

SUBMISSION ON POLICY ISSUES IDENTIFIED IN THE INTERIM REPORT

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Submission for: My Self

Name of other person, business or organisation:

Do you agree to your submission being published: Yes

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Summary:

The Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry states that "almost all of the conduct identified and criticised in this report contravened existing norms of conduct" - primarily existing laws but also promises whether general (e.g. industry codes) or specific (e.g. product/service agreements) that usually have legal effect.

Consequently, it argues "that breaches of existing law are not prevented by passing some new law that says 'Do not do that'. And given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity."

Instead it advocates some "very simple ideas that must inform the conduct of financial services entities:

- Obey the law.
- Do not mislead or deceive.
- Be fair.
- Provide services that are fit for purpose.
- Deliver services with reasonable care and skill.
- When acting for another, act in the best interests of that other. "

And concludes these should be enshrined by simplifying the existing law rather than adding to it. The Royal Commission Interim Report also suggests that future regulation of simplified laws can be made much more effective to limit this misconduct.

The essence of my submission is that the above approach - which presumes existing laws are largely sufficient and focuses on how to minimise future breaches of them - will not address the broadest and most significant adverse impacts of the financial services industry on Australians, especially on those most vulnerable and least financially savvy.

The terms of reference of the Royal Commission primarily directed the focus to misconduct - breaches of existing laws and community standards. The Royal Commission then asked some financial services firms to self-report these breaches, and spent most of the hearings investigating breaches. Hence, the conclusion of the Interim Report is circular and unsurprising. It's self-limiting starting point is evidenced by simply saying "obey the law" without querying what laws might actually be needed to minimise the worst impacts of financial services on Australians. Or querying whether the law might currently be used by those who have wealth and power to make their primary rackets, exploitation and predation as legal as feasible?

Misconduct is just the tip of a much larger iceberg of adverse impacts of the financial services industry on Australians. It is entirely feasible to operate "efficiently, honestly and fairly" within existing Australian laws and industry codes and primarily extract wealth from people rather than create value for them and be compensated for it. **The key big picture issue is that modern capitalism is plagued by currently-**

legal activities whose core purpose is to extract value rather than create it.

This phenomena isn't unique to Australia and occurs in all contemporary capitalist economies. Unsurprisingly, then, there is a constructive inquisition into how capitalism can better serve society going on in most democracies around the world. Unfortunately, in terms of the penetration of critical concepts - like value creation versus extraction - into mainstream media, politics and ordinary conversation, Australia is lagging not leading. The public appetite is there, particularly among some young people, but so far those who benefit most from the status quo have managed to stifle mainstream debate over the really consequential ideas such as: financialization, shareholder value/primacy, earned vs unearned wealth, productive vs unproductive activity, rentier capitalism, political and regulatory capture, and [neoliberalism](#).

Little of these deeper explanations has been examined in the Interim Report.

But can you really reform financial services without winding back financialization?

Can you permanently change the single-minded focus on profits without addressing the single-minded focus on shareholders?

Can you genuinely create more ethical wealth-seeking behaviours by those working in financial services without differentiating between earned and unearned wealth?

Can you actually drive firms to provide value-for-money products and services without changing the laws and incentives driving productive and unproductive activities?

Can you achieve substantially better policy and regulation without addressing political and regulatory capture?

Can you significantly change the culture within firms and industries without a broader cultural and political shift away from neoliberalism?

And can citizens ever really protect themselves from exploitation if they remain captive to the norms that engender it such as consumerism, status and happiness being achieved primarily through material wealth, the necessity of debt, whether most financial products and services are even necessary, and a lack of financial savviness?

Regardless of the limited scope of any inquiry into the conduct of financial services, I'd argue it must reference these deeper, causative ideas rather than be ignorant of them or actively preclude them. It cannot be "out of scope" to describe how the world really works, what the root causes of problems really are, and the type of changes needed to affect them.

In the remainder of this submission, which is specific to the Interim Report, I examine some of the financial products that were covered during the first four rounds of hearings. But, rather than focusing on misconduct, I highlight evidence or questions that indicate the larger adverse impact on Australians is due to the extractive nature of the industry and products themselves, as well as the other deeper explanations noted above. For some exemplary financial products I conclude with a simple verdict as to what the biggest issue is: Misconduct or Wealth-Extracting Product?

Rather than be exhaustive in this submission and produce a single, lengthy document that has a different focus to the Interim Report (breaches of existing laws), I will be using a blog to provide an ongoing series of separate posts that examines the underlying causes cited above. This will include specific evidence on many more of the currently-legal activities whose core purpose is to extract value rather than create it.

The real issue with funeral insurance wasn't misconduct it was value extraction

Funeral insurance has been provided to hundreds of thousands of Australians, almost all of it by firms operating **efficiently, honestly and fairly** within existing laws. Yet, over 98% of these people would have been far better off by putting their money into an online savings account or superannuation.

If the product itself is designed as a value extraction activity and is entirely legal, of course the provider will aim to be **efficient**. They'll sign you up and keep you enrolled as efficiently as possible. They'll take the money as efficiently as they can (direct debit). If your direct debit fails at some point due to lack of funds they won't cancel it, they'll proactively contact you in order to continue it.

If the product is designed as a value extraction activity and is entirely legal, of course the provider will aim to be **honest** in all of its obtainable written and recorded communication - that is, any communication that if false could easily result in a restriction on exploiting the activity. For example, on the questions of whether there is any refund of premiums if you ever cancel. Or whether you can be paid out an expense amount that is less than the total of premiums paid. The terms are always legal, correct and thus honest. You don't jeopardise an entirely legal and lucrative activity that can happily be run for decades. The operators or staff that overstep the law are simply replaced by the long-term extractors who know how to play the game.

If the product is designed as a value extraction activity and is entirely legal, of course the provider will aim to be **fair** in providing what has been agreed. Unfairness isn't needed, the provider isn't after a quick ripoff, they want the customer to continue paying for as long as possible. Some funeral insurance providers even forgive occasional or temporary missed payments in order to continue the long-term extraction. Some "generously" offer the first year free. If at some stage a customer can't afford the premium many providers will lower it to whatever level the customer can afford and just cut back the benefits too. The core problem isn't being treated unfairly, if that is taken to mean not getting what you signed up for and paid for. The problem is that products like funeral insurance are explicitly designed to extract value not provide it.

Interestingly, Royal Commission evidence and submissions demonstrated all of the above showing that funeral insurance is generally provided legally, efficiently, honestly and fairly.

If we followed the principal Interim Report approach of enforcing existing laws and honest and fair dealing but not questioning the value and thus legality of much current economic activity then we could at best eliminate every single consumer of funeral insurance who had been dealt with illegally, or outside of industry codes, or unfairly according to the terms of their product, or had been misled, or provided a product that wasn't true to label. But we would eliminate less than 5% of consumers. The other 95% would continue to have their wealth extracted till dead or financially exhausted. The funeral insurance industry would be delighted with that outcome.

Verdict: Wealth-Extracting Product

Proper Resolution: Funeral insurance should be banned completely as there are better options for 100% of customers. As part of their CSR/ESG activities, Australia's largest financial services firms should create and proactively facilitate the use of zero-fee protected savings products for disadvantaged and vulnerable Australians who misguidedly use funeral products as a way of saving.

The most importance sentence in the Interim Report

No, not the obvious one quoted [3,640 times](#) suggesting why the misconduct happened:

"Too often, the answer seems to be greed – the pursuit of short term profit at the expense of basic standards of honesty."

I'd argue the most important sentence is this one regarding funeral insurance policies but it was quoted [only once](#):

"If they give little value, how are they sold?"

Despite the best efforts of those who would rather not see an inquisition into modern capitalism, you can't fully suppress the most salient truths. When you eliminate illegality, deception, unfairness and all other potential misconduct, and still see the vast majority of consumers of a product being fleeced, you can't escape the naked reality: it is the product and industry itself which is extracting wealth while delivering poor value in return.

To restate this most important question more generally and usefully: **If a financial product or service has poor value for money, why isn't it illegal?**

I've replaced value with value for money as most financial products offer some value and many could be claimed to offer lots of potential value (insurance is a good example) **if you ignore the money paid and likelihood of benefits being obtained**. What matters is the **expected value** of the benefits compared to the costs. Focusing only on value also incorrectly leads many consumer advocates to narrow their concern to "junk products" (where benefits turn out to be very limited or hard to claim) but miss the reality that **all** financial products across the entire spectrum have an expected value and thus value for money rating. Products with considerable potential benefits that can be reliably claimed can also offer very poor value for money in relation to their expense.

The Interim Report in **Section 4: Pending changes in the law** notes the proposed "Design and distribution obligations on issuers and distributors" and ASIC "Product intervention power" which could be used to "ensure that products are targeted at the right people" including restricting distribution and even banning products.

The report refers to this possible product intervention power in asking whether funeral insurance for those under 18 should be made illegal as it gives so little value. This is the only time in the entire report where restricting or banning a financial product purely because of how little value it offers is explicitly suggested.

But, no matter, this key idea is now out of the bag. So let's follow the thread and see where else it might logically be applied? Where else does the Interim Report refer to a financial product having poor value for money?

Searching high and low for poor value financial products

I searched the Interim Report for references to the value, worth, usefulness or utility of financial products to consumers, or their profitability/margins for providers, or terms like "junk insurance" but there was only one other reference which was with respect to Add-on insurance:

"Are certain types of add-on insurance, by their nature, poor value propositions for customers?"

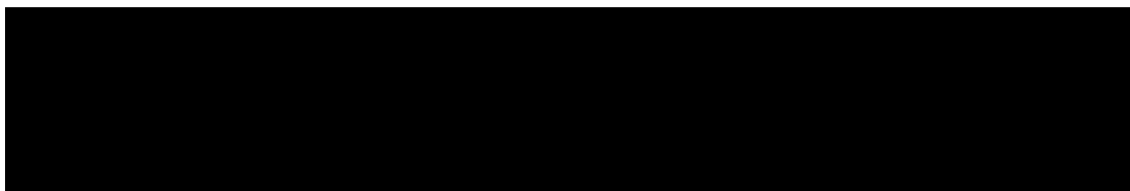
Add-on insurance is explained in Section 3.4:

"Consumer credit insurance has been a common form of insurance sold in connection with different forms of credit arrangements, including credit cards, personal loans, car loans and home loans. The policies are sold as insurance that will respond to some events that may prevent or hinder the borrower meeting the obligations undertaken to the lender. The principal events are death, disability or unemployment.

In addition, other forms of 'add-on' insurance have been sold in connection with the financing and sale of motor vehicles. Those other forms of insurance include comprehensive motor vehicle insurance (covering loss or damage to the vehicle), 'tyre and rim' insurance (sold as covering the cost of replacing tyres or wheel rims damaged by accident), 'gap' insurance (sold as covering the gap between the value of the vehicle and the amount owed on the loan used to buy it) and 'mechanical' insurance (sold as providing cover for the consequences of mechanical breakdown).

Entities that sell add-on insurance commonly receive a commission on the sale fixed by reference to the amount of premium charged. Since the NCCP Act, the commission that may be paid for has been capped at 20%. In 2011, ASIC reported that the net loss ratio for consumer credit insurance (calculated as the net incurred claims divided by the net premium revenue) for the years 2008 to 2010 had varied from 18% in 2008 to 34% in 2010. For more recent years, figures published by APRA in its General Insurance Claims Development Statistics recorded an ultimate net loss ratio for consumer credit insurance of about 20%. Consumer credit insurance has been, and remains, a very profitable form of insurance."

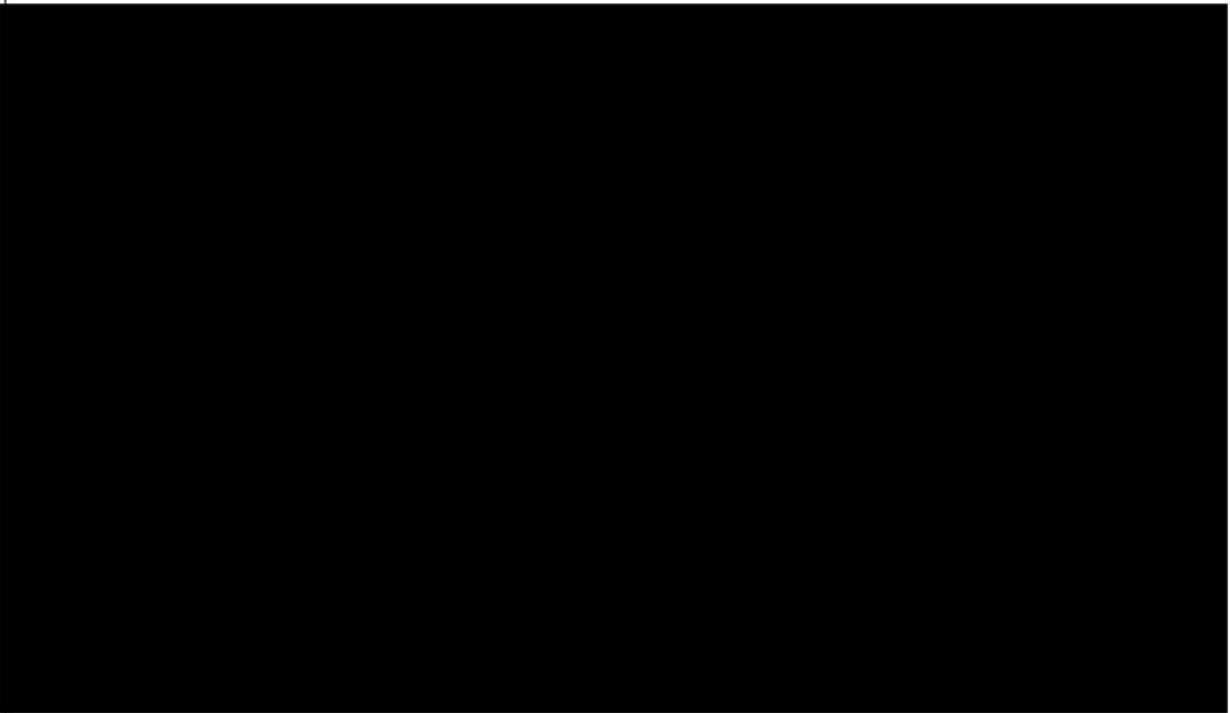
The Royal Commission hearings and Interim Report focused on the self-reported conduct issues, such as where add-on insurance was sold even when the customer would be ineligible for some of the benefits. In response, providers [REDACTED] withdrew products temporarily claiming they'd bring them back in a better-targeted way:








But the real issue of wealth-extraction is hiding in the details. 





Even if  back its loan insurance products with wealth-extraction ratios of 80% or even 60%, these are appallingly poor value products. Competition and savvy consumers shopping around won't ever drive the margins on such products to acceptable levels because financially-savvy consumers don't consider loan insurance necessary or worthwhile.

Despite what  says about meeting "important customer needs" there's no inherent demand for such products either. Since  temporarily took them away a negligible proportion of customers, if any, would have asked for them. These are predatory products created to extract wealth from the financially-naive and vulnerable. Rather than being a solution to financial stress, they are sold to loan customers by preying on their anxiety.

Note that in the quote from Section 3.4 we find out that the most recent APRA data indicates a "net loss ratio for consumer credit insurance of about 20%." This equals a gross profit margin across all such products of about 80%.

Verdict: Wealth-Extracting Product

Proper Resolution: Retail add-on insurance should be banned. All of it has extremely high profit margins, thus terrible value-for-money, and is sold predominantly to financially-naive consumers who can least afford extra repayments. All types of add-on insurance are dominated in terms of financial value by the consumer saving the premiums, or paying off their debt faster, or, if in a financially-insecure position, minimising their debts by forgoing or delaying consumption.

Consumer Lending

The Interim Report provides much worthwhile information regarding issues with intermediaries like brokers (including remuneration incentives), representation of the consumer's interest when using brokers or intermediaries playing an agent role, suitable lending obligations, and "customer needs" purely being treated as product selling opportunities.

However, it is in this section where it becomes abundantly clear how ineffective it would be to focus recommendations primarily on enforcing compliance with existing laws.

The vast majority of the problematic conduct reported or identified was **not in breach of existing laws**, so enforcing compliance wouldn't prevent it.

Most of the self-reported problematic conduct was reported as "conduct falling short of community standards" but these standards aren't defined or readily enforceable. Once the scrutiny of a Royal Commission fades it will be back to business as usual if the law hasn't changed and deeper causes haven't been addressed.

Moreover, some of the conduct that is in breach of some part of existing laws is problematic to enforce in a simple way. For example, virtually all customers want lenders to approve loans for their applied amounts regardless of strict compliance with responsible lending obligations. It is only if things turn out badly afterwards with the loan that customers claim the responsible lending obligations should have been used to limit their borrowing. Some of the suggestions for extra diligence, such as for working out actual expenses based on collecting and analysing expense statements, would either be found impractical or to substantially add delays and costs.

There is no mention of paternalism in the Interim Report. And there's barely any mention of affected customers being naive, unsophisticated, uninformed or not financially savvy. Let alone, sometimes lazy, injudicious or even dishonest - such as in deliberately underestimating their expenses so as to be lent more money. Yet, one of the most worthwhile actions that becomes clear from reading the entirety of the Interim Report is the need to protect consumers from their own lack of saviness, or poor judgement, or even dishonesty.

For example, Personal Finance 101 says: "Do not ever carry a balance on a credit card. Unless never paying interest and using them for cashback or rewards only, you shouldn't need a credit card."

There are no exceptions to this rule. No-one is better off by breaking it. But millions of Australians break it to their own long-term detriment.

Hence, it should be obvious that one can achieve much more for consumers in a paternalistic way by:

- Banning sending anyone a pre-approved credit card
- Banning provision of a credit card with other financial products or services (e.g. home loans)
- Banning unsolicited increases in credit card limits (and marketing/communication offers of increases)
- Requiring providers to obtain explicit continuation/renewal approval from customers for all credit cards with annual fees that haven't been used for over 12 months
- Capping interest rates on credit cards at some level less than 20%
- Capping all fees in proportion to their cost to eliminate fee-gouging
- And so on for any issue or conduct problem cited just add the strongest legal restriction feasible

The same paternalistic, restrictive approach can be applied to all relevant aspects of all financial products that are not in most consumer's interests.

