Submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Round 1 Hearing Consumer lending

Legal Aid NSW

Introductory remarks

Legal Aid NSW welcomes the opportunity to provide these written submissions.

The Commission has highlighted critical systemic issues in the conduct of banks and brokers. The experience of Legal Aid NSW in providing legal services is that this conduct is apparent across the financial services sector including second tier and fringe lenders, where the severity and impact of this conduct can be particularly serious, especially for vulnerable communities.

The community rightly expects banks to comply with the law, act fairly and honestly towards customers and provide safe and suitable products. In large part, the financial services regulatory framework reflects this expectation in the context of consumer lending. The Commission has received evidence of significant failings in this regard by Australia's leading financial institutions. Legal Aid NSW has prioritised assisting those who have been significantly impacted by these failings.

Legal Aid NSW's response to the questions in relation to the three case studies focus on areas where we have the most direct case work experience including:

- Residential Mortgages;
- Car Finance; and
- Add-On Insurance.

We have only responded to questions that are directly informed by the legal services we provide to consumers[1]. We also suggest possible areas for reform and further areas of inquiry.

Case Study One: NAB introducer program

Q1. Do remuneration and incentive policies that reward bank employees for volume of sales of loans create an unacceptable risk that bank employees will prioritise the sales of loan products over:

- ***First, the bank's responsible lending obligations;***

[1] In the 2016 / 2017 financial year Legal Aid NSW provided 2,230 legal services in credit matters, including 263 legal services for clients at risk of mortgage repossession

- ***Second, the bank's statutory obligation to provide loans to customers in a manner that is efficient, honest and fair;***
- ***Third, the bank's statutory obligation to have adequate arrangements to ensure that customers are not disadvantaged by any conflict of interest that may arise;***
- ***Fourth, the bank's obligation to ensure that the conduct of its employees in connection with the provision of loans is not misleading, deceptive or unconscionable?***

Yes. Our casework experience is that remuneration and incentive policies that reward bank employees for volume of sales distort sales practices and lead to:

- breaches of the bank's responsible lending obligations;
- failure to provide loans to customers in a manner that is efficient, honest and fair;
- lack of compliance with internal protocols to prevent conflicts of interest; and
- provision of loans in circumstances that are misleading, deceptive and unconscionable.

The fundamental flaw in current remuneration policies is that they create a conflict of interest between the consumer and the employee, where the employee's imperative on making a sale on the bank's behalf is placed above compliance with the law and what is appropriate for the consumer. This conduct is exacerbated where targets are linked only to volumes of sales, rather than compliance and customer service outcomes.

Because of an asymmetry of information between bank employees and consumers, consumers are more likely to trust what the bank tells them, and to agree to enter into products recommended to them by the employee, and in some cases, the broker. This dynamic is increased when bank employees use unfair and high pressure sales practices to induce a consumer to purchase a particular loan product. Where this misconduct is unchecked, or where there is a minimal penalty if the misconduct is discovered – as revealed in NAB's evidence provided to the Commission on 14 March 2018, staff are not deterred, but rather, encouraged to engage in such misconduct to meet sales targets.

A change to remuneration structures from sales driven targets towards consumer wellbeing measures would be a step towards remedying this. This should be accompanied by effective deterrence and compliance measures, including better oversight of lending practices and greater penalties for breach of responsible lending obligations.

Q2. Whether introducer programs create an unacceptable risk that banks will breach:

- ***First, their responsible lending obligations;***
- ***Second, their statutory obligation to provide loans to customers in a manner that is efficient, fair and honest;***
- ***Third, their statutory obligation to have adequate arrangements to ensure that customers are not disadvantaged by conflicts of interest; and***

- ***Fourth, their obligation to ensure that the conduct of their employees in connection with the provision of loans is not misleading, deceptive or unconscionable?***

The Commission has received evidence that introducer programs create an unacceptable risk that banks will:

- breach their responsible lending obligations;
- fail to ensure they provide loans to customers in a manner that is efficient, honest and fair;
- fail to comply with their internal protocols to prevent conflicts of interest; and
- provide loans in circumstances that are misleading, deceptive and unconscionable.

This case study highlights numerous concerning features of the introducer program. While each feature on its own is problematic, our casework suggests that in combination, they produce a high likelihood of poor consumer outcomes. We have identified the following:

- Lack of direct contact between the bank and the customer;
- The financial service provider relying on a broker or unlicensed third party to:
    - market their products; and
    - provide information to the bank about the consumer's financial situation and their requirements and objectives;
- Lack of oversight and risk management of loans arranged; and
- Minimal consequences for brokers, introducers and bank employees when misconduct is identified.

NAB's evidence on 13 and 14 March 2018 demonstrated that NAB systems were insufficient to identify and respond to misconduct in a timely, efficient and satisfactory manner. Further, the NAB systems were insufficient to allow managerial oversight of the loan application process to ensure that NAB staff were complying with their responsible lending obligations, and not relying on false information.

Linking remuneration to volumes of sales leads to distorted sales practices and consumer detriment. The structure of incentives is such that introducers and bankers are rewarded when new customers are introduced, and these incentives are proportionally linked to the amount of the loan the customer enters. Additional concerns are:

- Brokers may be included in the program even where they arrange commercial loans. This may create a financial incentive for brokers to encourage consumers to enter into commercial loans, even if their loan purpose is for household or domestic use.
- Introducers who are not brokers (such as tailors and gymnasium operators) do not hold a credit license and may not be considered a credit assistance provider. They are therefore unregulated by the *National Consumer Credit Protection Act 2009* (Cth).

- Including an introducer in the loan application process complicates a consumer's ability to seek redress against the bank and/or the introducer in the event of a complaint.

The terms of introducer programs must be structured in a way so that introducers and bank employees are incentivised to satisfy consumer needs and meet compliance standards. There must also be regulation of the parties involved in the transaction and rigorous oversight of such programs. Any person or entity remunerated for "introducing" a customer to a loan products should be required to have their own Australian Credit License or be the bank's credit representative.

Q4. Do banks have adequate policies to address customer detriment occasioned by misconduct of bankers or third parties such as introducers in connection with home loans in a timely fashion?

While we cannot comment on banks' specific policies, our casework experience reflects the evidence before the Commission that banks can be slow to identify and address misconduct. Where misconduct is brought to their attention by a consumer or their representative, banks will not readily acknowledge the issues – instead requiring the consumer to engage in lengthy, complex and sometimes expensive dispute resolution. The shortage of accessible legal services[2] leaves many consumers navigating this process on their own or unable to protect and enforce their rights.

Q6. Is the practice by banks of defaulting to the use of the HEM benchmark when a customer declares living expenses that are less than the HEM benchmark consistent with the statutory requirement to take reasonable steps to verify a customer's financial situation before entering into a home loan with that customer?

No. Legislation, case law and regulatory guidance is clear that lenders and brokers must take reasonable steps to enquire about and to verify the consumer's actual financial situation.

ASIC Regulatory Guide 209 at [RG209.105] states that "using benchmarks is not a replacement for making inquiries about a particular consumer's current income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses".

We also note the comments of the Federal Court in the matter of *Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 at [42] that:

> Assessing whether there is a real chance of a person being able to comply with his or her financial obligations under the contract requires, at the very least, a sufficient understanding of the person's income and expenditure. It is axiomatic that "reasonable inquiries" about a customer's financial situation must include inquiries about the customer's current income and living expenses. The extent to which further information and additional inquiries may be needed in order to assess the

[2] The Productivity Commission Inquiry Report: Access to Justice Arrangements September 2014 found significant unmet legal need, particularly in the area of civil law

> consumer's financial capacity to service and repay the proposed loan and determine loan suitability will be a matter of degree in each particular case.

The practice of raising a consumer's living expenses to the HEM benchmark where they are declared below this level demonstrates that the lender does not have a sufficient understanding of the person's expenditure. This is concerning because:

- It fails to identify the likelihood that expenses noted as below the HEM benchmark may be understated and require further inquiry; and
- Consumers whose actual expenses are less than the HEM benchmark are disadvantaged by assuming their expenses are higher than those in practice, reducing their borrowing capacity.

Case Study Two: CBA arrangements with mortgage brokers and aggregators

Q1. Does the use of upfront and trailing commissions for remuneration of head groups and the brokers who submit loans through head groups lead to poor customer outcomes?

Yes. The use of commission-based remuneration in respect of bank employees or brokers elevates sales above compliance and consumer needs, leading to very poor consumer outcomes. Please see our response to Case Study One for further detail.

Q2. Should upfront and trailing commissions be replaced with an upfront flat fee payment?

The Commission has received evidence that suggests remuneration structures must shift to support a culture focussed on satisfying consumer needs and providing quality customer service, rather than a sales culture. This is consistent with Recommendation 7 of the Retail Banking Remuneration Review that:

> Each bank should formally examine its workplace culture and institute formal processes to redress any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service.

In our view, this requires a complete restructure of the remuneration schemes in the financial services industry – it is unlikely that a shift to an upfront flat fee payment will achieve this aim.

Placing consumer needs at the centre of the financial services industry may be facilitated by linking remuneration structures to:

- Offering products that are appropriate for the consumer – this could be measured by ensuring that the product meets the requirements and objectives of the consumer, and that it is affordable over the term of the contract;

- Increasing accessibility of financial services to consumers – this could be measured by assessing a consumer's understanding of the key features of the product, how to use it and what they are paying for; and
- Ensuring consumer satisfaction in the event of a dispute – this could be measured by reviewing how complaints are raised by consumers and resolved by bank employees.
- Compliance with statutory obligations, such as responsible lending laws, and industry codes.

We recognise that the current remuneration structure is well-entrenched within the financial services industry. As a result, in order for changes to remuneration structures to have a meaningful effect on the established sales culture, they must be accompanied by the following:

- A clear communication strategy to employees, with extensive training about how to provide customer service in an efficient, fair and honest manner;
- Improved remedies for borrowers when a bank or intermediary breaches responsible lending laws. For more detail, please see our comments below at Question 4; and
- Proactive, well-resourced regulatory action by ASIC.

Q4. Will the program of reforms in the mortgage broking industry, announced by the Combined Industry Forum in 2017, ameliorate the conflicts of interest or any other issues that have been referred to in this case study?

The CBA case study sheds light on underlying drivers of misconduct in broker arranged finance across the financial services industry. These include:

- Remuneration arrangements that:
    - incentivise brokers to obtain loans of the highest amount and length;
    - incentivise bank staff to approve these loans;
- Lenders relying on information provided by the broker rather than making their own inquires, with insufficient managerial oversight of this process;
- Lenders having inadequate systems to identify and remedy broker fraud in a timely manner;
- Limited consequences for banks and brokers who fail to comply with their responsible lending obligations; and
- Difficulty accessing remedies for affected consumers.

In combination, these factors produce poor consumer outcomes generally and pose a particular risk for vulnerable consumers who may be exploited and encouraged to obtain inappropriate financial products.

While the program of reform announced by the Combined Industry Forum is a starting point, it will not produce the fundamental shift in broker conduct needed to address these issues and will do little to improve consumer outcomes. Critical limitations include:

- its lack of legislative backing and any provisions for consumer redress;
- the continuation of upfront commissions connected to the amount of the loan;
- the continuation of trail commissions; and
- it does not require the broker to act in the best interests of the consumer – proposing a lesser "good consumer outcome" test.

Best interests test

Legal Aid NSW strongly supports a legislative requirement that brokers must act in the best interests of their customer. This legal standard would be an effective means to overcome the many and entrenched issues around conflict of interest and poor consumer outcomes identified in this case study. The current legal position and the Combined Industry Forum proposals do not set a legal standard which meets community expectations that where a broker is instructed to act on their behalf they will do so in the consumer's best interest.

The role of banks

To ameliorate the issues highlighted in the case study, reform is also required by banks assessing loan applications submitted by brokers. Critically, lenders need to actively engage with the loan application submitted on the customer's behalf; as though it were submitted by the bank directly. The bank should undertake reasonable inquiries and verifications about the consumer, rather than relying solely on the information that is provided by the broker.

Banks also need to play an active role in improving standards in the mortgage broking industry when misconduct is identified. This could be achieved through changes to remuneration structures, such as:

- clawbacks of remuneration where poor compliance or misconduct is identified;
- mandatory reporting to the police in the case of broker fraud; and
- a requirement that the lender have at least one instance of direct communication with the customer.

In our casework experience, dealing with vulnerable consumers, particularly those experiencing domestic violence, direct communication with the consumer could have led the bank to identify their true situation. Without this interaction, it is difficult to understand how the bank can form their own view, in line with their responsible lending obligations, that the loan will not cause the consumer substantial hardship and is not unsuitable for their requirements and objectives.

The CBA case study also highlights the failure to properly disclose up front and trailing commissions in their home loan contracts. As the disclosure of ascertainable fees and charges is already required by section 17 of the National Credit Code, regulatory action may be required to ensure compliance with this obligation.

Access to redress

Any reforms in this area must be accompanied by strong consumer access to redress. One significant impediment to access to redress is the lack of any automatic remedy that flows to the consumer for breaches of the credit law. The consumer must establish that they have suffered loss or damage as a result of the conduct to obtain compensation under section 178 of the NCCP Act. Establishing this in any forum, either in internal dispute resolution, external dispute resolution or court, can be a complex and time consuming exercise.

To overcome this difficulty, Legal Aid NSW recommends that provisions in the NCCP Act should be introduced which automatically prevent a lender or broker from recovering any fees or interest on a loan, including commission, where the lender and/or broker has breached its responsible lending obligations. This would act as a deterrent to industry and make it simpler and easier for a consumer to pursue a claim where they have been provide a loan in breach of these key aspects of the credit laws.

Access to redress through the Court system is only meaningful if consumers are able to obtain independent legal assistance and representation. Access to services such as financial counsellors and free or affordable legal assistance is critical if avenues of redress are to be effective. This is not currently the case, leaving many consumers unable to protect and enforce their rights which can have devastating consequences for the individual and their family.

Q5. Who does a mortgage broker act for? Who does the customer think the broker is acting for? Who does the lender think the broker is acting for?

Our casework experience is that there is a misalignment between the consumers' understanding of a broker's role, the broker's role in practice and the position at law. While generally a broker is considered to be an agent of the lender, in our casework experience consumers largely perceive the broker to be a genuine intermediary, to representing both the consumer and the bank. Factors contributing to this include:

- The consumer often has no direct contact with the financial institution, relying on the broker to explain and execute loan documents with the client.
- A belief that "accreditation" with a particular lender means they are a lender's representative.
- Broker advertising, for example the Aussie Home 'What is a Mortgage Broker page' says that "A Mortgage Broker is a go-between between the borrower and the lender (usually a bank), who negotiates the loan on your behalf"[3].

[3] https://www.aussie.com.au/mortgage-broker/what-is-a-mortgage-broker.html

In circumstances of financial abuse, the consumer may not even understand that a broker is involved in the transaction.

The legal position that the broker acts for the consumer is undermined in practice by the following features of the transaction:

- The broker acts as a distributer and advertiser of bank products;
- The lender may rely heavily on the information provided by the broker and not conduct its own assessment; and
- The lender relies on the broker logistically to arrange the transaction, completing and executing paperwork with the consumer. The lender may never communicate directly with the consumer.

In these circumstances it is no surprise that the consumer may perceive (even correctly perceive) the broker to be a representative of the bank.

The legal impediments created by this agency issue are significant. In our casework experience, banks will routinely hold the consumer accountable for incorrect or misleading information provided by the broker, with the threat to the consumer that they may be pursued in a criminal action for fraud. Challenges pursing the broker directly are numerous:

- There may be insufficient time to proceed against a broker where the consumer is facing repossession of their home;
- The legal and factual issues are usually complex;
- At times the broker can be difficult to identify and locate; or they may no longer be trading or insolvent by the time misconduct comes to light;
- The broker and lender may be members of different EDR schemes; and

As demonstrated in the Aussie Home loans case study, consumers may not be aware of the misconduct even where it is known to the lender or the broker's employer. The commencement of AFCA, where all parties will be a member of the one external dispute resolution scheme, is one step to making access to redress easier for consumers.

This also highlights the importance of the proposed Design and Distribution Obligations applying more widely to financial products as defined by the *ASIC Act 2001* (Cth) – a definition which would include credit products The proposals as currently drafted do not extend to regulated and unregulated credit products and financial products not regulated by the Corporations Act. These are currently excluded on the basis that there may be an overlap with the responsible lending obligations. However, the responsible lending obligations only provide a specific and limited protection to individual consumers when entering into a contract with a credit license holder. The proposed design and distribution obligations are much broader than this, requiring issuers and distributors, which could include brokers, to consider the question of suitability during product design, product distribution and after the product has been sold. As consumer credit products are the very products that ordinary consumers, including vulnerable consumers, access the most, it is crucial that the products available in the market are safe, fair and suitable for consumers. The evidence before the Commission highlights the urgent need to reconsider the exclusion of credit from the Design and Distribution Obligations. For further detail, we refer to our March 2017 submission to Treasury about the Design and Distribution Obligations and Product Intervention Power proposals.

Case Study Three: Misconduct by Aussie Home Loan Brokers

Q1. Do remuneration structures that reward mortgage brokers for volume of sales of loans create an unacceptable risk that mortgage brokers will prioritise the sales of loan products over:

- ***Their responsible lending obligations;***
- ***Their obligation to recommend loans to customers in a manner that is efficient, fair and honest;***
- ***Their obligation to have adequate arrangements in place to ensure that customers are not disadvantaged by conflicts of interest; and***
- ***Their obligation to ensure that the conduct of the brokers is not misleading, deceptive or unconscionable?***

Yes. Remuneration structures that reward mortgage brokers for volumes of sales create an unacceptable risk that mortgage brokers will prioritise the sales of loans over their legal obligations and obtaining a suitable loan for the consumer. It is crucial that the financial services industry makes changes to remuneration structures to promote a culture focussed on consumer wellbeing, rather than sales targets.

Please see response to Case Studies One and Two. This equally applies to brokers.

Where a consumer enters into an unsuitable loan when assisted by a broker, it can be difficult for the consumer to seek redress. The bank's response is often that the responsibility lies with the broker, and the broker's response is that the responsibility lies with the bank. The broker and the bank are often members of different External Dispute Resolution schemes (although we note that this will change with the introduction of AFCA), adding further complexity to task of resolving the dispute.

Case study 4 – Robert Regan and ANZ home lending

Q1. Do credit providers have adequate policies to ensure that they comply with their obligations under the National Credit Act when offering broker-originated home loans to customers, insofar as those policies require them to make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract, to make reasonable inquiries about the consumer's financial situation, and to take reasonable steps to verify the consumer's financial situation?

No. The evidence before the Commission and our casework experience is that the policies of credit providers are inadequate.

Q2. Is use of the HEM benchmark an appropriate way to deal with the difficulties associated with securing an accurate assessment of living expenses from a customer?

No. The responsible lending provisions of the NCCP Act specifically contemplate these difficulties by placing an onus on lenders and brokers to make reasonable inquiries and take reasonable steps to verify the consumer's financial situation.

Rather than using a benchmark as a proxy for a consumer's actual living expenses, lenders need to develop loan application processes that assist consumers to better disclose their financial situation. This may be achieved by:

- Using targeted questions about expenses that consumers are typically poor at declaring, such as the total value of small regular expenses like coffee and cigarettes, or irregular expenses such a car maintenance;
- Interactive statements of financial position that can convert large annual expenses, such as car registration and home and contents insurance, to monthly or quarterly amounts; and
- Obtaining documentary evidence of easy to verify essential expenses, such as energy and telecommunications bills.

Lenders could also employ a system of red flags to indicate where further inquiries are warranted. For example:

- Low overall declared expenses, such as any expenses declared below the HEM;
- Unusually low essential expenses, such as energy costs or rental;
- Inconsistent information, such as where a motor vehicle is declared as an asset but where no associated costs are indicated as expenses;
- Unspent monthly income indicated on the statement of financial position that is notably different from the available bank account balance; and
- Undeclared debts, where evidence of these is apparent from account statements.

The evidence of ANZ that they chose to ignore available information in their own customers' bank account statements where this contradicts information in loan applications demonstrates an urgent need for change in these processes.

Q3. Is use of the HEM benchmark appropriate in assessing whether a loan is unsuitable for a customer?

Use of the HEM benchmark is only suitable to the extent that it provides an indicator that a consumer may have understated their expenses and further inquiry is warranted. This is reflected in in ASIC Regulatory Guide 209 at [209.49] that:

> After inquiries have been made and information about the consumer's financial situation has been gathered, a credit licensee may use benchmarks or automated systems and tools for testing the reliability of the information obtained as part of the process for taking reasonable steps to verify the consumer's financial situation… However, automated systems and tools are not a substitute for making inquiries about the consumer's current financial situation.

Q5. Does the widely-known use of the HEM benchmark as a default for customers' living expenses create an unacceptable risk that brokers will fail to make reasonable inquiries about a customer's financial situation, instead opting to declare an amount of living expenses for the customer that is known by the broker to be in the vicinity of the relevant HEM benchmark?

Yes, there is little incentive for brokers to make reasonable inquiries about the consumers' actual living expenses where it is known that expenses declared below this amount will not be interrogated and simply defaulted to the relevant benchmark.

Case study 5 – Irene Savidis and CBA add-on insurance

Q1. Are the processes that financial services licensees have in place for the sale of add-on insurance sufficient to ensure that those entities comply with their obligations under section 912A(1)(a) of the Corporations Act, the obligation to do all things necessary to ensure efficiently, honestly and fairly?

No. Our casework highlights the processes financial services licensees have in place for the sale of add-on insurance products are not sufficient to ensure that those entities comply with their obligations under section 912A(1)(a) of the Corporations Act.

Our casework experience is consistent with the case study presented to the Commission, and with the issues identified by ASIC in its Report 256. That is, we see customers sold inappropriate insurance products attached to finance where the consumer's particular personal circumstances mean they will never be able to claim on the insurance, even if a relevant event occurs.

Proper processes at the point of sale are crucial. For many consumers, it is the only opportunity to provide meaningful advice about the product. Consumers generally only seek legal advice when something has gone wrong. It is less likely that a consumer will read their PDS at some stage in the future and become concerned that the product is not providing value for money. Often when consumers get advice about add on insurance products it is because they are in financial hardship, for example, struggling to make loan repayments. When lawyers or financial counsellors obtain loan documents for the purposes of considering responsible lending or unjustness, it becomes apparent that the consumer is also paying (and often paying interest as well) for an inappropriate add on insurance product.

In the case study of Irene Savidis, she gave evidence that she questioned the value of the add on insurance product when she encountered difficulties paying the credit card, and sought legal advice when she received a letter from the bank. Customers who are paying loans without financial hardship may never question the value of an add-on insurance product. For this reason, it is crucial that consumers are empowered to make an informed decision about buying the insurance product in the first place.

Legal Aid NSW considers that proper process for distribution cannot be dealt with in isolation from design. ASIC's work in this area raises questions as to whether some products are designed in such a way that they never provide genuine value to consumer.

The case study presented by the Commission makes it clear that inadequacies of processes in relation to the sale of add on insurance products are part of a much broader cultural problem within the CBA. Once evidence of a systemic problem with CCI insurance was identified, ASIC had to deploy considerable resources to ensure that a) sufficient remediation was provided to affected customers, and b) that systems and processes were put in place to ensure the conduct did not continue. Solutions were only offered incrementally, and it was clear that if ASIC had not persisted, only minimal remediation and systemic change would have been implemented.

Q2. Are existing legal mechanisms considered in light of the regulatory changes which are anticipated to come into effect under the deferred sales model sufficient to address the issues associated with the sale of add-on insurance to customers identified by ASIC in its report 256?

No. Legal Aid NSW considers that a deferred sales model is insufficient on its own to overcome the issues associated with the sale of add-on insurance to customers identified by ASIC in its Report 256.

It is understood that the proposed changes referred to in this question are changes to be made to the Code of Banking Practice and our answer is based on this assumption. It is also understood that the proposed changes are not yet public. During his evidence, Clive van Horen referred to a four day period after the credit card is purchased before an add on insurance product can be sold to a consumer. Unfortunately, it is not clear whether the 'add on' insurance product can be marketed to the consumer before that four day period closes.

Legal Aid NSW considers there is value in a deferred period, and the value comes from separating sale of the credit card from sale of any additional insurance products. This is particularly important because, as Clive van Horen identified in his evidence, some consumers believe that add on insurance is a condition of the loan (**lines 30-33, page 562**). However significant questions remain about how a deferred sales model works, and how to avoid simply moving the problems already identified four days along in time. In addition, we consider four days to be insufficient for a deferral period.

In the case study of Irene Savidis, her evidence showed that the sale of the 'add on' insurance occurred separately to the sale of the credit card. However this did not stop high pressure sales tactics from occurring. While in her case the deferral period was less than four days, it is clear that high pressure sales tactics would have been used at any time, and were in fact used when she tried to cancel the product several months later.

Change needs to occur in the context of overall cultural change, both in terms of design of products, and how compliance issues relating to the distribution of products are identified and remediated. Remediation includes both remediation for the individual customer and steps taken to ensure the error is not repeated.

Design and distribution. Our view is that necessary changes to the distribution process are more easily identifiable if a proper design process is undertaken. For example, once a target market is clearly identified who will benefit from the product, it becomes easier to design knock out questions to reach that market. Any changes made to distribution processes should take a whole of product life cycle approach.

Period of deferral: Legal Aid NSW's view is that it is preferable to delay sales of additional insurance products for 30 days. A 30 day deferral period means it is likely that the consumer will have made at least one minimum monthly payment to the lender. A 30 day deferral period would also allow the consumer the necessary time after pressured sales experience to consider the value of the product to then seek advice and research other alternatives.

Case studies 9 & 10 – ANZ and Westpac car loans

Q1. Are the structural arrangements between banks and car dealers for the provision of car loans to consumers likely to result in the contraventions of the banks' responsible lending obligations under the National Credit Act?

Yes. Our casework experience is consistent with the evidence of consumers who appeared before the Commission in relation to car finance. Of particular concern is the Point of Sale (POS) exemption, referred to during the hearings.

The POS exemption means that credit licensees are effectively reliant on non-licence holders to collect information for the purposes of responsible lending assessments. Car yard sales people have an incentive to sell cars for a number of reasons ranging from car sales in their own right, to incentives for organising car finance and selling add-on insurance. This means that car dealers potentially have a conflict of interest in their role of assisting with car finance applications. Car dealers may be incentivised to take a less rigorous approach to collecting information for the purposes of a responsible lending assessment. If insufficient or inaccurate information is provided to the banks, the banks are likely to contravene their responsible lending obligations under the NCCP Act.

A number of problems associated with the POS exemption were identified and clearly articulated in a 2013 Treasury Discussion Paper; *The exemption of retailers from the National Credit Protection Act 2009.* A number of consumer groups made submissions in response to that paper. Legal Aid NSW considers that the POS exemption, in the context of the structural arrangements between banks and car dealers, means that responsible lending obligations are too often contravened and consumers suffer detriment. Legal Aid NSW would support a recommendation that the current POS exemptions be reviewed by Government.

Legal Aid NSW notes that the structural arrangements between banks and car dealers for the provision of car loans can give rise to additional problems in the form of unjust or unconscionable conduct on the part of banks, or a failure to provide loans to customers in a manner that is efficient, fair and honest. This occurs in the context of POS exempted car dealers taking steps to work around responsible lending obligations, even where they are adhered to.

Legal Aid NSW has acted for consumers who have entered into a contract for a car loan, but who have received no benefit of that loan, and in some cases did not know they were borrowing money. This has occurred where a customer's application for finance is rejected but the car dealer says: "does anybody in your family work?". The working family member is then contacted and asked to help their family member apply for the loan. In one case the working family member thought they were acting as a guarantor but were in actual fact the sole borrower. In another case, the family member thought they were co-borrowers but was the sole borrower.

Similar issues arise in the context of domestic violence. The Australian Bankers Association has identified a number of "red flags"[4], where it may be inappropriate to provide finance where the borrower receives no benefit and there are indicators of duress. However where the finance is arranged at a car dealer, the credit provider does not see the red flags. Typical scenarios involve a situation where the perpetrator of domestic violence has a poor credit history, and the victim does not. We have assisted women who signed contract for finance for a car for an abusive partner, often under duress. If she is able to escape the violence, she is often still left with the debt. One of our casework examples involves a situation where a car dealer said to a victim of financial abuse, "sign here, he is your husband". The relationship has now ended and he has the car while the debt is in her name. In this case the bank have agreed not to pursue her for the debt but will not remove her name from the loan.

Q2. Do remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies, or the interest to be charged to the customer, create an unacceptable risk that:

- ***dealers will prefer their own interests to the interests of customers; and***
- ***as a result, customers will suffer detriment?***

As discussed at Case Study one, our view is that the flaw in current remuneration policies is that they create a conflict of interest between the consumer and the employee, where the employee's imperative on making a sale is placed above compliance with the law and what

[4] ABA Industry Guideline: Financial Abuse and family and domestic violence policies

is appropriate for the consumer. In the case of car sales, this sale may be the sale of the car but it may also be the selling the finance or associated add on insurance products. This is conduct is exacerbated where targets are linked only to volumes of sales, rather than compliance and customer service outcomes.

The 2013 Treasury Paper outlines many examples of how consumers suffer detriment as a result of remuneration and incentive structures that reward car dealers for increasing the volume of their sales of cars or insurance policies.

This is consistent with our casework, where we see consumers who are encouraged to enter into loans which are significantly more than they can afford, and the loans frequently finance add on insurance products as well as the vehicle. This means customers are paying interest for an insurance product that offers them very little value.

The stage at which we see consumers in relation to inappropriate loans is when they are struggling with financial hardship and an event has triggered them to seek legal advice. They may have been contacted by a debt collector, be facing court proceedings for judgment or enforcement, or had their bank accounts garnisheed or have been contacted by Sheriffs who have a writ for possession of their personal belongings to be sold to pay the debt. This obviously has detrimental flow on effects for these consumers and their families, particularly children.

Concluding remarks

Legal Aid NSW submits the evidence supports a finding that banks prioritise sales above compliance with the regulatory framework and interests of customers. Where failures have been identified by regulators, banks are slow to act and resistant to remediation. Critically, they are slow to make systemic changes to ensure misconduct and breaches do not re-occur.

In the case of CCI add on insurance and the CBA, resources were deployed to resist ASIC intervention rather than remediate problems and compensate consumers. This conduct does not expose deficiencies in regulatory and legal obligations, but rather with industry's compliance with them. In addition, the consequences of non-compliance, particularly the penalties that are imposed, are not sufficient in order to act as a deterrent.

The Banking Code of Practice should drive cultural change and reform to the sector. Products should be designed to be safe and reliable for consumers at all stages of life, be available through appropriate distribution channels, and are sold in a system that allows for accessible remediation and systemic change if and when problems are identified.

Cultural change in the financial services sector requires support through legislation and regulation. For example, we urge legislative and regulatory change to review POS exemptions, and for more effective remedies for consumers when responsible lending obligations are breached.

In our experience, regulators and industry ombudsmen play a critical role supporting, monitoring and enforcing cultural change. Penalties must be set to provide a commercial deterrent. And legal services must be accessible to consumers in order to ensure they can protect and enforce their legal rights.