



Consumer Credit
Legal Centre NSW

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Submission in relation to the Financial System Inquiry's Draft Terms of Reference

by the

Consumer Credit Legal Centre (NSW) Inc

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

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

Thank you for the opportunity to comment on the Terms of Reference for the Financial System Inquiry. The Terms of Reference give broad scope to address a wide range of issues of concern to our organisation.

We make the following comments in the interests of ensuring the inquiry, which is no doubt likely to be dominated by the concerns of financial service industry participants, keeps a firm eye on the end-users of the financial system. The financial system has the potential to create significant benefits for (or cause significant harm to) the community as a whole, or particular groups within it.

Summary of Recommendations

1. The TOR should specifically mention access to the financial system or financial inclusion.
2. TOR 2.1 should be amended to recognise that competition, efficiency and innovation are not objectives in themselves, but are only beneficial to the extent that they contribute to achieving optimal end-user outcomes.
3. TOR 2.3 needs to include the benefits of regulation (to consumers, the market as a whole and the public interest) in addition to its costs and impositions; whether the objectives of the regulation are being met, and whether there are alternatives (including alternative regulation) that would meet the objectives more effectively.
4. There should be a panel representative with experience and expertise in consumer policy and financial inclusion.

Submissions Regarding the Terms of Reference

1. We applaud the use of the term *fairness* in the objectives. We believe a robust financial system which delivers appropriate outcomes for end users encompasses fair products and services and fair treatment of consumers.
2. We also appreciate the mention in TOR 1.3 of the “*cost, quality, safety and availability*” of financial services and products for *all end users*. As a service assisting low income and disadvantaged consumers as a priority we are concerned about financial inclusion. Many low income consumers struggle to find appropriate products such as fee free bank accounts, and affordable credit for small amounts. Many low income consumers have no car insurance, despite the considerable financial risk to themselves and others as a result, but will have poor value products like consumer credit insurance or funeral insurance. There has been considerable progress on some of these issues of late, but much remains to be done. At best, the financial system should provide for suitable products and services which build capacity and confidence among low income and marginal consumers— at the very least, products which exploit low income consumers and cause them to pay more than the majority of the population for inferior products and services should be minimised.

3. We are concerned about the assumption implicit in TOR 2.1 that stability and consumer protection are forces which inevitably operate in opposition to competition, innovation and efficiency. While there may at times appear to be tension between competition and innovation versus consumer protection, a closer examination reveals that they are in fact working in complement to achieve the goals of competitive (in terms of price), quality, safe and accessible financial products and services.

Competition is not a goal in itself. Competition is only positive where it results in better products and services, and/or more competitive prices for products and services of similar quality. Competition which undermines quality (especially to the point that products and services become unfit for purpose) is not a desirable goal. Consumer protection initiatives (regulation, enforcement, dispute resolution etc.) set the parameters in which competition occurs. It is vitally important to set the boundaries of competition in this way to ensure that companies delivering quality products and services are not outcompeted by inferior products and services and/or unscrupulous operators.

Similarly, innovation is only useful where it results in better outcomes for the end-user. Innovations which result in complex products which obfuscate the costs and benefits to consumers are of little benefit to the community or the economy.

Example 1: *Flood insurance*

In the wake of the catastrophic Queensland floods of January 2011 many consumers had purchased insurance that they believed covered them for flood, but at an apparently competitive price. What they had not realised was that the flood cover was severely limited by a monetary limit which rendered it completely unfit for purpose when it came to rebuilding or fundamentally repairing their homes.

Example 2: *Line of credit mortgages and linked credit cards*

It was very popular at one point for finance brokers to promote the advantages of living off a credit card and then paying it off from a line of credit mortgage account at the end of the interest free period. In this way, the theory went, a person's entire wage or salary could be paid onto the mortgage leading to interest savings and a mortgage paid off faster. Unfortunately the theory did not work for a significant number of consumers, because they spent more on the credit card than they would have spent had they been limited by the amount of cash available in their bank account. Added to this were a few other disadvantages – the brokers charged upfront fees of several thousand dollars to set up the arrangement and the consumer was usually put into a mortgage with a higher interest rate in order to access the line of credit facility. This meant that their loan was larger as a result of the transaction and their interest rate higher, costing tens of thousands of dollars over the life of the loan. In 2007 ASIC took action against one such broker because (among other things): they failed to disclose their connection to the lender, purported to assess people's suitability for the arrangement prior to the refinance but in fact did not do so, and used false case studies and faulty modelling to demonstrate the benefits of the arrangement. CCLC assisted many clients to apply for compensation in the wake of the proceedings. We discovered many consumers who had been paying off their mortgages successfully under a principle and interest arrangement with fixed repayments had gone backwards by thousands of dollars as a result of this "innovative" arrangement and several were in financial difficulty when this had never been the case previously.

Example 3: Funeral insurance

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

4. TOR 2.3 refers to assessing the consequences of regulation, including compliance costs, flexibility, innovation and trade, but makes no reference to the purpose the regulation serves, whether it is meeting that purpose effectively and efficiently, and what the benefits to the community are. In other words the TOR appears to concentrate on the costs and impositions on business side of the equation without reference to the benefit that regulation confers. While reading the TOR overall suggests that this weighing up is part of the process, there is a risk in the current drafting that extensive details about the impact of regulation will be divorced from the key questions in each case about why the regulation was introduced, whether that need still exists, whether the regulation is meeting that need and whether the need could be met more effectively and efficiently by some other regulatory setting or process.

Example 5: *Predatory lending against people's homes*

In the early to mid 2000's CCLC regularly assisted clients who were victims of predatory asset stripping. Particularly vulnerable property owners included:

- Clients who were desperate because they could not pay their existing mortgage and faced imminent repossession;
- Clients who were facing other pressing financial demands (medical costs, legal fees for a child);
- Clients who had low financial literacy levels and in some cases cognitive deficits but had inherited property or purchased it with compensation.

Such clients would be convinced to enter short terms loan contracts where between \$5,000 and \$30,000 were siphoned off in upfront fees and charges (including but not limited to brokerage). Often there were no repayments (interest was capitalised) or there were interest-only payments and the entire loan was due in 6-12 months. At the end of the term of loan the client was invariably sold up with additional default and enforcement charges added to complete the equity stripping process. If the client had sufficient equity at the end of the term of the loan, it might be rolled over repeatedly until the equity was gone (with no further benefit received by the client than the initial loan amount). This process lined the pockets of the parties involved in lending and brokering but left the consumers homeless and without any funds with which to start again. It also undermined financial resilience and led to stress, health, relationship and productivity impacts.

At the same time, NSW had a negative licensing system for finance brokers. In the 10 years prior to the commencement of the national credit laws in 2010/11, only a very small number of brokers were ever excluded from the market despite rampant fraud because it required complex and costly Supreme Court proceedings to obtain a banning order. Since the commencement of the new laws we no longer see the extreme cases of predatory lending that were prevalent before. Further ASIC bans or takes administrative action against brokers involved in fraudulent conduct on a regular basis. Where poor conduct does occur (as is inevitable), affected consumers have access to external dispute resolution. It is vitally important that the costs of regulation are weighed against their benefit to consumers, the market and the community as a whole.

5. As mentioned in point 2 above, the TOR must recognise that the overall objective of the financial services system is to serve a variety of end-users. While it is clearly necessary that the Panel includes considerable financial services expertise, it is vital that the demand side is also represented. We would particularly advocate for the inclusion on the panel of a person with consumer policy understanding and ideally an appreciation of issues related to disadvantage and financial exclusion.

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



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