specifically trail commissions.

This example serves to further illustrate our point about industry resisting and delaying reform, and then minimising its impact through disappointing self-regulatory processes. After years of resistance by the broker industry to any suggestion that commission structures might be causing poor consumer outcomes, it took the ASIC report and threat of government intervention for the industry to act. And when it did act, the self-regulatory response failed to adequately address the problem.

## Mortgage brokers information request

Given the evidence of practices in the home lending sector falling well below community standards and expectations, we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the problems in mortgage broking could be strengthened by requesting evidence from lenders, aggregators and brokers as to:

54 Ibid, para 291, 86.
55 See https://www.bankers.asn.au/images/uploads/CIF_Report_Submitted_281117.pdf

- Do banks that own mortgage broking businesses provide any additional incentives for brokers in those businesses to recommend the parent company's loans? Are any KPIs or other performance measures used to encourage or require a certain volume of loans be directed to the parent company?
- What service does a consumer receive from a mortgage broker over the life of a loan? What measures are in place to ensure that the consumer receives this service? How does this correlate with trail payments made over the life of the loan?
- How have banks adjusted commission payments to brokers over the last three years? What consideration was given to likely consumer outcomes because of these commission restructures?

## Interest-only loans

Interest-only loans can cause significant financial harm to consumers, particularly when there is a market downturn and expected equity gains are outpaced by the interest owed on a property. APRA has been so concerned about interest-only lending from a financial stability perspective that it has sought to impose caps on these loans. This appears to have been largely successful with growth in interest-only loans significantly slowing in the latter half of 2017.[56] However, there is a threat that the demand for these loans will just be shifted to other lenders in the market, such as non-bank lenders. An ASIC report on interest-only loans found that Australia's major banks have cut back their interest-only lending by $4.5 billion over the past year.[57] However, the report recognised other lenders have partially offset this decline by increasing their share of interest-only lending.

APRA's powers to quickly intervene in the home loans market to place caps on interest-only loans is a valuable power, however this responsiveness is something which is lacking throughout the financial services sector more generally. In contrast, the default stance sees attempts at self-regulation take precedence. As highlighted throughout this submission this has led to consumer suffering through delay, partial solutions and the eventual need for government intervention to fix a problem often identified years earlier.

The combination of low interest rates and high rental returns has meant that] many people have been able to keep from defaulting on loans. However, CHOICE remains concerned about the

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[56] 5 December 2017, APRA, 'Quarterly ADI property exposure statistics', available at http://www.apra.gov.au/adi/Publications/Pages/Quarterly-ADI-Property-Exposures-statistics.aspx

[57] ASIC, 2017, 'ASIC update on interest-only home loans', available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-341mr-asic-update-on-interest-only-home-loans/

potential for large-scale consumer harm if the slack in interest-only loan growth is picked up by non-bank lenders, particularly as the housing market slows. While the market remains relatively strong we are unlikely to see large scale defaults, nor were they represented in responses to our survey. However, we are keen to ensure consumers are well positioned to understand the risks of interest-only loans and the threat they pose in a housing downturn.

A discouraging sign is the generally poor levels of consumer comprehension of interest-only loan products. Reporting on a UBS study from 2017 claimed that up to a third of borrowers were unaware that they even had an interest-only loan.[58] From the case studies, even where consumers are aware they have an interest-only loan, it appears there is poor awareness of the precise terms of the loan. For example, some consumers gave feedback that they had been caught out by interest-only periods ending and being defaulted into principal and interest repayments without notice. These sudden changes can have a serious impact on a person's finances and lead to financial hardship.

### Regina's story

I rolled over my interest-only loan believing I would be continuing with their current interest-only repayments. I received a late payment penalty as I hadn't paid the correct amount as the bank had changed my loan without telling me to a principal and interest loan. When I rang to find out why they told me it was because their rule was lenders couldn't have an interest-only loan for longer than 5 years. I wasn't advised of this when I received the initial refinancing of my loan so that I could consider all my options.

I asked for the terms and conditions that specifically stated their 5 year rule & they weren't able to find it.

I was extremely frustrated as it was a huge increase in repayments.

### Ben's story

Arbitrary decision by NAB to convert interest-only loan to mortgage, no prior warning.

### Anton's story

I secured interest-only loans - they said for a max of 10 years, after 4 years, refused to renew, causing enormous hardship.

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[58] Jonathan Mott, UBS analyst, as reported in *The Australian:* https://www.theaustralian.com.au/business/economics/new-worry-on-interestonly-loans/news-story/aea8484dee0bc642bd8a5a1b4e4b950e

It is clear from the case studies that lenders could go further in ensuring customers are aware of the implications of interest-only loans.

It is unclear as to what extent lenders are adequately assessing the ability of people to pay principal and interest when interest-only periods expire, and there is evidence that lenders are not giving adequate notice to people whose interest-only period is about to expire.

## Interest-only loans – information request

Given the evidence of consumer confusion around interest-only loans and potential risk they pose to people's finances, we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the impact of interest-only loans on people could be strengthened by requesting evidence from lenders as to:

- What steps do lenders take to ensure customers understand interest-only loans? Is consumer understanding of key terms measured?
- What is the rate of default in raw number and percentage terms on interest-only loans?
- What steps do lenders take to inform customers of an upcoming switch to principal and interest repayments for interest-only loans?
- What assessment takes place of a customer's ability to repay principal and interest once an interest-only period expires for an interest-only loan?

## Lenders Mortgage Insurance

Lenders Mortgage Insurance (LMI) was the second most common concern for people who had issues with a home lending. The purpose of LMI is to protect against a lender's risk of loss after a default. Typically, on a standard loan if a borrower has less than a 20% deposit, LMI will be required. According to a major LMI insurer the additional cost of insurance for a person buying a median priced house in Sydney, with a 10% deposit, would be $30,000 upfront or an extra $151 per month if capitalised across the life of the loan ($54,360 in total).[59]

[59] According to Genworth Financial quote calculator, assuming a 30 year loan on a $904,000 property.

Having LMI is also not rare, with about one quarter of borrowing households taking out the insurance.[60] For these households, the cost of LMI is an extraordinarily large, further stretching the finances of people hoping to enter an already heated property market. Given a borrower's ability to add the premium to the value of the loan, this additional cost is commonly not felt until well into the life of the loan.

The Reserve Bank of Australia (RBA) in its 2013 financial stability review raised concerns about the financial stability risks associated with LMI.[61] Of primary concern is that this insurance may allow lenders to extend larger amounts of finance than would otherwise be prudent. As the RBA review said,

*"Lenders may respond by relaxing standards because they believe the LMI is assessing the risk – an unintended consequence of having a 'second set of eyes' – or because they believe that any loss is an LMI loss."*

This may lead to consumers being lent far more than they can afford to repay. Over the last few years where property prices have experienced growth, combined with historically low interest rates, many consumers have been able to avoid entering financial difficulty. However, if this was an unchanging state there would be no need for LMI. It is designed to cover losses during economic downturns. During downturns the true cost of inappropriate lending, fuelled by the moral hazard created by LMI will be borne by people sold into loans they cannot repay.

Contrary to popular belief, LMI protects the lender not the person borrowing money. However, a staggering 70% of borrowers mistakenly believe LMI is designed to protect them in case of default.[62] As one respondent to the CHOICE survey said,

*"[I was] told that mortgage insurance was mandatory but it wasn't explained that this insurance covered the bank NOT us in the event that something went wrong." - Lori*

Indeed, there are reports of families only discovering their lack of protection under an LMI policy when an insurer pursues them for losses after a default.[63]

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[60] 2014, Digital Finance Analytics, 'Is Lenders Mortgage Insurance A Good Thing?', available at: http://digitalfinanceanalytics.com/blog/is-lenders-mortgage-insurance-a-good-thing/
[61] 2013, Reserve Bank of Australia, 'Financial Stability Review', available at: http://www.rba.gov.au/publications/fsr/2013/sep/box-c.html
[62] Martin North, Digital Finance Analytics, as reported in: http://www.abc.net.au/news/2016-09-15/mortgage-insurance-providers-forcing-borrowers-to-bankruptcy/7848746
[63] 15 September 2016, McGrath P, 'Mortgage insurance providers forcing homeowners into bankruptcy', ABC, available at http://www.abc.net.au/news/2016-09-15/mortgage-insurance-providers-forcing-borrowers-to-bankruptcy/7848746

Given the confusion about its purpose and the financial stability risk it poses, CHOICE is concerned that current practices around LMI have the potential to cause serious financial harm.

## The impact of LMI on competition

The ability of consumers to switch to better offers where available is one of the hallmarks of the properly functioning market. As the case studies below demonstrate LMI damages this balance, as it unfairly limits the ability of consumers to move to a better loan product.

### Tamara's story

Having to pay mortgage lenders insurance that protects that bank only ie I pay the premium on their insurance policy - no risk for them and thousands of extra dollars on my mortgage. I attempted to refinance my loan only to discover I would need to pay this insurance again with the new lender - I am still with the same bank. I felt that this trapped me into an institution when I would have liked to have changed. Especially given that my current bank's (ANZ) customer service was less than stellar and their advice was misleading when I was applying for the mortgage.

It is also not clear on what basis LMI premiums are determined. As the case study below demonstrates, there can be wild price variations over a short space of time and between insurers over the same loan. Evidence of premiums at one insurer almost five times higher than at a competitor may be indicative of extreme profiteering. For a person under a tight deadline, attempting to secure finance for a property purchase, there are limitations in their ability to shop around for a component product like LMI. There is a risk they will settle for a lender with the best interest rate, unaware of the large variations in LMI costs. This can lead to market distortions with lenders potentially able to offer lower interest rates cross-subsidised by high LMI costs. This makes an already difficult, high stress decision making process extremely complex, potentially leading to the addition of thousands of extra dollars to the loan.

### Natalie's story

When applying for my first home loan with Westpac 9 years ago they could not guarantee what my mortgage insurance would be. It was the time Rudd had announced the $14000 first buyer grant and during the 2 weeks or so while I was liaising with Westpac about applying for a loan the proposed mortgage insurance raised every single day from its starting point at a couple of thousand ending at 14000 coincidentally the same amount as the first home owner grant. I went with a different bank whose mortgage insurance was about 3 thousand or so from memory.

The application of LMI also seems to be subject to some discretion. As the case study below demonstrates, Commonwealth Bank of Australia was willing to waive LMI when a customer threatened to go to a competitor. This calls into question the true purpose of LMI – if it is a needed protection for the lender, rather than simply a profitable add-on, then why would a bank waive insurance so easily?

### Darrell's story

We were building a new house and using the current one as collateral. CBA was charging us an establishment fee, although we already had a home loan with them. Charged for mortgage insurance, although we never had it previously. [Customer service] person refused to waive these. Called back a few days later, talked to a different [customer service] person, who collected all of the previous information in our account and then only waived these when I informed her that I would be taking my business elsewhere. All fees were then waived, except the valuation fee, and a reduced interest rate was given as well.

Given the evidence of practices associated with LMI falling well below community standards and expectations we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the impact of LMI on people could be strengthened by requesting evidence from lenders as to:

- How often do lenders claim on LMI?
- How is premium pricing for LMI determined, including typical profit margins and expected losses recouped from borrowers?
- What steps do lenders take to ensure customers understand LMI?
- On what basis does a lender offer LMI from one insurer as opposed to another (e.g. are there incentives like commissions or profit sharing in place)?
- What barriers to switching are associated with moving a home loan with LMI?

## Guarantor loans

Guarantor loans made up a relatively small portion of the total issues raised by respondents to the CHOICE survey (1.8%), perhaps due to their lower take-up; however the case studies indicate some serious concerns, particularly in relation to the competence of mortgage brokers in offering these products.

Some mortgage brokers seem to be unaware of the added complexity of guarantor loans and are failing to explain how these loans work to their customers. Looking to the future, CHOICE believes it is likely that, if market conditions change in Sydney or Melbourne, that more people will struggle to pay their home loans. People who have relied on guarantor loans will have their own home, and the home of their guarantor, at risk. Currently, some institutions appear to be selling guarantor loans without actively informing consumers of the risks they may face.[64]

### Natasha's story

Taking out our mortgage on our first home Mum and Dad offered to go guarantor to save us lenders insurance. Our mortgage broker was an idiot - sale almost fell through because he was slow with forms, and he didn't tell us that them taking the guarantee was the same as taking out two mortgages, so we were hit with double the fees. […] When Mum and Dad wanted to sell we had to refinance our place to get the mortgage off their place (which we hadn't realised was a 2nd mortgage, we just thought two lots of paperwork meant double fees) and our bank was so unhelpful. So we switched to a new bank - and paid mortgage insurance... plus establishment fees. The mortgage package we switched to has an annual fee that seems to go up every year.

### Robert's story

Guarantor loan a huge problem when selling house. Bank SA a nightmare to negotiate with and get prompt action. Agreement draconian and almost impossible to understand. Refusal to answer some queries.

## Guarantor loans – information request

Given the evidence of practices associated with guarantor loans falling well below community standards and expectations we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the impact of guarantor loans on people could be strengthened by requesting evidence from lenders as to:

- What are lenders' modelled impacts on family homes at different interest rate rises (e.g. 1-6% rate rise)?
- What is the percentage of guarantor loans that default?
- What steps do lenders take to ensure customers understand guarantor loans?

[64] See for example the St George Family Pledge product. Online advertising contains a list of benefits for the product with no emphasis on the risk the guarantor will face https://www.stgeorge.com.au/personal/home-loans/tools/home-loan-features/family-pledge

# Personal lending

The CHOICE survey prepared for the Commission found excessive fees (66.3%) and poor customer service (46.3%) are two of the most common experiences for people in relation to personal loans.[65] People also found lenders to be poor at assessing an ability to repay loans (43.1%).[66] The case studies provide a number of examples where lenders had plenty of information to indicate a loan product was inappropriate. However, information, including evidence of low salary, little if any disposable income and history of late payments, all appear to be no barrier for approving people for ever increasing loans.

The case studies highlight the impact inappropriate lending has on people's personal relationships and family who are often required to step in and pay off debts.

## Irresponsible lending practices

### Burt's story

I was 20 years old at the time, one year out of college working part time at DHS. I had low rate credit card which I was not struggling with, bank advised I had been pre-approved eligibility for personal loan due to my repayments on Credit Card. I was naive and didn't know much about loans, I submitted a same day loan request and the same afternoon $5000 was approved and in my account. No paperwork or contact, filled out a few boxes and it was sorted. I was not earning enough (I thought I was at the time, now I see I didn't have the capacity with that income to repay). I managed to have another 3 loans approved over the course of 4 months, due to being immature and not understanding the position I was getting into. The bank (CBA) approved me to a debt amalgamation of $27,000 total at 20 years age, no previous loan experience and barely any contact from bank until I started to default. It was paid out in 2015 buy a family member due to stress, inability to repay due to being casual after losing the part time role, and having no income at all due to it being used to catch up on interest due to frequent defaults.

I want the banks to be more accountable and serious background checks when approving loans in future, as I still hear this happens in 2017/2018 and it shouldn't be that simple for a young adult to obtain a huge sum of debt with ease like I did.

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[65] CHOICE survey of the people who had an experience with a personal loan which did not meet the person's standards or expectations, n=246
[66] CHOICE survey of the people who had an experience with a personal loan which did not meet the person's standards or expectations, n=246

### Dana's story

Banks being dishonest about fees and high interest rates. Also the fact they lend money inappropriately. I rolled my partners debt and am paying off as a joint loan. [It's] under control but have no idea how they could justify giving him so much credit which he clearly couldn't afford (based on constant late payments) but still offered new loans and credit increases.

### Marvin's story

Took out a personal loan for $12,000 a few years ago, and was not properly assessed for my ability to repay it (student on Centrelink benefits). Got sent to a debt collection agency.

Car loans appeared as a particular source of irresponsible lending, especially for younger people on low incomes. CHOICE is concerned by evidence of an over-reliance on credit assessments based solely on measures such as Household Expenditure Measures (HEMs). Given these measures are estimates they may be significantly different from actual living expenses. As one of the cases below shows this may lead to inappropriate assessments of a person's ability to repay.

### Lacey's story

I obtained a car loan through a car yard that was provided by GE money, it was my first time getting a loan, I was by myself and the financial advisor hid the complete amount of interest that would be calculated for the loan on the document he showed me before signing. I only realised when I re-read once home.

### Kennard's story

When I just finished school (over 10 years ago) I applied for a $25 000 loan for a car (and they increased the loan a number of times eventually to $35 000) without fully doing an assessment of capacity to repay the loan. I clearly would not have been in a position to pay this debt off as my wages were low. When I made a complaint to the Financial Ombudsman Service, the finding was due to the fact that the loan would not push the applicant into poverty status.

On every increase in loan the bank did not even bother to compare the figures from the previous loan. Everything was done on the phone and no due diligence was done. When I spoke to the bank official they said that they have an amount they use to work out the amount required to live on (pauper amount) and provided the client has that amount available after the loan is approved, then the loan will be approved. They made no effort to get the actual costs I incurred. I feel that they had a duty of care to take the time to get a clear idea of my financial position - I banked with them and they could see my outgoings left the account as soon as the money arrived. These loans caused me to be locked into a cycle of always trying to keep up with payments and never being able to get on top of the debt. If it had not been for my family helping me I would still be in the financial quagmire which locked me into not being able to further myself.

I have since paid off my debt with assistance from family - just stating this to clarify that I have no hidden agendas with this complaint.

There are reports of people attempting to take control of their finances being denied low cost personal loans, instead being pushed into high cost credit cards. In the case below, bank practice failed to protect the personal information of a victim of domestic violence.

### Louise's story

Stuck with unexpected unemployment of my partner there was quite a few bills. I was advised that I didn't qualify for a loan at a low rate, but did qualify for a high interest credit card.

I was rejected for a low rate personal loan because it was deemed I "couldn't afford" the repayments. I was making the payments at a high interest rate with another organisation.

On splitting up with my ex who left me in huge debt (amongst a whole range of other factors in the news), it was indeed difficult to separate finances. My new address details appeared on the paperwork that needed to be completed by both of us. Meaning that the current process does not protect victims of domestic violence completely.

## Personal lending information request

Given the evidence of practices associated with personal lending falling well below community standards and expectations we see this as an important area of further exploration for the Royal Commission. The Commission's understanding of the problems in the credit and lending sector could be strengthened by requesting evidence from insurers as to:

- What are the Key Performance Indicators (KPIs), indirect benefits and remuneration practices for staff recommending credit cards over lower cost options?
- Information on the credit assessment processes. For example, how often are Household Expenditure Measures (HEMs) solely relied upon to estimate a borrower's living expenses? In what circumstances do lenders use HEMs? Are they used for people on

social security payments? Are they used when actual expenses are known or should reasonably be known?

# Unfair fees

81.3% of the survey respondents said that they would like to see the Royal Commission tackle unfair fees.[67] In 2016, Australian households paid $4.3 billion in bank fees, with the average Australian household paying $468 on bank fees every year.[68]

This is the fourth consecutive year that bank fees for households have risen. Despite concerns raised by consumer advocates and public pressure from a number of class actions, these fees have continued to rise. High bank fees hurt Australian consumers as they erode savings and escalate debt. They unfairly penalise lower income Australians. The sheer volume of survey responses CHOICE received from everyday Australians about this issue highlights how the banking sector's addiction to fees falls well below community standards and expectations.

There are two broad problems that need to be resolved with the imposition of fees on consumers. First, consumers continue to feel fees do not correspond to a fair estimate of the cost to the business. Survey respondents told us that bank fees are "too high", "unfair", and "outrageous". The High Court found that late payment fees charged on a credit card were not unenforceable as penalties, nor did they contravene statutory prohibitions against unconscionable conduct, unjust transactions and unfair contract terms.[69] However, during the hearings the bank was forced to justify the make-up of its fees. This is something rarely done and without such evidence consumers are not in a position to judge the fairness or otherwise of bank fees.

As an example, surveyed consumers have reported that foreign exchange fees are "excessive", "consumer gouging" and "double dipping". Consumers expressed a belief that fees should fall within a reasonable market range and not impose an unfair penalty on consumers.

## Clayton's story

Excessive fees on overseas transactions. As the world becomes a "smaller place" the major

[67] CHOICE survey in response to: "What issues should CHOICE champion in the Banking and Financial Services Royal Commission?", n=2,763
[68] The Australian Banker's Association, Fees for Banking Services – 2017 report, available at https://www.bankers.asn.au/images/uploads/ArticleDocuments/134/Report__Fees_for_Banking_Services_2017.pdf
[69] *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28.

banks generally charge excessively for an overseas credit card transaction. Typically this will be 3% above the mid bank exchange rate. This is well above cost and I see it as consumer gouging.

Second, consumers have identified a lack of clarity and misinformation around the imposition of fees. It is important that consumers are actively informed and warned about fees across the product lifecycle so they can better avoid these charges.

### Gweneth's story

I have had more than one bad experience and on a number of different levels. And from at least three different banks. Plus financiers who offer no interest loans. The fees are outrageous and then they charge fees on top of fees. As are the exorbitant high interest rates they charge, even when they say no interest, there are many unethical things going on in the banking and finance sector.

### Marco's story

I had a Wizard Clear Advantage credit card. This was subsequently rebranded by GE Money as the 28 Degrees Mastercard, and (even later) sold to Latitude Financial Services.

Latitude, around the middle of 2016, introduced a fee for paying outstanding balances using BPay. This was not adequately advised to customers: whilst they met their legal obligations, there was a great deal more they could have done at low cost to raise awareness of the change (such as emailing customers directly to advise of the fee), but didn't.

The legal obligations were met by an advertisement in the Australian newspaper (which I never buy or read), and a small notice at the bottom of a single monthly statement (which was effectively superseded by the use of online banking to track transactions in close to real time, meaning a great many people never needed to read their statements.)

A great many people complained about this change, publicly - for example, on 28 Degrees' Facebook page, strongly indicating that the issue I had was not isolated.

## Fees information request

Given the evidence of the charging of excessive fees falling well below community standards and expectations, we see this as an important area of further exploration for the Royal

Commission. The Commission's understanding of the problems in charging excessive fees could be strengthened by requesting evidence from financial services entities as to:

- What is the breakdown of the cost to business of commonly charged fees?
- What percentage of customers with a credit card are paying late fees? What measures have financial services providers put in place to help customers avoid fees?

## Compensation scheme of last resort

Throughout this submission we have called for a shift in thinking away from self-regulation as a first resort. This approach recognises that properly equipped, fast acting regulators are best positioned to play a harm prevention role in the financial services sector. While harm prevention should be the primary focus, ensuring consumers are protected when the system fails is also vital. Currently the financial services sector lacks a last resort scheme capable of compensating consumers for these failures, leaving many without remedy.

The Corporations Act and National Consumer Credit Protection Act impose an obligation on licensees to provide compensation to consumers for certain losses incurred.[70] However, there remain circumstances when consumers are left without compensation, typically when financial service entities become insolvent.

The human impact of these failures can be catastrophic. In some cases people have invested their retirement savings or leveraged their homes based on poor financial advice, only to lose it all. The stress placed on a person can impact both mental and physical health. Ultimately the costs of these types of failures are borne by the wider Australian community through increased reliance on support services, including social security.

CHOICE supports the observations made by the Ramsay Review as to the benefits of a compensation scheme of last resort.[71] The scheme should be designed to ensure it is properly funded by financial firms and capable of compensating consumers in the event of failure. Such a scheme should shift the cost of misconduct away from the community and onto the sectors which are causing harm. The lead banking lobby group, the Australian Bankers' Association,

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[70] *Corporations Act 2001* and the *National Consumer Credit Protection Act 2009*
[71] September 2017, Ramsey Review, 'Supplementary Final Report – Review of the financial system's external dispute resolution and complaints framework', p.41, available at http://192.195.49.161/ConsultationsandReviews/Reviews/2016/Review-into-Dispute-Resolution-and-Complaints-Framework/Final-Report

has publicly supported the creation of a compensation scheme of last resort, believing it would be an important measure in restoring trust in the sector.[72]

We maintain that in a properly functioning financial services sector the focus should be on harm prevention and empowering regulators as a first resort. However, when the system fails the sector as a whole should be responsible, through the funding of a last resort compensation scheme, to ensure consumers are not left financially ruined and without remedy.

[72] February 2017, Australian Bankers' Association, submission to the Ramsey Review Interim Report of the Review of the financial system's external dispute resolution and complaints framework, p.16, available at https://static.treasury.gov.au/uploads/sites/1/2017/06/R2016-002_Australian-Bankers-Association.pdf