

Independent Review of Product Sales Commissions and Product Based Payments

Legal Aid NSW Submission
to the Australian Bankers' Association

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About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the Legal Aid Commission Act 1979 (NSW) to provide legal assistance, with a particular focus on the needs of people who are socially and economically disadvantaged.

Legal Aid NSW provides information, community legal education, advice, minor assistance and representation, through a large in-house legal practice and private practitioners.

Legal Aid NSW also funds a number of services provided by non-government organisations, including thirty five community legal centres and twenty eight Women's Domestic Violence Court Advocacy Services.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact most on disadvantaged communities, such as credit, debt, housing, employment, social security and access to essential social services. Customer issues constitute the largest category service for our Civil Law Division.

In 2014-2015 Legal Aid NSW provided 4,887 in house advice and 5,477 minor assistance services in customer law matters. More than one quarter of these matters dealt with credit products,

including customer leases. This submission draws on the casework experience of civil law solicitors in providing these services.

Legal Aid NSW's Mortgage Hardship Service assists people who are in danger of losing their homes because they cannot pay their mortgage or because a guarantee is being enforced against them. If required, the Service also assists people to sell their home to minimise the loss and ensure a favourable outcome to the borrower.

Legal Aid NSW welcomes the opportunity to provide a submission to the Independent Review of Product Sales Commissions and Product Based Payments being undertaken by the Australian Bankers' Association. Our submission follows the broad topics identified in Terms of Reference. The names of all clients in the case studies provided in the submission have been changed to protect their privacy.

Should you require any further information or wish to discuss this submission, please contact Dana Beiglari, Senior Solicitor, Civil Law at Dana.beiglari@legalaid.nsw.gov.au; or Annmarie Lumsden, Director, Strategic Planning and Policy at Annmarie.Lumsden@legalaid.nsw.gov.au

Scope of Terms of Reference

Legal Aid NSW welcomes the opportunity to contribute to the Independent Review of Product Sales Commissions and Product based Payments (**the Review**). The Review is an important step towards increasing transparency and building trust and confidence in the banking industry. However, we have a number of concerns with the Scope of the Review as outlined in the Terms of Reference.

We are disappointed that the Scope specifically excludes remuneration structures, product design issues and quality of advice regarding life insurance products.

In our view, this is a missed opportunity to assess how product based payments in life insurance lead to poor customer outcomes. Further, information about the remuneration structures involved in the sale, offer and distribution of banking products is not readily available to our clients. Without access to this information, it is difficult for Legal Aid NSW to thoroughly assess if remuneration structures align with customer outcomes.

Information about existing product sales commissions and product based payments

As outlined above, Legal Aid NSW does not have information about remuneration structures required to comment on existing product sales commissions and product based payments in relation to the sale, offer and distribution of banking products to customers.

In the Australian Banking Association's (**ABA**) Industry Statement released on 12 April 2016, the ABA noted its commitment to making it easier for customers to do business with [the banks] and the importance of independence and transparency.¹ To achieve this objective, Legal Aid NSW recommends that any product sales commissions and product based payments are explained to customers in plain English both verbally at the point of sale, as well as being outlined in the product's contract.

¹ <http://www.nab.com.au/content/dam/nabcampaigns/personal/help-and-guidance/nab-message/nab-message-industry-media-release-21-April-2016.pdf>

Recommendation

Product sales commissions and product based payments should be disclosed to the customer in plain English (verbally and in writing) at the point of sale of the product.

Poor outcomes for customers

Legal Aid NSW assists many clients who purchase 'add-on' insurance, such as consumer credit insurance (**CCI**), often without their knowledge or consent. We also advise clients who purchase consumer credit products, such as a home loan, with the assistance of a third party.

Our casework experience shows that product sales commissions and product based payments in retail banking lead to poor customer outcomes, as they encourage salespeople to act in their own interests, rather than in the customer's interests. This conflict of interest is exacerbated in circumstances where the credit product is used to pay for the insurance product.

Selling unsuitable products

Incentivising sales by paying commissions creates a significant risk that the salesperson will recommend products to customers which are unsuitable for the customer's needs. A salesperson's failure to make a suitability assessment of the insurance product for the customer is largely unchecked by law, because of the limited consumer protection in this area. For example, section 12ED of the *Australian Securities and Investment Commissions Act 2001* (Cth) provides that every contract for the supply of financial services should be reasonably fit for the purpose for which they are supplied. However, insurance products are exempt from this provision.²

Legal Aid NSW regularly sees cases of unsuitable insurance products being sold to customers. For example, CCI for income protection regarding sickness or accident is sold to disabled pensioners who would never be able to claim any benefit under the policies. The lack of legal protection in these situations impacts most harshly on vulnerable customers, as demonstrated by the following case study.

² Section 12ED(3) of the *Australian Securities and Investment Commissions Act 2001* (Cth)

Case study: Unsuitable CCI

Carlo has a mental disability. Until recently, Carlo worked casually in a community organisation that employs disabled people. Carlo purchased a car with a car loan.

When his mental health deteriorated, Carlo was forced to stop work. He soon fell into financial hardship and was unable to meet his loan repayments. Upon review of Carlo's car loan documents, Legal Aid NSW noticed that CCI and mechanical breakdown insurance had been added to the cost of Carlo's loan. This increased the loan amount by over \$4,000. The loan documents also revealed that there was a 20% commission paid on some of the insurance policies.

Carlo's CCI policy requires that he be employed full-time to be eligible to make a claim. As a casual employee, he is therefore unlikely to be able to claim on his CCI policy. Further, Carlo already had comprehensive motor vehicle insurance, so mechanical breakdown insurance was unnecessary.

Customers' lack of awareness about product

Legal Aid NSW provides advice about add-on insurance or credit products purchased with the assistance of a third party. In these cases, our clients regularly report that the salesperson misrepresented or failed to explain the nature of the product sold to them. In some cases, our clients report that they were not aware that they had even purchased the product. Our experience is consistent with the Australian Security and Investment Commission's (**ASIC**) report on the sale of CCI.³ The lack of transparency around purchase of add-on insurance, such that customers may not even be aware that they have purchased a particular product, is very concerning. This is highlighted by the following case studies.

Case study: Purchase of add-on insurance without knowledge

Peter is a young Aboriginal man. He went to a car dealer to purchase a car with a car loan. Peter spent several hours picking out his car, completing documentation with the dealer and waiting for the dealer to process the documentation.

³ ASIC (October 2011) *Report 256: Consumer Credit Insurance: A review of sales practices by authorised deposit-taking institutions*

Peter was not aware that he had been sold Loan Protection Insurance, Gapcover Insurance and Tyre and Rim Insurance. Peter was not aware that the add-on products were financed by the car loan and that he would pay interest on the increased amount of the loan.

Further, Peter was paying for Loan Protection Insurance. As a casual employee however, he would not be eligible to claim on this policy if he lost his job.

Case study: Home loan applied for without consent

Rita is an elderly woman with health problems. Rita's son, Evan, contacted a broker to arrange a home loan, secured by Rita's home, with Rita as the borrower. Evan received the benefit of the loan funds. Rita did not meet the broker and did not instruct the broker to apply for a home loan in her name. Rita's only source of income is the Age Pension and her home is her only asset. Rita never had the capacity to repay the home loan.

Legal Aid proposes a number of recommendations below to address these concerns around the lack of transparency and suitability of add-on insurance and credit products.

Increased financial burden of customer

Credit products are often used to pay for both add-on insurance as well as an intermediary's fees. Where this occurs, the customer pays interest on the increased amount. This is especially concerning where the intermediary has signed up customers for these products without their knowledge.

While the credit product is available to pay for the add-on insurance product, there is a guaranteed revenue stream for the credit provider and insurer which incentivises the sale of insurance products. If the model was changed so that credit could not be used to purchase the insurance product, these unsuitable products would no longer be sold in such significant volumes.

Legal Aid NSW therefore recommends that the use a credit product to pay for an add-on insurance product be prohibited. Customers would then be in a position to make a genuine and informed choice about the suitability and affordability of add-on insurance. This would avoid situations such as the following:

Case study: Add-on insurance products and fees increase loan amount by nearly 30%

Ivan signed up for car finance to purchase a car. The finance, arranged at the car dealer using a broker, totaled \$53,000. This approximated to cover of the car (\$25,000), Consumer Credit Insurance (\$7,700) Security Shortfall Insurance (Gap) (\$1,725) and the broker's origination fee (\$770).

Ivan was not aware that he had purchased over \$9,000 in add-on insurance products, or that he was paying a broker's fee as well as interest on these amounts. For Ivan, an increase of the loan amount by nearly 30% made the credit contract unaffordable.

Recommendations

The use of a credit product to pay for an add-on insurance product should be prohibited.

In the alternative:

- Add-on insurance should be disclosed to the customer in plain English both verbally and in writing at the point of sale of the product,
- Staff who sell add-on insurance with any credit product should have the qualifications to provide financial advice, and
- A requirement that the insurance product be suitable for the customer's needs should be developed and consistently applied by staff selling insurance.

Removing product sales commissions and product based payments

In Legal Aid NSW's view, paying salespeople to sell products to customers constitutes a direct conflict of interest between the customer and the salesperson. This inevitably leads to poor customer outcomes. Improved customer outcomes would be ensured by the removal of product sales commissions and product based payments. Legal Aid NSW strongly advocates for such reforms to be legislated, and supported by regulatory guidance and amendment to the Banking Code of Practice.

Recommendations

Product sales commissions and product based payments should be prohibited by law.

Further or in the alternative, ASIC and the Code of Banking Practice should provide guidance to industry about how to better align remuneration structures with the best interests of the customer.