Financial Services Royal Commission

Interim Report

Legal Aid NSW submissions in response

October 2018

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Legal Aid NEW SOUTH WALES

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Questions raised in specific sections of interim report:

Introduction

Legal Aid NSW welcomes the opportunity to provide written submissions following the release of the Interim Report by the Royal Commission in to Misconduct in the Banking, Superannuation and Financial Services Industry (the Commission).

Our responses to the questions raised by the Commission are directly informed by the legal services we provide to consumers in NSW, including many Indigenous consumers who are part of remote and regional communities. The Commission has highlighted critical systemic issues in the conduct of banks and brokers, and providers of funeral insurance. In our view the community rightly expects banks and other financial services 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 lending 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 raised in this report focuses on the areas where we have the most direct case work experience including:

- Consumer lending including issues arising out of the use of brokers and intermediaries;
- Third party guarantees;
- Funeral insurance;
- Remote communities.

The final part of our discussion focuses on the power and resources of ASIC. Legal Aid NSW considers that ASIC's remit is appropriate, however we support increased resourcing for ASIC. Any changes made as a result of the Royal Commission will only be effective if they are enforced. This requires commensurate funding for ASIC.

Chapter 2: Consumer Lending

Question: What duties should an intermediary owe to a borrower?

Legal Aid NSW strongly supports a legislative requirement that intermediaries must act in the best interests of the borrower. 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 the case studies from Round 1. The current legal position and the Combined Industry Forum proposals do not set a legal standard which meets community expectations, namely that where an intermediary is instructed to act on the borrower's behalf they will do so in the consumer's best interest.

Question: How can entities' systems be improved to detect and prevent breaches of responsible lending obligations by intermediaries?

To ameliorate the issues highlighted in the case studies from Round 1, reform is also required by banks assessing loan applications submitted by intermediaries. Critically, lenders need to actively engage with the loan application submitted on the customer's behalf; as though it were submitted to the bank directly by the customer. The bank should actively make reasonable inquiries and seek verification from the consumer, rather than relying solely on the information that is provided by the intermediary.

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 of dealing with vulnerable consumers, particularly those experiencing domestic violence, direct communication with the consumer could have led the bank to identify the consumer's 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.

Question: Are 'introducer' programs compatible with responsible lending obligations?

No. 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.

The case studies from Round 1 highlight 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/intermediary 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/intermediaries, introducers and bank employees when misconduct is identified.

NAB's evidence to the Commission 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/intermediaries may be included in the program even where they arrange commercial loans. This may create a financial incentive for brokers/intermediaries to encourage consumers to enter into commercial loans, even if their loan purpose is for household or domestic use;
- Introducers who are not brokers/intermediaries (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); and
- 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.

Question: Do broker contracts, as they stood at the time of the hearings, meet the statutory requirement imposed by Section 912A of the Corporations Act 2001 (Cth) to have arrangements in place to manage conflicts of interests? Do broker contracts, as now made, meet those requirements?

Question: What should be disclosed to borrowers about an intermediary's obligations to the lender and to the borrower?

Our casework experience indicates that there is a misalignment between the consumers' understanding of an intermediary's role, the intermediary's role in practice and the position at law. While generally a broker is considered to be an agent of the borrower, in our casework experience consumers often perceive that the broker's role is to represent and assist both the consumer and the bank.

Factors contributing to this perception include:

- the consumer often has no direct contact with the financial institution, instead relying on the broker/intermediary to explain and execute loan documents with the consumer;
- a belief that 'accreditation' with a particular lender means the broker/intermediary is the lender's representative;
- Broker/intermediary 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".[1]

An intermediary is obliged to disclose to the borrower the intermediary's statutory obligations, in accordance with the NCCP Act. An intermediary should be obliged to disclose to a borrower, as transparently as possible, their links/associations with the lender, with a particular focus on the intermediary's remuneration from the lender.

Question: What should be disclosed to borrowers about an intermediary's remuneration?

As much information as possible should be disclosed to borrowers about an intermediary's remuneration. This information could assist a borrower in making an informed assessment about the actual role of the intermediary in that particular borrower's situation.

Remuneration structures that reward intermediaries for volumes of sales create an unacceptable risk that intermediaries will prioritise the sale of loans over their legal obligations and obtaining a suitable loan for the borrower. If remuneration structures are made more visible to borrowers it may lead to changes to such remuneration structures which will promote a culture focussed on customer wellbeing rather that sales targets.

Question: What steps, consistent with responsible lending obligations, should a lender take to verify a borrower's expenses?

Currently some lenders only consider the income and expenditure information available from the borrowers' bank accounts with that particular lender. Legal Aid NSW submits that lenders must review information available in statements from all of the borrower's accounts and regardless of whether or not they are held by the lender about an existing customer.

We also recommend clarification of ASIC's Regulatory Guide 209 to require to reflect this. that borrowers review all bank statements .Our case work experience indicates that a consideration of a borrower's bank statement leads to a more accurate assessment of a borrower's true financial situation and therefore whether the loan is suitable.

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

Question: Do the processes used by lenders, at the time of the hearings, to verify borrowers' expenses meet the requirements of the NCCP Act? Do the processes now used meet those requirements?

No. 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 to illicit information 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;
- obtaining documentary evidence of easy to verify essential expenses, such as energy and telecommunications bills; and
- consideration of the consumer's bank statements.

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 House hold Expenditure Measure (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 bank account balance; and
- undeclared debts, where evidence of these is apparent from bank account statements.

The evidence from Round 1 of ANZ choosing 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.

Question: Should the HEM continue to be used as a benchmark for borrowers' living expenses?

Yes, however, the 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.

Question: Is the offer of a credit limit increase, where the customer has consented to receive such marketing, consistent with the NCCP Act obligation not to provide credit that is not unsuitable for the customer, having regard to their requirements and objectives?

No. In this situation the offer of a credit limit increase is not consistent with the NCCP Act obligations placed on the lender.

Question: Is the offer of a credit limit increase based only on information held by the bank about a customer a breach of the NCCP Act obligation to take reasonable steps to verify the consumer's financial situation?

Yes. In our case work experience customers can have multiple debts with a number of different lenders. It is insufficient for a bank to rely on only the information that they hold, to make an assessment of a customer's financial situation when considering a credit limit increase.

Question: When an employee or intermediary is terminated for fraud or other misconduct, should a licensee inform their clients of the reason for termination?

A licensee should consider the impact on those clients who may be directly affected by the conduct of the terminated employee. Licensees should have a consistent procedure in place that protects everyone's interests.

Question: When an employee or intermediary is terminated for fraud or other misconduct, should a licensee review all the files or clients of that employee or intermediary for incidence of misconduct?

Yes. It would be in the best interests of both the clients and the licensee for such a review to take place in a timely manner.

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

Yes, Legal Aid NSW refers to the research done by Choice[2], Consumer Action[3] and the General Insurance Code Compliance Committee[4] in this regard. This conclusions of this research is consistent with casework of Legal Aid NSW. Many products, particularly CCI insurance and Extended Warranties on cars contain so many restrictions or exclusions that they are of little or no value to the insured.

[2] tps://www.choice.com.au/money/insurance/car/articles/junk-car-insurance.
[3] https://consumeraction.org.au/junk-insurance-and-rubbish-warranties/.
[4] https://www.fos.org.au/custom/files/docs/code-governance-committee-who-is-selling-insurance-report.pdf.

In spite of this the people who sell these products usually receive very large commissions, yet the sale of these products remains largely unregulated. Further, if a consumer has a complaint about the claims handling process it is unclear who they can complain to, or what redress, or EDR scheme (at least prior to commencement of AFCA) they may have access to.

Chapter 4: Small and medium enterprises – third party guarantees

Introductory remarks – Flanagan case study

Our submission focuses on the case study of Ms Carolyn Flanagan, a client assisted by Legal Aid NSW. Our response to the questions raised by the Commission in this section is informed by the legal services we provide to consumers and guarantors of business loans for the benefit of a third party.

In addressing the Commission's questions, we have structured our response using three themes: (1) the inadequacy of the current law; (2) reflections on the balance between consumer protection and consumer choice; and (3) proposals for improvements to the law.

Inadequacy of the current law

Question: Is there a reason to shift the boundaries of established principles, existing law and the industry code of conduct?

Yes. Legal Aid NSW considers that the current law does not go far enough in protecting vulnerable people and making sure they make informed decisions when contemplating financial transactions that could have devastating consequences.

As we noted in our Written Submissions to the Round 3 Hearing[5] (**Written Submissions**) and Ms Beiglari's oral evidence, the clients that Legal Aid NSW assists with guarantee disputes are regularly older, vulnerable people. Often, these clients view the transaction as providing help to a loved one, without fully understanding the implications of the contract. Some may have been pressured or misled by family members to sign the guarantee.

[5] Legal Aid NSW, Written Submissions – Round 3 Hearing, 1.

We are concerned that the current law does not offer adequate safeguards to protect prospective guarantors at the point of considering and entering into the guarantee. In support of this position, we refer to our Written Submissions[6].

In summary, we submit that the current law has the following limitations:

- Majority of protections operate after the financial transaction has been completed;
- Protections, such as the laws of unconscionability, are legally complex to argue and have had an inconsistent application by the courts;
- Protections require a strong recollection of the factual scenario, often contrary to what appears plain from the documents;
- Presence of legal advice can restrict the availability of protections; and
- Some protections, such as the Code of Banking Practice (the **Code**), are only binding on banks that volunteer to be bound by it, and it does not apply to non-bank lenders.

Balance between consumer choice and consumer protection

Question: How is the law to deal with the undoubted fact that a parent may guarantee a loan to an adult child because the parent wishes to support and encourage the child's ambitions?

Legal Aid NSW recognises the importance of striking the right balance between sufficient protections for prospective guarantees, and allowing people the freedom to choose to help their adult child by becoming a guarantor for their child's loan.

In deciding how the law should strike this balance, we submit that it is useful to consider two classes of parents considering becoming a guarantor. Both classes of parents wish to support and encourage their child's ambitions. Both classes may have some vulnerability, but have the capacity to enter into a contract. The first class of parents does not understand at all the terms of the guarantee, or has some general understanding of the terms, but does not understand the specific implications and tangible risks of the transaction. The second class thoroughly understands the implications and risks of the transactions.

Ms Flanagan is an example of a parent in the first class of prospective guarantors. She understood generally the meaning of a guarantee, but she did not understand the amount of money that she was guaranteeing, nor how her Centrelink benefits and health and aged care choices may be affected. This was the case even though she had received legal advice, on the face of the documents. In our casework experience, Legal Aid NSW assists many clients like Ms Flanagan who fall within the first class of prospective guarantors.

In our view, an adequate balance between consumer protection and consumer choice is struck where the law prevents the first class of parents from entering into a guarantee, but

[6] Legal Aid NSW, Written Submissions – Round 3 Hearing, 2.

allows the second class of parents to do so if they wish. As we explain in the following section, this might be achieved by reforming the process of entering into a guarantee, with obligations for lenders to take reasonable steps to ensure the guarantor understands, and can demonstrate their understanding, of the financial transaction. Through this process, the first class of parents could change and join the second class, by becoming properly informed about the risks and implications of entering into the guarantee.

Another important factor, which may affect either class of parents, is where the guarantor would suffer substantial financial hardship if they had to repay the loan. Legal Aid NSW has strong concerns about lenders entering into guarantees in these circumstances. However, again to balance the concepts of protection and autonomy, we propose that the guarantor can elect to enter into the guarantee provided they receive independent advice, are fully informed about the specific risks to their life, and can demonstrate their comprehensive understanding of the transaction.

Question: If established principles of judge-made law and statutory provisions about unconscionability would not relieve a guarantor of responsibility under a guarantee, and if, further, a bank's voluntary undertaking to a potential guarantor to exercise the care and skill of a diligent and prudent banker has not been breached, are there circumstances in which the law should nevertheless hold that the guarantee may not be enforced? What would those circumstances be? Would they be defined by reference to what the lender did or did not do, by reference to what the guarantor was or was not told or by reference to some combination of factors of those kinds?

Question: If the guarantor is a volunteer, and if further, the guarantor is aware of the nature and extent of the obligations undertaken by executing the guarantee, is there some additional requirement that must be shown to have been met before the guarantee was given if it is to be an enforceable undertaking?

Yes. Legal Aid NSW considers that there are circumstances in which the law should (but may not currently) hold that a guarantee may not be enforced. In our view, Ms Flanagan's case study is a significant example of this. As the Commission suggests, we consider that these circumstances should be defined by a combination of factors, including:

- What the lender did or did not do when entering into the financial transaction;
- What the guarantor was or was not told, by the lender or other person;
- If the guarantor could demonstrate their comprehension of the terms and conditions of the contract before signing the guarantee;

- The guarantor's ability to service the loan should the guarantee be called upon, and the lender's assessment of this;
- If the guarantor received meaningful independent legal and financial advice; and
- If the guarantor received meaningful advice about the viability of the proposed business financed by the business loan.

With these factors in mind, we propose that the current laws should be amended to ensure:

- that the process of entering into a guarantee equips prospective guarantors with information tailored to the individual circumstances of the transaction so that they can make a fully informed decision; and
- that the process of enforcing a guarantee takes into account the potential vulnerabilities of the guarantor.

Entering into a guarantee

We outline below a number of obligations that should be placed on lenders when entering into a guarantee with a volunteer, or a person who does not stand to gain any tangible benefit from the transaction. We consider that the proposed changes should be included in both the Code and the *National Consumer Credit Protection Act 2009* (Cth) (the **NCCPA**).

In summary:

1. The lender should take reasonable steps to verify if the guarantor is receiving a direct financial benefit.
2. The lender should conduct a suitability assessment of the loan for the guarantor and the borrower, and provide these assessments to the guarantor. Where appropriate, the lender should explicitly warn the guarantor and their legal advisor that the loan has been assessed as unsuitable for the guarantor.
3. The lender should provide information about the viability of the business, as compared to similar businesses, to the guarantor and their legal advisor.
4. The lender should provide information about the impact that the transaction may have on the guarantor's Centrelink benefits, and health and aged care choices to the guarantor and their legal advisor.
5. The lender should obtain written notice from the guarantor that they have obtained independent advice, or waived their right to do so.
6. The lender should be satisfied that they have taken reasonable steps to fully inform the guarantor about the risks and implications of the transaction, and that the guarantor can demonstrate this understanding.

Where the lender does not comply with any of these obligations, and where the guarantor is a volunteer or has not received a tangible benefit, we consider that the guarantee should not be enforceable against the guarantor.

Obligation 1: Verifying direct financial benefit

Further to the evidence raised by the Commission[7], we have concerns about the process that Westpac undertook in assessing if Ms Flanagan would receive a direct financial benefit by entering into the guarantee.

We recommend that lenders be required to take reasonable steps to inquire about and verify the direct financial benefit that the guarantor will receive as a result of the transaction.

Obligation 2: Undertaking a suitability assessment

As noted in our Written Submissions[8], we consider that the Code should impose a positive obligation on banks to assess the suitability of the loan for a guarantor who stands to gain no tangible financial benefit, in particular if the arrangement would cause the guarantor substantial hardship if the guarantee is called upon. The suitability assessment should be shared with the guarantor in a comprehensible way. We provide further information in the section below about how meaningful disclosure of this information could be achieved.

Where the loan has been assessed as unsuitable, this information should be explicitly provided in the form of a warning to the guarantor and their legal advisor. Legal Aid NSW has significant concerns about lenders entering into guarantees where the prospective guarantor is likely to suffer substantial financial hardship if the guarantee is called upon. However, in order to facilitate a balance between protection and autonomy in this area of the law, we propose that a guarantor may decide to enter into the guarantee following an assessment of unsuitability, provided they receive legal advice, and can demonstrate their comprehensive understanding of:

1. The terms and conditions of the guarantee;
2. The outcome of the suitability assessment of the guarantor and the borrower;
3. The viability of the business;
4. How, because the loan has been assessed as unsuitable for them, it is very likely that they will need to sell their home to pay the loan if the guarantee is called upon; and
5. The significant impact that paying the loan would have on their Centrelink benefits and health and aged care choices.

Obligation 3: Improving disclosure about the business

The evidence that came to light during Ms Flanagan's case study showed that Westpac's assessment of the viability of the Poolwerx business was significantly lacking. Further, the assessment that Westpac did conduct about the business and its ability to service the loan was not provided to Ms Flanagan.

[7] Transcript of Proceedings, In the Matter of a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 22 May 2018.
[8] Legal Aid NSW, Written Submissions – Round 3 Hearing, 2.

We consider that the law should impose a positive obligation on the lender to disclose to the guarantor their assessment of the viability of the business, the business' ability to service the loan, the borrower's financial position and the reason why the lender requires the guarantee. This could include a warning about the number of businesses that fail in the bank's experience, where possible. For example, the bank could inform the guarantor that franchises similar to the franchise being purchased by the business loan commonly fail within a certain period of time, such that the guarantee is called upon.

We provide further information about how the lender might achieve meaningful disclosure to the guarantor in the section below.

Obligation 4: Improving disclosure about impact on Centrelink payments and on health and aged care choices

Centrelink payments

As noted in our Written Submissions[9] and in our submission to the Khoury Review[10], Legal Aid NSW recommends that additional safeguards be placed in the Code about the impact of Centrelink's gifting rules to ensure that vulnerable people are not placed in further hardship. Specifically, we recommend that the Code be amended to:

- Require banks to provide a mandatory disclosure notice to customers informing them that acting as a guarantor (and also mortgaging a property) can affect the guarantor's Centrelink income;
- Require banks to have a discussion with the guarantor about the content of this disclosure notice;
- Require banks to be satisfied that the guarantor can demonstrate their understanding of the above information; and
- Require guarantors to provide evidence to the bank that they have received legal and financial advice about the potential impact of the guarantee on their Centrelink income.

Health and aged care

As noted in our Written Submissions[11], we recommend that the Code should:

- Require banks to provide a mandatory disclosure notice to customers informing them that acting as a guarantor (and also mortgaging a property) can affect the guarantor's aged and health care choices;
- Require banks to have a discussion with the guarantor about the content of this disclosure notice;
- Require banks to be satisfied that the guarantor can demonstrate their understanding of the above information; and

9 Legal Aid NSW, Written Submissions – Round 3 Hearing, 4.
10 Legal Aid NSW submission to the Australian Bankers' Association, August 2016.
11 Legal Aid NSW, Written Submissions – Round 3 Hearing, 4.

- Require guarantors to provide evidence to the bank that they have received legal and financial advice about the potential impact of the guarantee on their aged and health care.

Obligation 5: Improving process of receiving independent advice

We recommend that the present requirement in the Code that a bank notify the guarantor that they should seek independent legal advice should be strengthened. The present requirement should be accompanied by a positive obligation on the bank to obtain written notice from the guarantor as to:

- Whether they have obtained independent legal and financial advice; and
- Where they have not obtained this advice, indicating that they understand that they have actively waived their right to do so.

Banks should also have a positive obligation under the Code to provide further information to the guarantor and their legal advisor, such as the borrower's financial position, that the guarantor's asset is being relied upon, the reasons why the bank requires a guarantee before entering into the credit contract, and the suitability assessments.

We recommend that legal advisors use this information to provide advice about the advantages and disadvantages of the financial transaction. In making this suggestion, we refer to the process of making a binding financial agreement in the family law context. Section 90G(1)(b) of the *Family Law Act 1975* (Cth) provides, amongst other things, that a financial agreement is binding on the parties if, and only if:

> before signing the agreement, each spouse party was provided with independent legal advice from a legal practitioner about the effect of the agreement on the rights of that party and about the advantages and disadvantages, at the time that the advice was provided, to that party of making the agreement.[12]

Obligation 6: Ensuring guarantors are fully informed and can demonstrate understanding of the transaction

Westpac's current lending policy provides:

> Exercise extreme caution where parents are offering to guarantee the business borrowings of their children. Before accepting these types of guarantees make sure that the guarantor demonstrates that they are making a fully informed decision and that they are fully aware of their potential liability.[13]

Despite having this policy, Westpac allowed Ms Flanagan to enter into a guarantee without being fully informed about her decision and without being fully aware of her potential liability. To avoid this outcome in the future, we recommend an obligation for lenders to fully inform prospective guarantors about the risks and implications of the financial transaction, and be satisfied that prospective guarantors can demonstrate their

[12] *Family Law Act 1975* (Cth), s 90G(1)(b).
[13] Interim Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 2: Case studies, p.261.

comprehensive understanding of this information. We refer to our comments under the heading 'Obligation 2' which set out the key points of information that guarantors should be required to demonstrate their knowledge about.

In addition to the obligations proposed above, we note Legal Aid NSW's strong support that the proposed Design and Distribution Obligations apply to regulated and unregulated credit products[14].

In our view, the exclusion of credit under the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* is a missed opportunity to improve consumer protections in respect of credit products, including third party guarantees.

Enforcing a guarantee

In our experience, Ms Flanagan's experience of Westpac's enforcement of the guarantee, and their failure to properly consider her hardship assistance request at first instance, is not uncommon. To improve this process, we submit that lenders should be required to take into account the potential vulnerabilities of the guarantor when enforcing a guarantee.

Question: Legal Aid NSW proposed that a lender should be required to make an assessment about whether the contract of guarantee would be unsuitable for the guarantor because it is likely that, at the time the guarantee would be given, the guarantor could meet a call on the guarantee only with substantial hardship. Would that be a rule to be applied to all guarantors (and thus the principals of a corporate borrower)? If a contract of guarantee were to be assessed as unsuitable for the guarantor, what would follow: a warning to the potential guarantor or prohibition of the transaction? Would adopting provisions of this kind mean, in practice, that a guarantor could never provide his or her place of residence as security for the guarantee?

We refer to our comments in the above section. In summary, Legal Aid NSW has strong concerns about lenders entering into a guarantee where the guarantor (acting as a volunteer) cannot pay the loan without substantial financial hardship. We do not think lenders should enter into guarantees in these circumstances. However, to allow Australians to make their own decisions about their own property, and often the way they want to support their family, we consider that a guarantor may choose to enter into the guarantee provided they receive independent advice, are fully informed about the transaction, including a warning about the implications of the suitability assessment, and can genuinely demonstrate this understanding.

[14] Design and Distribution Obligations and Product Intervention Powers - Legal Aid NSW submission to the Treasury, August 2018.

Question: Would the provision of advice (legal, financial or both) permit giving a guarantee otherwise judged to be 'unsuitable'?

No. Legal Aid NSW does not consider that the mere provision of legal and financial advice would 'cure' a guarantee that is assessed as unsuitable. The guarantor must be fully informed about their rights and obligations, have a genuine understanding of the financial transaction, and be able to demonstrate this understanding. We note our comments in the previous section about measures we suggest could improve the provision of advice.

Question: If the concern is protection of the vulnerable, how could the relevant class be defined in a way that was neither over-inclusive, nor under-inclusive? Legal Aid NSW pointed out, in its submissions that '[a]llowing a Centrelink recipient (usually an older person or a person with a disability) to act as a guarantor means that an already vulnerable person will likely become homeless, or dependent on social housing funded by the State, if the debtor defaults on the credit contract'. Is being a Centrelink recipient to be treated as a disqualifying characteristic?

As noted in the previous section, we consider that a suitability assessment of a person's ability to service the loan, and a process that focuses on fully informing the guarantor, ensuring they have a genuine understanding of the transaction and can comprehensively demonstrate that understanding, will serve as a strong protection for the vulnerable. We do not propose that a class of vulnerable people be defined.

Question: Is protection of the vulnerable achieved, or advanced, by providing potential guarantors with more information? Should lenders tell some potential guarantors that giving a guarantee may affect what choices they can make about health or aged care? Should lenders give potential guarantors more information about the borrower or the proposed loan? What information could be given with respect to a new business?

Yes. It is paramount that potential guarantors are well informed about the legal implications and risks of entering into a guarantee.

As noted in the above section, Legal Aid NSW recommends, amongst other things, that lenders should be obliged to inform potential guarantors about how the financial transaction may affect their Centrelink pension, and their health and aged care. Lenders should also inform guarantors about their assessment of the financial viability of the business, and the risk that the business, or a similar business, would default in respect of the loan.

It is important that this information is communicated in a meaningful way, using plain English. Research from Stanford University's Law School Law Lab notes that effective disclosure can be measured by its ability to:

1. Engage the target audience's attention;
2. Improve the audience's comprehension of the material presented;
3. Improve the individual's decision-making, so it corresponds with her own values and interests; and
4. Get the individual to follow through on the decision she has made.[15]

This research also noted a number of strategies that can be employed to achieve effective disclosure, including use of plain English and good visual designs and interactive, staged and customised communications.[16]

Drawing on this research, we recommend that the lender be obliged to employ effective and meaningful disclosure when providing the above information to prospective guarantors.

Question: Should there be some recommended, or prescribed, cooling off period? Legal Aid NSW proposed seven days rather than the three-day period given in the 2019 Code.

Yes. Legal Aid NSW recommends a seven-day cooling-off period. We refer to our Written Submissions[17] for further detail about our position.

Chapter 7: Remote communities

Introductory remarks

The first part of our submissions on Chapter 7 focuses on the funeral insurance policy issues identified by the Commission. We have also included some general comments on the interim report and suggest possible additional areas for policy and law reform. Our submissions are directly informed by the legal services we provide to consumers of funeral insurance and financial services.

As part of the civil law division of Legal Aid, we provide a dedicated 'civil law service for Aboriginal communities' which delivers advice, casework and education services to specific Aboriginal and Torres Strait Islander communities (**Aboriginal communities**, for brevity) across New South Wales (**NSW**). Due to the prevalence of funeral insurance matters, Legal Aid NSW now employs a dedicated solicitor working solely on these

[15] Designing 21st Century Disclosures for Financial Decision-Making, Margaret Hagan, Stanford Law School Law Policy Lab, 2016. https://www-cdn.law.stanford.edu/wp-content/uploads/2016/10/Hagan-Designing-21st-Century-Disclsoures-for-Wise-Financial-Decision-Making-FINAL-2016.pdf.
[16] Designing 21st Century Disclosures for Financial Decision-Making, Margaret Hagan, Stanford Law School Law Policy Lab, 2016.
[17] Legal Aid NSW, Written Submissions – Round 3 Hearing, 5.

matters. We have provided advice and assistance to more than 100 Aboriginal people across NSW about the products sold by the Aboriginal Community Benefit Fund and related companies (**ACBF**), and currently have approximately 68 open matters to provide assistance to customers of ACBF.

The second part of our submissions focus on the policy issues related to overcoming barriers to service provision, and in the final part we address policy issues related to the provision of banking services. We have not responded to those questions that require answers outside our casework experience.

Funeral Insurance

General comments on the interim report

Legal Aid NSW welcomes the findings in the Interim Report in relation to the case studies of ACBF and Select. We agree that the case studies examined highlight that funeral insurance policies have little value, and are often sold by unscrupulous traders to vulnerable consumers. Thus, the primary question is how funeral insurance products should be regulated in the future.

The Commission summarises that three points have emerged:

1. whether funeral insurance policies should attract the use of the soon-to-be product intervention powers (**PIPs**) of ASIC;
2. whether Chapter 7 of the Corporations Act should apply to all funeral insurance (including funeral 'expenses only' products); and
3. whether Part 2, Division 2 of the ASIC Act should apply to all funeral insurance (including funeral 'expenses only' products). [18]

Whilst we agree that the above three points are important, there are additional areas where policy and/or law reform is required. This is primarily because the above three points are unlikely to wholly address the issues with funeral insurance identified in the evidence before the Commission.

For PIPs to be effective in this sphere, ASIC would need to be adequately resourced, and would need to prioritise intervention in the funeral insurance market. Given the breadth of findings of the Commission in relation to the financial services industry more broadly, the discretionary use of PIPs by ASIC cannot be relied upon as a fail safe way to protect vulnerable consumers. We are of the view that more direct changes to the regulation of funeral insurance are required to properly address the issues with funeral insurance for vulnerable consumers. Funeral insurance should be subject to additional regulation in a similar manner to that of other potentially predatory products such as small amount credit contracts. For example, a cap on costs and a suitability assessment requirement would provide consumers with significant protections and if legislated appropriately, clear and

[18] Interim report, pages 263-264.

accessible remedies. This kind of regulation would be preventative in nature rather than relying on use of PIPs after damage has already be caused.

The latter two points raised by the Commission relate to expanding ASIC's regulation to all funeral insurance policies (including 'expenses only' policies). Requiring funeral 'expenses only' insurance providers to obtain an Australian Financial Services Licence (and be subject to financial services regulation) would be a welcome change. Importantly, changes to the *Life Insurance Act 1995* (Cth) (**LIA**) to remove a similar exemption would be required if further anomalies in regulation are to be addressed.

At present funeral 'expenses only' policies are not regulated by Australian Prudential Regulation Authority and not required to meet prudential standards. At section 2.1 of the Interim Report the Commission states:

> …both funeral life polices and funeral expense polices are life policies under the *Life Insurance Act 1995* (Cth) and contracts of life insurance under the *Insurance Contracts Act 1984* (Cth).

Whilst this statement is correct, it is important to note that a business who offers funeral expenses policies is not considered a 'life insurance business'[19] under the LIA and is therefore also not a 'life company'.[20] In effect, this means that companies such as the Aboriginal Community Funeral Plan Pty Ltd (**the Plan**) are not regulated by the Australian Prudential Regulation Authority (**APRA**) and not required to meet prudential standards.

Whilst the primary issue identified by the Interim Report concerns the regulation of funeral insurance in the future, we are of the view that the Commission should also address the evidence before it about the clear need for a safe and suitable product that assists vulnerable and disadvantaged consumers to meet the costs of funerals. In summary, given the evidence before the commission we are of the view that the government has a role to play in providing safe mechanisms for consumers to be able to pay for their funerals. We address this point further at page 2 onwards.

Therefore, it is our view that in addition to the above three points identified by the Commission, three further points arise:

1. whether additional regulation of funeral insurance is required, acknowledging that it is a potentially harmful product for vulnerable consumers;
2. whether additional changes are required to the LIA to ensure APRA regulation of all life insurance products including funeral expenses only policies; and
3. whether the government should play a role in creating an appropriate mechanism to allow Aboriginal people and other vulnerable consumers to meet the costs of their funerals.

[19] Section 11(3)(e) of the *Life Insurance Act 1995* (Cth).
[20] Schedule – Dictionary of the *Life Insurance Act 1995* (Cth).

Question: Are funeral policies, or particular kinds of funeral policy, financial products warranting intervention by ASIC in the exercise of its product intervention powers?

PIPs and Design and Distribution Obligations (**DDOs**) have the potential to significantly improve outcomes for consumers who are currently sold funeral insurance products. Features of funeral insurance policies which warrant intervention of this kind include:

1. product design – ie products where there is a risk that the insured could pay more in premiums than their benefit amount;
2. lack of disclosure/warnings;
3. inappropriate marketing (eg free toys for children, promotion of funeral insurance policies to cover children);
4. inappropriate distribution and sales strategies (door to door and other unsolicited sales, high pressure sales);
5. misleading conduct including misrepresentations about the Aboriginality of the ACBF companies and the suitability of their products for Aboriginal people;
6. misleading conduct including misrepresentations about increasing cover;
7. misleading conduct including misrepresentations about the key features and essential terms of the product – ie failing to adequately disclose the key features of the policies, including that the insured could pay more in premiums than their benefit amount, or that the policy is 'expenses only';
8. failure by the insurer to assess whether or not the product being sold is suitable for that consumer, including the sale of funeral insurance to cover children and infants;
9. sale of products in a manner that discriminates against people based on disability and race; and
10. sale of products that in all the circumstances is unconscionable.

Legal Aid broadly supports the reforms set out in the exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018. However, we are concerned that the proposed reforms do not extend to financial products not regulated by the *Corporations Act 2001* (Cth) (***Corporations Act***) and the *National Consumer Credit Protection Act 2009* (Cth) (***NCCPA***). As a result, the PIPs and DDOs would not apply to funeral 'expenses only' products, such as those provided by ACBF. Legal Aid has also emphasised the need for clearer and more accessible remedies for consumers affected by breaches of DDOs than those proposed.

Question: Should all forms of funeral insurance be financial products for the purposes of Chapter 7 of the Corporations Act 2001 (Cth)?

Yes. The experience of Legal Aid in assisting clients with the current ACBF product (the Aboriginal Community Funeral Plan) demonstrates that the current regulatory framework is inadequate. The 'expenses only' exclusion in the Corporations Act means ACBF is not required to have an Australian Financial Services License (**AFSL**) and the product is not

governed by the protections contained in Chapter 7 of the *Corporations Act*. The exclusion is also mirrored in the *Life Insurance Act 1995* (Cth) (***Life Insurance Act***) and results in ACBF not having the requisite prudential standards of the *Insurance Act 1973* (Cth) (***Insurance Act***).

There is no valid reason to draw a distinction between 'expenses only' products and other funeral insurance products. The products are comparable in every aspect i.e. often have stepped premiums, similar benefit amounts, and the total premiums paid will often exceed the costs of a funeral. The only difference is that 'expenses only' products require the insured to produce receipts of the funeral expenses when making a claim. It is not clear why this should disentitle the insured to less regulatory protection.

We are of the view that amendment is required to include funeral expenses products within the definition of a 'financial product' so that the obligations outlined in Chapter 7 of the *Corporations Act* apply to issuers of 'expenses only' products such as ACBF. Amendments would need to ensure pre-paid funeral services covered by state based legislation are not inadvertently caught. A similar amendment should also be made to the *Life Insurance Act*.

Question: Should all forms of funeral insurance be covered by Part 2 Division 2 of the Australian Securities and Investments Commission Act 2001 (Cth)?

Yes. We are of the view that the consumer protection provisions of the *Australian Securities and Investment Commission Act 2001* (Cth) (***ASIC Act***) apply to 'expenses only' funeral insurance policies. However, given the complexity of regulation in this area, any ambiguity should be rectified.

Question: Should it be unlawful to sell funeral insurance for persons under 18 years?

In our view, it is preferable for funeral insurance for children to be excluded under a suitability assessment framework. This could be clarified through the introduction of a presumption that policies for children are unsuitable. This is because there are some cases where taking out a funeral insurance policy for a child may be appropriate. Where a suitability assessment framework is not adopted, Legal Aid supports a total prohibition on funeral insurance for children.

Both case studies examined by the Royal Commission highlight the need for a legislative obligation on insurers to conduct an assessment as to the suitability of any proposed insurance product for an individual consumer. Had a suitability assessment been conducted at the time the contracts were entered into with both Ms Marika and Ms Walsh, it is likely that those products would not have been sold to either of them.

Any such suitability assessment could be modelled on provisions set out in the NCCPA such that the insurer is required to:

- Assess the suitability of the product for the consumer prior to the provision of insurance;
- Make reasonable enquiries and obtain verification as part of the assessment, such as enquiries about the consumer's financial circumstances and the their requirements and objectives in obtaining the policy; and
- Presume the product is unsuitable in specified circumstances such as where the contract is likely to cause the consumer substantial financial hardship, where the policy will insure the life of a child or, where the insurance fails to meet the requirements and objectives stated by the consumer.

Alternatively, the 'fit for purpose' test contained in section 12ED of the *ASIC Act* should apply to insurance markets to protect against insurance products being sold that are simply not fit for their purpose and are a danger to those who have purchased them.

Breach of a suitability requirement or a fit for purpose test should give rise to an actionable claim that is easily enforced by consumers without the need to bring an action in the Federal or Supreme Courts. The current remedies available to consumers where an insurer has breached consumer protection legislation can be limited and difficult to enforce. We would therefore advocate for clearly articulated consumer rights to claim for detriment suffered including the right to rescind and claim damages in respect of breaches of unsolicited sales obligations and any suitability test developed. Without clearly articulated relief, available to consumers through easily accessible forums, protections enshrined in legislation have little value. The case studies presented to the Commission demonstrated that without the dedicated intervention of consumer advocates, Ms Walsh and Ms Marika would not have been able to obtain the outcomes they did.

Case study findings

We welcome the Commission's findings in the Interim Report in relation to ACBF (at pages 452 -457) and Select (at pages 466-470). We refer to our previous submissions on these case studies, and urge the Commission to consider whether ACBF and Select's conduct also breached the *Insurance Contracts Act 1984* (Cth) (***Insurance Contracts Act***) and amounted to unconscionable conduct when drafting the Final Report.

Additional policy and law reform

The evidence that emerged out of the funeral insurance case studies examined by the Commission was of predatory sales practices, and ultimately the sale of funeral products that were unsuitable for the consumers purchasing them. In our experience, this is apparent across the funeral insurance sector and the impact of this conduct leads to particularly harsh outcomes for vulnerable Aboriginal people and communities. As outlined in our previous submissions, we are of the view that the following reforms are required to address the issues highlighted by the evidence before the Commission:

1. the introduction of a suitability assessment requirement, including the presumption that insuring children is unsuitable or a total ban on insurance for children (outlined above);
2. extension of the 'fit for purpose' test contained in section 12ED of the ASIC act to cover insurers (outlined above);
3. the development of a suitable funeral product for vulnerable consumers
4. a cap on premiums;
5. a comprehensive prohibition on unsolicited sales, including anti-avoidance provisions;
6. more robust disclosure requirements regarding total cost and other matters;
7. the introduction of product intervention powers (outlined above);
8. the extension of unfair terms legislation to insurance products, and
9. amendment of the *Insurance Contracts Act* to allow judicial review of unconscionable contracts; and
10. State and federal legislation concerning funeral products should be reviewed and streamlined, and should include appropriate remedies.

<u>The need for a suitable product or service for vulnerable consumers</u>

The evidence presented to the Commission, supported by Legal Aid's significant volume of casework in this area, demonstrates there is an urgent need for a suitable, safe and affordable product, or system for vulnerable members of our community to pay for funerals. The Commission heard evidence that Aboriginal people rely on funeral insurance products because of the: [21]

1. cultural significance of funerals;
2. cultural obligation to ensure that sorry business occurs in a culturally appropriate way;
3. cost of funerals; and
4. number of funerals that Aboriginal people are obligated to contribute to.

Given the cultural significance and cultural obligations around sorry business, the government has an obligation to provide appropriate means for Aboriginal people to pay for funerals. In our view such a product or service could be provided appropriately by the Federal Government to low income earners and should include the following:

- affordable payments;
- total cost capped at benefit amount;
- cover that does not cease;
- protections from the risk of cancellation due to non-payment; and
- features or terms that are easy to understand.

[21] Evidence of Mr Nathan Boyle, transcript of the Royal Commission public hearing held on 3 July 2018, page P-3749, at 20-35.

Products co-designed with Aboriginal communities are more likely to ensure that they are appropriate to meet the needs of the community.

Centrelink could be used as a means to access the product and funeral bonds could provide a useful template for a product that may be better suited to the needs of vulnerable consumers.

A prescribed cap on premiums

We consider that a legislated cap on the total amount of premiums payable would ameliorate some of the problems associated with the provision of insurance in circumstances where the consumer is likely to pay a significant amount over the agreed benefit. We submit that consumers should not have to pay more than the benefit amount. There are already products like this in the market place that have been developed following *ASIC Report 454*. [22]

We also consider that fixed premiums should be considered so that consumers are not required to pay increasing premiums over their lifetime. We have seen multiple cases where premiums have increased significantly each year resulting in financial hardship or product cancellation. Again, this issue has subsided since the publication of ASIC Report 454 and we have seen most insurers very willing to settle disputes on a confidential basis where increasing premiums were not properly disclosed at the time of contracting.

Need for a comprehensive prohibition on unsolicited sales

Based on our casework experience, many Aboriginal consumers who have products through ACBF entered these contracts as a result of unsolicited sales including door-to-door sales, unsolicited phone calls and unsolicited meetings at Aboriginal community based organisations. For example, Ms Walsh signed up with ACBF during the course of her employment at an Aboriginal health co-operative. The evidence of ACBF CEO, Mr Bryn Jones, suggests this unsolicited sales method is due to increase in the future.

Given the concerns raised in evidence about misrepresentations as to ACBF's ownership and the benefits of the product to Aboriginal people, this kind of unsolicited sales practice is concerning. By aligning the sale of their product with community based organisations and events, they increase the perception in the community that the product is for the benefit of Aboriginal people.

In the case study of Ms Marika, Select avoided the prohibition on unsolicited sales for insurance products by engaging a third party to first contact Ms Marika to participate in a survey. In the course of that contact the representative obtained her consent to contact her in relation to the sale of funeral insurance. This example demonstrates the need for anti-avoidance provisions to ensure that financial service providers are not establishing

[22] ASIC Report 454 Funeral insurance: A snapshot.

systems for the sole or predominant purpose of avoiding the application of unsolicited sales provisions.

The unsolicited selling of financial products, including through door-to-door sales, is prohibited by the anti-hawking provisions contained in section 992A of the *Corporations Act.* Where this section is breached, s 992A(4) gives the consumer a right of return and refund within one month of the relevant cooling off period. Breach of the provision is an offence but this provides no relief to a consumer seeking to remedy their detriment, and no relief at all beyond the one month cooling off period.

For financial products subject to the *ASIC Act*, section 12DMA provides that a consumer has no liability to pay for a product sold to them by way of unsolicited sales. The *Australian Consumer Law* and the *NCCPA* also have provisions seeking to regulate and provide relief from unsolicited sales. In addition, the language used to encompass unsolicited sales varies across legislation including 'door to door' sales, 'anti-hawking', 'canvassing' and 'unsolicited' sales.

In our view there is a lack of consistency and coherence in the regulation of unsolicited sales of financial products. The existing protections cause confusion, do not have sufficient remedies and produce inequitable results for consumers.

We are of the view that a clear, comprehensive prohibition on unsolicited sales should be established for the financial services sector. A provision should be included in the *ASIC Act* that combines the anti-hawking provisions of the *Corporation Act* with specific consequences for breach including compensation so that all financial products are dealt with consistently. The carve outs that exist in section 992A(3) of the *Corporations Act* should be removed to create a comprehensive prohibition and to implement anti-avoidance provisions, similar to those elsewhere in the *Corporations Act*.

<u>Disclosure of total cost and other matters</u>

In Legal Aid's experience, many of our clients who sign up to funeral insurance have poor English literacy, limited education and poor financial literacy. In the vast majority of cases, the likely total cost of a funeral insurance product is not discussed with the consumer at the point of sale. In many cases, the risk that the cost of the funeral insurance might exceed any benefit paid out, and also the estimate total cost of the product, only becomes clear to our clients upon receiving legal advice.

It is clear from the evidence presented to the Commission that current disclosure practices are insufficient, and that Aboriginal consumers are particularly vulnerable to signing up to funeral insurance products that are inappropriate and unsuitable and which are fundamentally misunderstood.

Under section 1013D of the Corporations Act, insurers are required to disclose a number of matters including any significant risks associated with holding the product. While it is reasonable that risks about total costs and the risk that benefits may be insufficient should be considered significant and hence disclosed, it is evident that in practice this does not occur.

Upfront disclosure at the point of sale may address some of the problems associated with inappropriate sales practices, such as occurred in both Ms Marika and Ms Walsh's cases. Section 1013D of the *Corporations Act* should be clarified to require disclosure by funeral insurers about the following matters:

- Estimated total cost based on life expectancy;
- Risk that the cost could likely exceed the benefit;
- The date when the premiums paid will exceed or equal the benefit amount to be paid out;
- The risk that the benefit might not cover the cost of a funeral; and
- Details about how or if the premiums will increase over time.

In order to improve consumer comprehension of funeral insurance products consideration should be given to requiring disclosure in a prescribed form. That form should include:

- Both visual and verbal disclosure;
- Disclosure that is specific to the individual consumer, including about associated risk and costs;
- Be in plain English; and
- Be in the form of an infographic.[23]

We note however that disclosure can be of limited value for some vulnerable consumers, particularly those with poor financial and English literacy. We are therefore of the view that a suitability test, requiring insurers to disclose the above matters in addition to the matters already required to be disclosed under the law, is needed to provide adequate protection to vulnerable consumers.

Performance based regulation

Another approach to improving consumer comprehension is 'performance based regulation' as suggested by Professor Lauren Willis.[24] This type of regulation creates performance standards for consumer comprehension or suitable consumer product use. Providers of financial products are motivated to ensure that customers understand products and purchase appropriate products, in order to comply with regulation. Such an approach can align the interests of industry with the goals of regulators and consumer advocates.

[23] By way of example, see factsheet produced by the Insurance in Super Working Group which utilises infographics at Page 32 https://www.superannuation.asn.au/ArticleDocuments/270/ISWG_Consultation_Paper_Draft_Code_of_Practice_150917.pdf.aspx?Embed=Y.

[24] See for example: Willis, LE 'Performance Based Consumer Law' (2015) 82 University of Chicago Law Review 1309.

Unfair contract terms

We welcome the federal government's current consultation on implementing unfair contract terms in relation to insurance and are strongly supportive of reforms to ensure ACBF and other funeral insurers are subject to unfair terms legislation.

Amendment of the Insurance Contracts Act to allow judicial review of contracts

At present section 15 of the *Insurance Contracts Act* prevents a consumer from bringing a claim against an insurer seeking judicial review of the contract on the ground that it is 'harsh, oppressive, unconscionable, unjust, unfair or inequitable'. This means relief available under the *ASIC Act* for unconscionable conduct is limited to pre-contractual conduct and severely curtails a consumer's remedies in respect of an unjust contract and in respect of misrepresentation. We are strongly of the view the *Insurance Contracts Act* should be amended to be brought in line with the consumer protections available to consumers in respect of other consumer contracts such as credit. The evidence presented to the Commission about the ACBF contracts demonstrates that such limitations significantly impair a consumer's access to justice.

Interaction between state and commonwealth laws

Currently, the relationship between the Commonwealth and State regulation of funeral products, such as through the *Funeral Funds Act 1979* (NSW) (***Funeral Funds Act***) is unclear. The *Funeral Funds Act* does not appear to exclude insurance or 'expenses only' products, however the legislature's intention was that funeral insurance would not be captured by the Funeral Funds Act, as these products were regulated by Commonwealth legislation such as the LIA.[25] As stated above, the ACBF 'expenses only' product is not regulated under the LIA.

In addition, enforcement of ACBF's legislative obligations by the Office of Fair Trading has been limited. Further, the *Funeral Funds Act* does not provide consumers with any right to claim for breaches of the obligations.

The lack of clarity as to which regulatory regimes apply, and inability of consumers to enforce legislative obligations under the *Funeral Funds Act*, creates uncertainty for consumers as well as product issuers about the application of regulations and makes the resolution of disputes unnecessarily challenging.

A review of the regulation affecting funeral products should occur with a view to:

1. streamlining regulation;
2. clarifying the application of State and Commonwealth jurisdiction (particularly in relation to ensuring there is prudential oversight at either the state or commonwealth level); and
3. ensuring that regulation includes appropriate remedies for consumers.

[25] Second reading speech, Funeral Funds Amendment Bill 2003, NSW Hansard Articles : LA 15/10/2003 : #47.

Overcoming barriers and obstacles in service provision

Question: Do financial services entities have in place appropriate policies and procedures to assist Aboriginal and Torres Strait Islander people to overcome obstacles associated with geographical remoteness, to address the cultural barriers to engagement that some of these people face, to address the linguistic barriers to engagement that some of these people face, and to address the obstacles posed by the financial literacy levels of some of these people? And, if appropriate policies and procedures are not in place, what changes should be made to those policies and procedures to deal with those matters?

Significant changes are required to our financial systems to deal with the barriers faced by Aboriginal people in accessing financial services. As already noted those barriers include:

- geographic remoteness of Aboriginal customers;
- obstacles posed by financial literacy levels; and
- obstacles posted by the failure of financial services to take account of cultural and linguistic differences.

Our submission does not propose to set out in detail the changes that would be required.

Banks and other financial service providers should engage with the Aboriginal communities they service and allow those communities to inform them about the way that current practices impact access and the solutions to those problems. In order to do this, at a minimum financial service providers need to collect data about whether they have Aboriginal customers and identify where those customers reside.

Financial services providers should consider implementing meaningful Reconciliation Action Plans as a means of identifying and documenting:

- Any objectives in relation to servicing Aboriginal customers;
- Any other objectives in relation to social corporate responsibility that can benefit the Aboriginal community; and
- Measures for achieving those objectives.

In our experience as service providers to Aboriginal communities, employment of Aboriginal staff and staff with specialised experience and knowledge of the disadvantage experienced by Aboriginal people is a key component of enabling access to services.

Specialised and local services designed for and with Aboriginal people are most effective in removing barriers to accessing those services. Banks could consider implementing outreach services to locations with high levels of Aboriginal customers to enable those

customers to have access to basic banking services. For example, to identify and assist eligible Aboriginal customers to open fee-free bank accounts. We would caution against using outreach services to sell discretionary products such as loans and/or insurance.

We reiterate our concerns set out above in relation to issues with identification and the need for flexibility.

Banking services

Question: Are banks' identification requirements appropriate for Aboriginal and Torres Strait Islander customers? If so, are those identification requirements sufficiently understood and implemented by staff on the ground?

We do not have sufficient casework experience related to the identification requirements imposed by banks to comment on that aspect of the question.

However, our casework supports evidence presented to the Commission that identification issues arise for Aboriginal people during the course of attempting to access many different government and non-government services.

In our experience, some of those issues are:

- Lack of any identification documents or lack of approved forms of identification;
- Difficulties in obtaining birth certificates and/or photo identification because of:
    - cost;
    - lack of approved identification;
    - difficulties getting identification certified due to geographic location;
    - high prevalence of unregistered or unrecorded births;
    - the use of various names or multiple spellings; and
    - inaccuracies in current identity documents such as spelling mistakes or misstated dates of birth.

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**), which sets out the requirements for customer identification and verification for banks also provides sufficient scope for flexibility. Given that Aboriginal people living in remote areas are likely to be considered low risk, applying flexibility to enable such customers to access basic bank services, is appropriate. Flexible and culturally appropriate guidelines for identification should be actively pursued by financial institutions subject to the AML/CTF Act.

Question: should more banks have a telephone service staffed by employees with specific training in assisting indigenous consumers?

Yes. Banks should also have Aboriginal specialists available in branches located in areas of high Aboriginal populations.

In Legal Aid NSW's experience, Indigenous specific phone line services which are commonly provided by government agencies, are a means of addressing problems with accessibility. They can ensure that Aboriginal customers are able to speak to staff members with an understanding of Aboriginal people and the particular disadvantages they might experience in attempting to access a service. For example, Legal Aid, Centrelink, the ATO, Fair Trading, ASIC, ACCC and some banks all have an Aboriginal specific phone line.

Question: do banks take sufficient steps to promote the availability of fee-free accounts to eligible customers?

Through our experience assisting Aboriginal people with consumer complaints we often see people whose sole income is Centrelink being charged multiple dishonour fees on their accounts, often in relation to multiple direct debits, due to having insufficient funds. This leads to further financial hardship and debt. The evidence presented to the Commission suggests that it is likely many of our clients are not being offered fee-free accounts. Income information of consumers is readily available to banks and should be used to identify that a customer is eligible for a fee-free account. We are strongly of the view that banks should be engaging ethically and responsibly with consumers, especially those on low incomes.

Chapter 8: Regulation and the regulators

Question: Is ASIC's remit too large?

- If it were to be reduced, who would take over those parts of the remit that are detached
- Why would detachment be better?

Legal Aid NSW does not consider that ASIC's remit is too large to warrant the narrowing the scope of its responsibilities.

In particular, we share the concerns raised by Treasury in its 13 July submission to the Royal Commission that *'a structural separation of ASIC…could be a major shift in Australia's regulatory architecture and, in turn, could also be complex, disruptive and have unintended consequences'*.[26]

[26] Financial Services Royal Commission Submission on Key Policy Issues, Treasury Background Paper No. 24, 13 July 2018 at [131].

As Treasury notes in its submission, the Financial System Inquiry found that synergies between functions would be lost if such functions were moved to other agencies.

Any proposal to significantly reduce ASIC's remit should be assessed with caution, particularly where alternatives, such as enhancing ASIC's capabilities, may be more effective in addressing issues that emerge from the Royal Commission and elsewhere.

ASIC plays a vital function in Australia's economy.

Legal Aid NSW considers that ASIC ought to be better resourced for it to function effectively.

Question: Should industry codes relating to the provision of financial services, such as the 2019 Banking Code of Practice, be recognised and applied by legislation like Part IVB of the Competition and Consumer Act 2010 (Cth)?

Industry Codes are an important mechanism for consumers in resolving disputes with banks and other credit providers and provide a clear, plain-English outline of what a consumer can expect when interacting with a bank or credit provider.

In advocating for vulnerable consumers in disputes with credit providers, Legal Aid NSW solicitors frequently draw on provisions of the 2013 Banking Code of Practice in circumstances where issues may not be addressed in the law, but where a consumer has nevertheless been treated in a way that is contrary to community standards and expectations.

For example, where a consumer is being treated unfairly by debt collectors, we may refer to relevant provisions in the Code when advocating on behalf of that consumer in Internal Dispute Resolution.

The new code goes further in protecting vulnerable consumers. For example, Chapter 14 of the 2019 code says that banks will 'take extra care with vulnerable consumers', including consumers who are experiencing domestic violence, mental illness or elder abuse.

These kinds of undertakings are important for Legal Aid NSW's priority client base who tend to face more acute disadvantage than the general community when interacting with banks and credit providers. The provisions in industry codes (at least in principle) mean that the circumstances of each particular consumer ought to be taken into account during day to day interactions with entities.

However, Legal Aid NSW's case work experience as well as evidence given during the Royal Commission's public round of hearings highlight the way in which industry codes are often treated as 'aspirational' or 'best practice' rather than obligatory.

Under the current regime, the enforcement of norms established under the Banking Code of Conduct is left to the consumer. A 'contravention' of the code is not really a contravention at all, and may at best be considered a breach of contract.

Disadvantaged consumers, who may be in financial hardship as a result of a bank's misconduct will quite often lack the means or resources to enforce these norms. Legal Aid NSW agrees with the observation made in the Interim Report that poor conduct by the banks will, despite the existence of a code of conduct, go unrecognised.

This will in turn lead to poor consumer outcomes.

For the 2019 Banking Code to be effectual Legal Aid NSW considers that it (and other industry codes) ought to be recognised and applied by legislation in the same way that 'applicable industry codes' are regulated under Part IVB of the *Competition and Consumer Act*.

As the ACCC is able to do with respect to 'applicable industry codes' under the *Competition and Consumer Act*, ASIC should be given legislative power to commence civil penalty proceedings against entities that contravene applicable industry codes.

This would result in:

- Entities being bound by important industry codes;
- Increased consumer confidence in the industry; and
- ASIC having the ability to seek appropriate penalties for breach, which will in turn have an important deterrent effect.

Question: If the recommendations of the Enforcement Review are implemented, will ASIC have enough and appropriate regulatory tools?

Implementation of some measures proposed under the ASIC Enforcement Review are likely to lead to better outcomes for vulnerable consumers in NSW.

However, for ASIC to be a fully effective regulator requires an increased and ongoing funding commitment from Government and significant resourcing.

Evidence given during public hearings showed that entities were slow to self-report breaches of the *Corporations Act*, despite the existence of an obligation to do so under section 912D of that Act.

Legal Aid NSW therefore supports proposed measures designed to better the way that entities identify and report their own misconduct as well as the provision of directions powers to credit licensees in order to prevent risk to consumers.

That said, Legal Aid NSW notes the concern raised in the Interim Report that the efficacy of any proposed changes will depend on the extent to which they are enforced and applied.

For this reason, Legal Aid NSW considers that ASIC ought to be appropriately resourced to deal with any increased demand as a result of the implementation of these measures.

As noted above, Legal Aid NSW considers that ASIC should be given more powers with respect to the enforcement of industry codes. To be effective in achieving better consumer

outcomes, industry codes (such as the 2019 Banking Code) should be recognised and applied by legislation in the same way that 'applicable industry codes' are regulated under Part IVB of the *Competition and Consumer Act*.

Further, Legal Aid NSW broadly supports recommendations to increase civil penalty amounts under the *Corporations Act* to (for corporations), the greater of 50,000 penalty units ($10.5 million) or three times the value of the benefit obtained or losses avoided, or 10% of annual turnover in the 12 months preceding the contravention.

As it stands, penalties are not high enough to effectively deter entities from doing the wrong thing. For a corporation, civil penalties are capped at $1 million. Larger entities may simply incorporate these penalties into their cost of doing business; there is little deterrent effect.

Penalties ought to be sufficiently high to properly deter entities from engaging in misconduct that can be harmful to consumers.

Again, ASIC needs to be properly resourced to pursue such penalties regularly and effectively.

Legal Aid NSW also supports furthering ASIC's powers in ways that are not referred to in the Enforcement Review.

For example, Leal Aid broadly supports the introduction of a product intervention power for ASIC where there is a risk of significant consumer detriment. We consider that this power should be extended to apply to credit, including unregulated credit, as well as financial products not regulated by the *Corporations Act*.[27]

Question: Are ASIC's enforcement practices satisfactory? If not, how should they be changed?

ASIC's enforcement practices comprise a number of regulatory mechanisms, including litigation, negotiated outcomes, enforceable undertakings and the issuing of infringement notices.

The commencement of civil penalty proceedings against entities is an important component of ASIC's enforcement mandate, resulting in:

- Greater certainty as to the way in which a piece of legislation is to be interpreted and applied (better law);
- Entities being deterred from doing the wrong thing; and
- Redress for consumers who have been wronged, including remediation.

Favourable outcomes in Court can be good for disadvantaged Australian consumers who have been victims of wrongdoing by banks, credit providers and other regulated entities.

[27] Legal Aid NSW has provided a detailed response to the proposed bill: https://static.treasury.gov.au/uploads/sites/1/2018/09/c2017-t247556-Legal-Aid-NSW.pdf.

At the same time, alternatives to litigation that can also result in positive consumer outcomes. For example, in conjunction with Civil Penalty proceedings, ASIC recently secured the refund of around $11.8 million to consumers who had overpaid in their consumer lease agreements with Radio Rentals.

This outcome was secured by way of an Enforceable Undertaking and is undoubtedly a good result for consumers.

For ASIC to be an effective litigator, appropriate and long term funding is essential. ASIC needs to be properly resourced to allow it to deal with the high and sometimes unpredictable costs associated with large scale litigation.

ASIC's obligation to act as a model litigant, which includes a requirement for it to consider alternative dispute resolution before initiating proceedings, is also significant.

That said, Legal Aid NSW agrees that this obligation does not preclude ASIC from commencing proceedings where its desired regulatory outcome is not reached by way of negotiation. Where ASIC commences negotiations with an entity, but is unable reach the outcome that it wants, ASIC should have the confidence to pursue the matter in Court.

Again, for ASIC to do so in an effective manner requires greater funding and significant resources.

Consideration may also be given to a cost-cap mechanism in circumstances where ASIC brings proceedings against an entity and loses. This would likely lead to a greater willingness on the part of ASIC to litigate matters without the fear of incurring significant costs to tax-payers.

In some circumstances, litigation is not the most appropriate regulatory tool as it has considerable disadvantages. Litigation costs money, is time consuming and diverts resources from other regulatory tools at ASIC's disposal that may be more effective.

Legal Aid NSW considers that consumer education, particularly through the better resourcing of such programs as MoneySmart can achieve good consumer outcomes, allowing consumers to identify problems at their inception.

In our casework experience, disadvantaged consumers are often not aware of the existence of these valuable resources.

Litigation and the commencement of court action therefore needs to be considered as just one important aspect of ASIC's enforcement mandate, rather than the default approach.

Chapter 10: Issues that have emerged (7.4 Intermediaries)

Question: Is it desirable to prescribe that some or all of those who are not employees of banks, but deal with bank customers, must act in the interests, or the best interests, of the client?

- In particular, what duty, if any, should a mortgage broker owe to the prospective borrower?
- Is value based commission, paid to the broker by the lender, consonant with that duty?
- Should a mortgage aggregator owe any duty to the borrower?
- Again, are the remuneration arrangements for aggregators consonant with that duty?

Question: If some or all of those who are not employees of banks, but deal with bank customers, should owe the customer a duty to act in that customer's interests, is it enough to prescribe the duty and require 'management' of conflicts between interest and duty?

- What is to be made of the fact that, when persons are paid to give advice and rewarded for selling their employer or sponsoring entity's products, all too often the client's interests are treated as coinciding with the adviser's commercial advantage, no matter how obviously that course harms the client?
- Perhaps the adviser believes that selling the employer's or sponsor's product is in the client's interests, perhaps the adviser does not think about the conflict. But in too many cases, what is sold is not in the interests of the client.

We refer to our response in this submission to questions asked in Chapter 2 and our discussion there about brokers and intermediaries.

Question: What, if anything, is to be done about remuneration of intermediaries?

- How is a value based commission consistent with acting in the interests, or best interests, of the client?

- Should intermediaries be subject to rules generally similar to the conflicted remuneration prohibitions applying to the provision of financial advice?

We refer again to the our discussion in Chapter 2 regarding brokers/ intermediaries and add the following;

Legal Aid NSW submits that Mortgage Brokers, Mortgage Aggregator, Employees and Intermediaries should have a duty to disclose:

a. Any commission/s that they receive from the Bank/s; and
b. If they work for one or a limited number of banks only and what those banks are; and
c. If they have not provided with client with the best loan option for them advise the client that they may have a better option.

This information should be made clear on their website or any advertising.

In addition employees who provide financial advice should be required to disclose the conflict of interest between interest and duty to the customer and explain the process the employee has undertaking when assessing the conflict before recommending the product.