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ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

Submission on Round 1 Hearings - Consumer Lending

1. Summary

1.1. The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to provide written submissions addressing issues raised during the consumer lending hearings of the Commission.

1.2. We strongly support the available findings recommended by Counsel Assisting Rowena Orr QC in closing submissions on 23 March 2018.

1.3. We have made submissions on additional available findings relating to our clients Robert Regan, Irene Savidis and Nalini Thiruvangadam in Case Studies 4, 5 and 9 respectively. We have also made submissions in response to questions for written submissions relating to Case Studies 4, 5, 6, 9, 11 and 12. Further, we have made submissions on additional findings open to the Commissioner about industry practices and regulation generally.

2. Introduction

2.1. The evidence presented during the consumer lending hearings shows banks failing consumers throughout the entire product life cycle and customer journey. The Commission heard evidence of banks designing and marketing unsuitable products, failing to manage conflicts of interest, breaching responsible lending obligations and failing to remediate customers appropriately. Ultimately, this has led to consumers being provided unsuitable loans that have led to significant financial and personal hardship.

2.2. Evidence presented during the hearings suggests banks have not invested properly in systems and processes to identify problems or remediate customers in a timely manner. At times, banks have been strongly resistant to remediating customers at all. Further, the Commission heard evidence of numerous instances of banks' internal dispute resolution and hardship procedures failing consumers experiencing financial difficulty.

2.3. There was also evidence of a 'first mover' problem in the industry. For example, Westpac admitted it continues to pay hidden flex-commissions to car dealers and will do so until prohibited by the Australian Securities & Investments Commission (**ASIC**). The evidence indicates a reluctance to improve compliance where to do so would affect profitability, without regulator or government intervention.

2.4. Another consistent theme throughout the hearings was a lack of transparency — with consumers, ASIC, and even the Commission. The Commission heard a number of examples of financial services entities failing to inform consumers about significant features of products,[1] commissions paid to intermediaries,[2] or the misconduct of their staff.[3] The evidence also established numerous examples of significant delays in notifying ASIC of potential misconduct, despite the mandatory breach reporting requirements under section 912D(1) of the *Corporations Act 2001* (Cth) (**Corporations Act**). In relation to co-operating with the Commission, Ms Orr noted the inadequacy of some banks' responses to requests from the Commissioner, which failed to properly

[1] For example, the consumer credit insurance sold to Irene Savidis: Transcript of Proceedings (Day 6, 19 March 2018) 494–7.
[2] For example, CBA home loans failing to disclose payments or amount of payments of commissions: Transcript of Proceedings (Day 4,15 March 2018) 259–62.
[3] For example, Aussie Home Loans failing to inform customers of fraudulent activity of brokers: Transcript of Proceedings (Day 5, 16 March 2018) 378.

identify all instances of misconduct or provided information in a way that did not enable an assessment of the type or scale of misconduct.[4]

2.5. At the heart of the misconduct and conduct falling below community standards and expectations identified during the hearings is a harmful sales culture with limited incentives to comply with the law. Banks and brokers have implemented remuneration structures that create conflicts of interest by prioritising sales over customer wellbeing. The evidence shows that banks have strongly prioritised customer acquisition and sales, and failed to act even when customer harm was evident.

2.6. Before and during the hearings, representatives of various entities made promises that practices have changed or would improve. However, little evidence has been produced showing improved consumer outcomes. Instead, the evidence establishes a serious reluctance on the part of the banks to move away from practices that cause consumer harm for fear of losing market share or profits.[5]

2.7. These systemic failures cause devastating harm to the victims of misconduct, as shown by the testimony of the consumer witnesses during the hearings. From Mr Robert Regan's evidence about his reliance on charities for food,[6] to Ms Thiruvangadam's evidence about missing rent and utility bill payments to pay her car loan repayments, the heavy personal toll attributable to irresponsible lending is clear.[7] So too is the significant power imbalance between financial services entities and the customers whose interests they claim to serve. There is a wide chasm between bank decision-makers and the customers affected by those decisions, with a reluctance on the part of the banks to admit to wrongdoing and make amends.

2.8. The remedies available to consumers and penalties available to the regulator when financial services entities break the law have failed to incentivise compliance and deter misconduct.

3. Defining community standards and expectations

3.1. Banks play a unique and critically important role in our community and economy. As a result, we submit that there is an implicit social licence granted to the banking sector that should be considered when determining community standards and expectations.[8]

3.2. Much has been written about banking and social contract, which we do not intend to repeat in our submission.[9] However, we submit that the implied social licence and privileged position granted to banks means that they are subject to higher community expectations of conduct. As stated by the Finance Sector Union (FSU): "Australians do not have the day-to-day capacity to simply opt out of the banking system. Banking is connected and integrated into our ability as citizens to function and exist in modern society."[10]

3.3. In determining these heightened community expectations, we agree with the Commissioner's observations in the initial public hearing that an important element of community standards and expectations may be derived from the Financial System Inquiry (**FSI**) led by Mr David Murray AO. That Final Report of FSI stated that the financial system should be 'efficient, resilient and fair', and that fundamental to fair treatment is 'the concept that financial products and services should perform in the way consumer expect or are led to believe.'[11]

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[4] Transcript of Proceedings (Day 10, 23 March 2018) 969.
[5] For example, CBA still paying mortgage broker commissions despite Mr Narev admitting it can lead to poor customer outcomes: Transcript of Proceedings (Day 4, 15 March 2018) 240–3, and Westpac still paying flex commissions despite admitting it is a huge conflict of interest: Transcript of Proceedings (Day 8, 21 March 2018) 752–4.
[6] Witness Statement of Robert Regan, Exhibit #1.82, WIT.0001.0006.0007.
[7] Witness Statement of Nalini Thiruvangadam, Exhibit #1.138, WIT.0001.0012.0011.
[8] This role was recognised by the Senate Economics Committee in 2011, which said that: *"…banks are accorded a special status and given special privileges. In exchange they have social obligations to provide banking services to the broad community.":* Senate Economics References Committee, Australian Senate, *Competition within the Australian banking sector,* (2011) 226 <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2010-13/bankingcomp2010/report/index>.
[9] For example: Mehrsa Baradaran, 'Banking and the Social Contract' (2014) 89 *Notre Dame Law Review* 1283, <http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1941&context=fac_artchop>.
[10] Finance Sector Union of Australia, Submission No 80 to Senate Standing Committee on Economics, *Competition within the Australian banking sector*, May 2011, <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed_inquiries/2010-13/bankingcomp2010/report/index>.
[11] Transcript of Proceedings (Initial Public Hearing, 12 February 2018) 8.

Marketing as well as consumer interactions with staff is therefore critical to the assessment of community standards.

3.4. We also support Ms Orr's closing submissions that the community expects financial services entities faced with allegations of inappropriate conduct to "firstly, fix the problem; secondly, compensate the customer for any detriment caused to the customer as a result of the problem; and thirdly, to do so in a timely fashion."[12]

4. Case Study 4: Robert Regan and ANZ home lending

4.1. *Available findings of misconduct*

4.2. We strongly support the findings of misconduct outlined in closing submissions.[13] We have provided our reasons for supporting these findings below, and made further submissions on additional available findings of misconduct.

4.3. *Summary of facts*

4.4. Through a broker, Robert Regan applied for a $50,000 home loan with ANZ in February and March 2017 to obtain money to send to individuals overseas he subsequently discovered were part of a dating scam. The loan was secured against his previously unencumbered home. Mr Regan was 72 years old at the time the home loan was approved. The bank statements supplied by Mr Regan to the broker (and then to ANZ) showed that he had transferred at least $13,500 overseas in the month prior to applying for the home loan.[14] The broker recorded Mr Regan's expenses as $1,140 per month. However, Mr Regan's actual expenses were approximately $1,386 per fortnight which therefore meant the broker underestimated Mr Regan's expenses by more than 50 percent. Mr Regan's income at the time of applying for the loan was approximately $1,229 per fortnight.

4.5. The broker's estimated expenses for Mr Regan fell below the Household Expenditure Measure (**HEM)** benchmark for the December 2016 Quarter.[15] ANZ's evidence about its assessment of Mr Regan's loan application as "not unsuitable" is set out in the Witness Statement of William Ranken dated 4 March 2018.[16] In summary, ANZ's uncommitted monthly income (**UMI**) calculator defaulted to the higher HEM benchmark figure of $1,189 per month.[17] ANZ's serviceability assessment concluded that Mr Regan had a positive UMI of $831.91 per month.[18] ANZ received identity documents, rates and valuation notices, a letter from Centrelink dated 4 February 2016 and Mr Regan's bank statements for the period 1 February 2017 to 28 February 2017 from the broker in support of the loan application.[19]

4.6. Mr Regan's evidence is that he had to seek regular assistance from charities for groceries and that since stopping his ANZ loan repayments he has been able to afford food without the need to seek assistance from charities.[20] Mr Regan, an elderly pensioner, will be required to sell his home if the dispute is not determined in his favour and he is held liable to pay the principal debt to ANZ.

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[12] Transcript of Proceedings (Day 10, 23 March 2018) 998.
[13] Transcript of Proceedings (Day 10, 23 March 2018) 989–91.
[14] Transcript of Proceedings (Day 5, 16 March 2018) 438–9; Witness Statement of Robert Regan dated 8 March 2018, "RER-2" Exhibit #1.82, WIT.0001.0006.0001.
[15] There are three available HEMs benchmarks which could apply to Mr Regan's loan. Smoothed HEMS not adjusted for place residence or income which would be $1209 per month; smoothed HEM not adjusted for income which would be $1257 per month; or smoothed HEM for a person living in Melbourne with an income of $30,000-$35,000 per annum which would be $1,166 per month. Source: Melbourne Institute of Applied Economic and Social Research (2016), *Household Expenditure Measure December 2016*.
[16] Witness Statement of William Ranken, Exhibit #1.86, ANZ.800.327.0001 [44]–[59].
[17] Witness Statement of William Ranken, Exhibit #1.86, ANZ.800.327.0001 [59(b)(ii)]; Letter from ANZ to Consumer Action Law Centre dated 15 March 2018, Exhibit #1.84, RCD.0014.0002.0002. Consumer Action disputes the accuracy of this HEMS benchmark.
[18] Witness Statement of William Ranken, Exhibit #1.86, ANZ.800.327.0001 [59(b)(ii)]; Letter from ANZ to Consumer Action Law Centre dated 15 March 2018, Exhibit #1.84, RCD.0014.0002.0002.
[19] Witness Statement William Ranken, Exhibit #1.86, ANZ.800.327.0001 and exhibit marked "WAR-7" to that statement, ANZ.800.141.3018.
[20] Witness Statement of Robert Regan, Exhibit #1.82, WIT.0001.0006.0001 [30].

4.7. *Responsible lending obligations and contraventions*

4.8. Both the broker and ANZ were required to assess whether Mr Regan's home loan was not unsuitable.[21] A credit contract will be unsuitable where it either does not meet the consumer's requirements and objectives, or the consumer cannot meet the repayment requirements without 'substantial hardship'. There are three steps in the process of assessing unsuitability under the National Credit Act:

- make reasonable inquiries about the consumer's financial situation, requirements and objectives;
- take reasonable steps to verify the consumer's financial situation; and
- conduct an assessment as to whether the credit contract is 'unsuitable' for the consumer.[22]

4.9. We support the findings of misconduct outlined in closing submissions relating to responsible lending obligations and the Banking Code of Practice for the following reasons:

- ANZ did not verify Mr Regan's general living expenses at all. ANZ only checked whether the expenses recorded in the application were the same of those recorded in the statement of financial position[23] and then applied the HEM benchmark. That process was inadequate to assess whether Mr Regan could afford the loan without substantial hardship;
- In approving Mr Regan's home loan, ANZ did not follow its own lending guidelines[24] for verifying Mr Regan's income because it accepted a Centrelink statement that was older than 60 days (it was 1 year old)[25] and bank statements which were less than 3-month consecutive period[26] (there were 1 month of statements);
- ANZ did not consider that "the significant transactions" recorded in Mr Regan's statements evidenced any ongoing financial commitments.[27] ANZ failed to make further inquiries with Mr Regan about this inconsistent information;
- ANZ did not make inquiries into or verify inconsistent information between the supporting bank statements and the records submitted by the broker. ANZ provided evidence that its processes in these circumstances are "to do nothing";[28]
- ANZ granted the loan on the basis that Mr Regan could 'downsize' to make repayments, implying that he would only be able to make repayments by selling his principal place of residence. A loan is presumed to be unsuitable in these circumstances under section 131(3) of the National Credit Act;
- ANZ did not consider Mr Regan's age (72) vis-a-vis the loan term of 30 years.[29] This is a critical issue as to whether the home loan would be suitable to Mr Regan; and
- ANZ's evidence is that Mr Regan applied for hardship on 7 June 2017, approximately 3 months after it had received Mr Regan's home loan application, and incorrectly denied that application. Had it assessed Mr Regan's application properly, ANZ's evidence is that Mr Regan's revised statement of financial position would have shown a negative UMI.[30] This evidences that the home loan was unaffordable as Mr Regan's financial circumstances had not changed between March 2017 and June 2017 save for being liable to pay the ANZ home loan repayments.

4.10. *Additional available findings of misconduct – unconscionable and unjust conduct*

4.11. We submit that it is open for the Commission to make further findings of misconduct against ANZ. We submit that ANZ's conduct was unconscionable or unjust[31] because: firstly, granting the loan amounted to "asset lending"; and secondly, an ANZ staff member was involved in transferring loan funds to the United Kingdom.

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[21] *National Consumer Credit Protection Act 2009* (Cth) ss 116, 128.
[22] *National Consumer Credit Protection Act 2009* (Cth) ss 128–130.
[23] Transcript of Proceedings (Day 6, 19 March 2018) 464.
[24] Mortgage Credit Requirements 6 March 2017, exhibit "WAR-3" to witness statement of William Ranken, Exhibit #1.86.3, ANZ 800.282.0001.
[25] Transcript of Proceedings (Day 6, 19 March 2018) 463, 479.
[26] Transcript of Proceedings (Day 6, 19 March 2018) 479.
[27] Letter from ANZ to Consumer Action Law Centre dated 15 March 2018, Exhibit #1.84, RCD.0014.0002.0002.
[28] Transcript of Proceedings (Day 6, 19 March 2018) 469–70.
[29] Transcript of Proceedings (Day 6, 19 March 2018) 484.
[30] Witness statement of William Ranken dated 4 March 2018, Exhibit #1.86, ANZ.800.327.0001 [61(c)]; Transcript of Proceedings (Day 6, 19 March 2018) 486–7.
[31] *National Consumer Credit Protection Act 2009* (Cth) sch 1 (*'National Credit Code'),* ss 96, 204.

4.12. In relation to asset lending, this is where a credit provider lends money without regard to the borrower's ability to repay under the contract because there is adequate security in the event of default.[32] We submit that there is ample case law on asset lending[33] to support a finding that ANZ acted unconscionably with respect to Mr Regan. In Mr Regan's case, ANZ assessed his home loan as being "not unsuitable" on the basis that he could downsize his home.[34] ANZ's evidence, in relation to the manual assessment of Mr Regan's loan application, is that the assessor devised an exit strategy that Mr Regan could downsize his home if required to pay out the loans, as he does not have any dependents.[35] ANZ's evidence is that no one at ANZ spoke to Mr Regan about whether it was acceptable to him to have to sell him home to make the loan repayments.[36] Mr Regan's evidence is that he does not want to sell his home because, after discharging the ANZ loan, he would not have enough money to buy another suitable property.[37]

4.13. In relation to the overseas money transfer, there was "striking"[38] evidence that the staff member who had signed the mortgage documents on behalf of the bank had assisted Mr Regan to drawdown more than $30,000 of the loan amount in British pounds rather than Australian dollars. This occurred despite the mortgage documents claiming the loan was for 'renovation' purposes. We submit that this exacerbates the unconscionability of ANZ's conduct.

4.14. We submit that it is also open to the Commissioner to make a finding that ANZ's conduct amounted to a breach of contract, and breach of directors' duties for the reasons set out in paragraphs 9.1 to 9.8 below.

4.15. *Available findings of conduct falling below community standards and expectations*

4.16. We support Ms Orr's submissions that ANZ's response to Mr Regan's hardship applications and its assessment of home loan applications falls below community standards and expectations.

4.17. We submit that it is also open to the Commissioner to make findings that ANZ's remuneration of brokers created conflicts of interest and that ANZ lacked appropriate supervision of broker conduct, and that this amounts to conduct which falls below community standards and expectations. This is because ANZ paid volume-based commissions to its brokers, which provided an incentive for brokers to submit inaccurate supporting documentation to increase the likelihood of loan approval and therefore the payment of commissions. Further, ANZ has relied on a broker distribution model to increase its home loan portfolio, but has failed to adequately monitor the compliance of these brokers to ensure customers (such as Mr Regan) have been treated fairly.

4.18. *Questions for written submissions in response*

4.19. *HEM Benchmark*

4.20. We submit that relying on the HEM benchmark alone is an inappropriate method to assess the suitability of a consumer credit application and to verify a consumer's expenses because:

- This conduct is contrary to ASIC Regulatory Guide 209, which provides that the use of benchmarks cannot be a replacement for making inquiries about a particular consumer's correct income and expenses;[39]

[32] *Perpetual Trustee Company Limited v Albert and Rose Khoshaba* [2006] NSWCA 41.
[33] *Fast Flx Loans Pty Ltd v Samardzic & Anor* [2011] NSWCA 260; *Perpetual Trustee Company Limited v Albert and Rose Khoshaba* [2006] NSWCA 41; *Elkofari v Perpetual Trustee Co Ltd* [2002] NSWCA 413.
[34] ANZ's conduct also breaches s 131(3) of the *National Consumer Credit Protection Act 2009* (Cth) because there is a presumption that a consumer can only comply with the consumer's financial obligation with substantial hardship if the consumer could only comply by selling their principal place of residence.
[35] Transcript of Proceedings (Day 6, 19 March 2018) 484; Exhibit #1.90, ANZ800.141.3095.
[36] Transcript of Proceedings (Day 6, 19 March 2018) 486.
[37] Witness Statement of Robert Regan, Exhibit #1.82, WIT.0001.0006.0001 [42].
[38] Transcript of Proceedings (Day 10, 23 March 2018) 991.
[39] ASIC, *Regulatory Guide 209 — Responsible lending conduct*, 5 November 2014, RG 209.105.

- Credit providers must make further inquiries where the information provided by the consumer is inconsistent with extrinsic documents[40], such as bank statements or pay slips. Relying on the HEM benchmark alone does not discharge that obligation;
- This conduct falls below the standards contained in the National Credit Act, which requires credit providers to make reasonable inquiries about a consumer's financial situation and to take reasonable steps to *verify* the consumer's financial situation;
- This conduct falls below the standards set out in responsible lending case law such as *ASIC v Cash Store*[41] and *ASIC v Channic*.[42] It is axiomatic that 'reasonable inquiries' about a consumer's financial situation *must* include inquiries about the consumer's current income and *living expenses*.[43] This is the *minimum* requirement and additional inquiries may be needed depending on the situation.[44] The assessment of affordability needs to reference the consumer's expenses *against* the consumer's income;
- Where a credit provider is supplied documents by a broker they must 'bring their own inquiring mind' to the assessments. Relying on benchmarks does not meet that standard;[45] and
- Reliance on benchmarks alone cannot guarantee that a consumer will be able to comply with the financial obligations under the contract without financial hardship. A credit provider must make further inquiries to satisfy that legislative requirement.

4.21. The HEM benchmark is too conservative to assess whether a consumer can meet their financial obligations without financial hardship. The objective of the National Credit Act is to ensure that the borrower can repay with sufficient comfort, not to live at or below the poverty line.[46] We note that ANZ's evidence is that the HEM benchmark could be improved by making different components of it higher.[47]

4.22. *Broker-originated home loans*

4.23. We submit that the evidence presented by NAB, Aussie Home Loans, CBA and ANZ during the hearings supports a finding that credit providers do not have adequate policies to ensure that they comply with their obligations under the National Credit Act when offering broker-originated home loans to customers.

4.24. Banks' inappropriate reliance on financial information submitted by intermediaries was a consistent theme throughout the hearings. For example, NAB failed to verify expense information provided by introducers, in contravention of its own policies about accepting information provided by introducers.[48] An audit report noted that CBA was reliant on brokers to confirm the product offered to customers was 'not unsuitable'.[49] ANZ's failure to verify Mr Regan's financial information was also established by the evidence.

4.25. ANZ (and others) continue to rely heavily on information about income and expenses submitted by brokers, and the HEM benchmark. This is despite significant concerns raised by KMPG during its review of ANZ's home lending practices.[50] From 418 files reviewed, KPMG found 68 observations relating to incomplete or incorrect borrower financial information. In 73 percent of the files reviewed, the customer's expenses defaulted to the HEM benchmark. The KPMG review recommended cross-checking of customers' actual living expenses, but this recommendation was not actioned by ANZ. When questioned on this point, ANZ witness William Ranken dismissed the need to make further inquiries and to verify expense information on the premise that it is 'very complex to design processes' to do this.

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[40] ASIC, *Regulatory Guide 209 — Responsible lending conduct*, 5 November 2014, RG 209.46–50.
[41] *Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 *('Cash Store')* (the liability decision) and *Australian Securities and Investments Commission v The Cash Store Pty Ltd (in liquidation) (No 2)* [2015] FCA 93 (the penalty decision).
[42] *Australian Securities and Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174 (liability decision) ('*Channic*'); *Australian Securities and Investments Commission v Channic Pty Ltd (No 5)* [2017] FCA 363 (penalty decision).
[43] *Cash Store* [2014] FCA 926 [42].
[44] *Cash Store* [2014] FCA 926 [42].
[45] *Channic* [2016] FCA 1174 [1804].
[46] See *FOS determination 319270* (27 November 2013), [23] <https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/319270.pdf>.
[47] Transcript of Proceedings (Day 6, 19 March 2018) 472.
[48] Transcript of Proceedings (Day 10, 23 March 2018), 970.
[49] Transcript of Proceedings (Day 10, 23 March 2018), 980.
[50] Transcript of Proceedings (Day 6, 19 March 2018) 473.

4.26. Further, we submit that evidence presented during the hearings supports a finding that credit providers do not have adequate systems in place to remediate customers with broker-originated home loans affected by misconduct. For example, the findings of ANZ's KPMG review suggested systemic breaches of responsible lending laws, yet no evidence was provided by ANZ of investigation into the number of consumers affected or remediation offered. Aussie Home Loans also said it had not been able to identify the how many customers had been affected by fraudulent conduct.[51]

4.27. The Commission also heard evidence of ANZ's failure to manage conflicts of interest related to its brokers. As flagged by the Commissioner during the hearing, there is 'nothing in it' for the broker to ensure the customer is facing the truth of his or her expenditure, or to 'interrogate the customer when the customer reports living expenses as X dollars a month'.[52] The Commission heard evidence of other banks also failing to deal with conflicts of interest resulting from volume-based commissions, indicating a systemic problem in the home loan sector. For example, CBA's CEO Ian Narev admitted that upfront and trailing commissions for mortgage brokers can lead to poor customer outcomes, yet CBA failed to disclose these commissions to consumers or change to a fee-for-service model.[53] Documents produced by NAB relating to the Project Winnow investigation into its introducer program summed up the problem as follows[54]*: "The risk and reward equation for bankers was unbalanced in favour of sales over keeping customers and the bank safe."*

4.28. *Broker, lender and customer relationship*

4.29. The Commissioner asked 'who does the broker act for', 'who does the customer think the broker is acting for' and 'who does the lender think the broker is acting for'.[55] As set out in our initial submission, the mortgage broker industry markets itself as acting for the consumer to help them get the best deal. However, in reality the question of who the broker is really acting for is far more complex.

4.30. The courts have traditionally approached this question as one of agency which is a question of fact.[56] FOS has adopted a similar approach.[57] The cases relating to whether the knowledge of the broker should be ascribed to the credit provider are mixed, however more recently the courts have taken into account the level of control and direction exerted by the principal and agent.[58] Other relevant facts include whether the broker has had the sole interaction with the borrower, the arrangements between the bank and the broker and agreements between the borrower and the broker.[59]

4.31. We consider that the current approach for resolving this question in consumer lending disputes is inadequate. This is because:

- Banks routinely claim that the broker is acting as the agent for the borrower and that the borrower should lodge a complaint against the broker for any incorrect assessment of expenses;[60]
- Irrespective of whether the broker was the agent for the consumer or the bank, the bank must take reasonable steps to verify the consumer's financial situation.[61] The uncertainty of this issue impedes the resolution of the consumer's complaints because the consumer must provide detailed evidence of fact to an external dispute resolution scheme to establish whether the broker was acting as their agent;
- The overwhelming evidence before the Commission is that brokers do not act in the best interests of the consumers, but are instead driven by sales incentives such as upfront or trail commissions; and

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[51] Transcript of Proceedings (Day 6, 19 March 2018), 393.
[52] Transcript of Proceedings (Day 6, 19 March 2018), 467, 476.
[53] Transcript of Proceedings (Day 4, 15 March 2018), 259.
[54] Transcript of Proceedings (Day 10, 23 March 2018), 974.
[55] Transcript of Proceedings (Day 10, 23 March 2018), 982.
[56] *Perpetual Trustees Australia Limited v Schmidt & Anor* [2010] VSC 67 (4 May 2010) *Custom Credit Corporation Ltd v Lynch* [1993] 2 VR 469, 481.
[57] See *FOS Determination 293257* (4 February 2015) <https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/293257.pdf> and *FOS Determination 287764* (22 August 2014) <https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/287764.pdf> in which FOS held that the brokers were the agents of the Financial Services Provider.
[58] *Perpetual Trustees Australia Limited v Schmidt & Anor* [2010] VSC 67; *Michalopolous v Perpetual Trustees Victoria Ltd & Anor* [2010] NSWSC 1450.
[59] Australian Banking Industry Ombudsman, *Ombudsman Bulletin* 36 (2002), recently upheld as the current FOS approach in *FOS Determination 287764* <https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/287764.pdf>.
[60] See Letter from ANZ to Consumer Action Law Centre dated 15 March 2018 re: Robert Regan, Exhibit #1.86.
[61] *National Consumer Credit Protection Act 2009* s 130.

- Consumers have a poor understanding of the role of brokers and lack awareness of any conflicting incentives, such as commissions, which may distort the broker's advice.

5. Case Study 5: Irene Savidis and CBA add-on insurance

5.1. *Available findings of misconduct*

5.2. We strongly support the findings of misconduct outlined in closing submissions, including findings of misleading and deceptive conduct. We also consider that evidence adduced in the case study of Irene Savidis showed CBA's failure to comply with section 912A(1)(a) of the Corporations Act (the requirement to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly)[62] by reason of its:

- sales practices and procedures for consumer credit insurance (**CCI**), and
- failure to identify customer detriment and respond appropriately.

5.3. This misconduct was systemic and widespread in CBA. Based on our casework over many years, it is possible that the equivalent systems and procedures of other banks, insurers and their representatives which sell CCI may have led to similar results. We refer also to ASIC remediation announcements in relation to various insurers referred to in the Witness Statement of Michael Saadat from ASIC.[63]

5.4. *CBA sales practices*

5.5. As the evidence of Irene Savidis[64] and Clive Van Horen[65] showed, CBA's sales practices and procedures incentivised staff to sell add-on insurance to customers, and required them to do so without regard to whether or not an individual customer would be eligible to make a claim.

5.6. The Commission heard evidence that a bank staff member pressured Ms Savidis to take out CreditCard Plus (**CCP**) insurance, despite having told the staff member that she was unemployed. Mr Van Horen provided evidence of sales targets and campaign-related sales incentives including staff prizes associated with the sale of CCP and other forms of CCI. We submit that inappropriate sales of CCI, including to Ms Savidis, were not a compliance failure, but a predictable consequence of the systems which CBA put in place.

5.7. Separate to sales incentives paid to individual staff members, lenders receive commissions from insurers for sales of add-on insurance. Section 145 of the National Credit Code caps commission at 20 percent of the premium for CCI sold on regulated consumer credit contracts. As lenders are not the underwriter of the product, their interests are not directly aligned with the product being of benefit to the consumer, which creates a conflict of interest.

5.8. We submit that CBA's CCI sales processes and failure to manage the risks inherent in CCI sales have breached section 912A(1)(a). Based on our casework experience and ASIC Report 256[66], we consider that it is likely that the processes of other banks and other financiers may also breach section 912A(1)(a) on the same basis.

5.9. *CBA's failure to address misconduct and remediate customers*

5.10. We submit that CBA also breached its obligations under section 912A(1)(a) by failing to:

- address identified problems in its practices and procedures, and
- adequately compensate affected customers in a timely manner.

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[62] The definition of financial services under the Corporations Act includes the issue of general and life insurance products and related activities (such as arranging for the issue of general and life insurance products).
[63] Exhibit #1.158, WIT.0001.0003.0001, [110]-[122].
[64] Witness Statement of Irene Savidis, Exhibit #1.92, WIT.0001.0004.0001, [11].
[65] Transcript of Proceedings (Day 6, 19 March 2018), 505–8.
[66] Exhibit #1.99, RCD.0021.0001.0003.

5.11. We submit that CBA knew, or should have known, that it was at risk of mis-selling CCI before 2015. The same is true of other banks and insurers. Since the the late 1980s, a series of reports[67], regulatory actions and litigation have put CBA and other financial services entities on notice that the sale of CCI is inherently risky. At least since 2011, CBA should have been aware of the Payment Protection Insurance scandal in the United Kingdom,[68] and of the conclusions and recommendations of ASIC Report 256.

5.12. We submit that CBA was too slow to identify the initial 64,000 unemployed customers who were mis-sold CCI and remediate them. Further, CBA's response, once it identified these customers, has been inadequate because:

- CBA made an informal 'good governance notification' to ASIC in relation to only 27,800 customers, rather than a significant breach notification in relation to the full number of customers;[69]
- CBA made changes to its sales processes, but did not include an employment eligibility knock out question to prevent further mis-selling for online applications until 2017;[70]
- In 2015, CBA initially only intended to compensate unemployed customers who had active CCP insurance policies. It failed to take any steps to address consumer detriment in relation to the sale of a similar Loan Protection Insurance product until ASIC made it aware of a consumer complaint in 2016. It did not take action in relation to lapsed CCI policies; and
- Other than students, unemployed customers will be required to proactively respond to CBA in order to receive compensation. Vulnerable and disadvantaged customers are less likely to actively contact CBA and secure the refunds to which they are entitled . The people most likely to miss out on remediation include culturally and linguistically diverse people, people with low literacy and people who are not easily contacted (for example, due to housing insecurity or not owning a telephone).

5.13. It is unclear how CBA identified unemployed customers, given that they did not record this information at the point of sale. There also appears to be a gap in CBA's remediation program in respect of customers who were ineligible to claim for other reasons, for example, due to that fact that their work was casual or they were self-employed.[71]

5.14. We submit that CBA's failure to address its misconduct, including its reluctance to notify ASIC of the extent of the breach, its failure to rectify the sales process to prevent further mis-selling and its inadequate remediation, is a breach of section 912A(1)(a). Again, we submit that other financial services entities may have similar CCI mis-selling problems which they have failed to address.

5.15. Beyond CBA, it is likely that there are large groups of people, including customers of other banks, who were mis-sold CCI but are yet to be identified and refunded.

5.16. *Additional available findings of misconduct*

5.17. We submit that the evidence provided during Ms Savidis' case study supports a finding that CBA engaged in unconscionable conduct under section 12CB of the ASIC Act by selling CCI to people who were unemployed and therefore ineligible to claim on it.

5.18. On 26 August 2014, the Federal Court held in *ASIC v The Cash Store (in liq)* [2014] FCA 926 that The Cash Store engaged in unconscionable conduct by selling CCI to unemployed customers. The Cash Store was fined $1.1 million. In 2015, insurers agreed to refund $2.4 million to people who were mis-sold CCI through The Cash Store.[72] This put CBA on further notice that it should, at a minimum, refund customers in that same

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[67] This includes the 1987 Australian Financial Counselling and Credit Reform Association report *Need or greed: a report on consumer credit insurance*, and the 1991 report from Redfern Legal Centre*, 31 cents in the dollar: a report on consumer credit insurance from the consumer perspective.*

[68] Financial Conduct Authority, *History of payment protection insurance regulation* <https://www.fca.org.uk/publication/documents/history-ppi-regulation.pdf>.

[69] Transcript of Proceedings (Day 6, 19 March 2018), 516–8.

[70] Transcript of Proceedings (Day 6, 19 March 2018), 521-2.

[71] See Witness Statement of Clive Richard Van Horen (CCP & LPP), Exhibit #1.95, CBA.9006.0001.0001, p 4–6, 14–16.

[72] ASIC, 'Allianz agrees to refund $400K in 'useless' payday insurance premiums' (Media Release, 15-044MR, 3 March 2015); ASIC, 'CGU Insurance and Accident and Health International to refund $2 million in 'useless' payday insurance premiums' (Media Release,15-175MR, 7 July 2015).

category. Yet CBA had a system that both incentivised and required staff to sell CCI without contemplating a customer's employment status, and the suitability of its CCI products significantly depended on a customer's employment status.[73]

5.19. We further submit that it is open to the Commissioner to make findings that:

- Colonial Mutual Life Assurance Society Ltd (**CommInsure**) breached its duty of utmost good faith under the *Insurance Contracts Act 1984* (Cth), by providing cover for a risk that did not exist;[74]
- CBA and CommInsure breached section 912A(1)(aa) of the Corporations Act, by failing to have in place adequate arrangements for the management of conflicts of interest (see paras 5.4 to 5.8 of this submission); and
- CBA's conduct amounted a breach of contract, and breach of directors' duties for the reasons set out in paragraphs 9.1 to 9.8.

5.20. *Questions for written submissions in response*

5.21. *Processes for compliance with section 912A(1)(a)*

5.22. The mis-selling of add-on insurance is systemic. In that regard, we refer to the Witness Statement of Michael Saadat.[75] Whilst the hearing focused on the sale of CCI by CBA, Consumer Action's casework experience and ASIC investigations show that other financial services providers also have systems which facilitate that sale of unsuitable add-on insurance. ASIC has described the sale of add-on insurance through car yards as 'a market that is failing consumers'.[76]

5.23. Add-on insurance products, such as CCI, are inherently complex. Yet, they are sold by sales staff on a 'no advice' model, in a system that incentivises them to sell products, without considering whether or not the product is likely to be useful for the customer. While the hearing focused on CBA selling CCI to unemployed people, many people have been sold CCI which they are ineligible to claim on, because they are employed part-time or casual, or are self-employed. They may also be precluded from claiming due to a pre-existing medical condition.

5.24. We respectfully suggest that the Commission considers separately whether or not insurers have engaged in misconduct and conduct falling below community expectations in relation to their role in add-on insurance mis-selling. Insurers are ultimately responsible for the products, the way they are sold and the commissions they pay salespeople. The proposed Product Design and Distribution Obligations will codify this responsibility.

5.25. *Deferred sales model*

5.26. A proposed deferred sales model[77] is inadequate to prevent consumer detriment. Ms Savidis gave evidence that when she applied for the credit card online, CBA immediately conditionally approved the application, then later sold her CCI in the branch. Despite this delay between the credit application and sale of CCI, Ms Savidis was subjected to high pressure sales tactics and was sold unsuitable CCI.

5.27. Ms Savidis' situation demonstrates that any deferred sales model must require that a customer initiate the sale of add-on insurance, rather than allow a salesperson to initiate marketing after a delay. If a customer were required to proactively purchase add-on insurance, they would actively consider whether they wanted it, rather than passively accept it from a salesperson who is incentivised to sell it.

5.28. CBA and other banks have the resources to ensure compliance with financial services legislation. Despite this, the evidence adduced revealed systemic misconduct. Add-on insurance products are complex and low value, and mis-selling is systemic. We submit it is therefore open to the Commission to make findings that:

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[73] Transcript of Proceedings (Day 6, 19 March 2018), 505-8.
[74] *Insurance Contracts Act 1984* (Cth) s 13; *Carter v Boehm* (1766) 3 Burr 1905, 1909–10.
[75] Exhibit #1.158, WIT.0001.0003.0001.
[76] ASIC, 'A market that is failing consumers: The sale of add-on insurance through car dealers' (Report No 492, ASIC, 12 September 2016).
[77] ASIC, 'Banks to overhaul consumer credit insurance sales processes' (Media Release, 17-255MR, 1 August 2017).

- add-on insurance should only be sold under a deferred sales model in which the customer must pro-actively choose to buy the product after a delay; or
- add-on insurance sales processes should be prohibited entirely, meaning customers may only buy these policies separately.

5.29. *Conclusions about CBA's 'withdrawal' from the market*

5.30. CBA announced on 7 March 2018 that it was withdrawing from selling CCI on credit cards and personal loans[78], but not home loans. Home loan CCI has provided the most premiums of CBA's CCI line.[79] CBA stated that it intends to work with AIA to develop 'alternative' products.

5.31. We do not consider this a wholesale withdrawal from the market by CBA. It may instead have been a timely announcement that CBA would suspend problematic business practices in the week before they were scrutinised at the Royal Commission hearings. Without knowing CBA's planned 'alternative' product and processes, it is difficult to judge whether this is a move to address harm to consumers or reputational harm to CBA.

5.32. We submit that genuinely withdrawing from the market appears to be the most viable option for industry to resolve its own problems with CCI. CCI is a complex, low-value product which has limited benefit to many people.

6. Case Study 9: Nalini Thiruvangadam and Westpac car finance

6.1. *Available findings of misconduct*

6.2. We strongly support the findings of misconduct outlined by Ms Orr in closing submissions. We have made further submissions below on additional findings of misconduct open to the Commissioner.

6.3. *Additional available findings of misconduct*

6.4. For the reasons set out in paragraphs 6.14 to 6.17 below in relation to structural arrangements, we submit that it is open to the Commissioner to make a finding of misconduct that Westpac breached its statutory obligation under section 47(1)(e) of the National Credit Act to take reasonable steps to ensure that its representatives comply with the credit legislation.

6.5. For the reasons set out in paragraphs 6.18 to 6.23 below in relation to remuneration and incentives, we submit that it is open to the Commissioner to make a finding of misconduct that Westpac breached its statutory obligation under section 47(1)(b) of the National Credit Act to ensure that clients of the licensee are not disadvantaged by any conflict of interest.

6.6. Further, we submit that the conduct of Allianz and the business manager at the car dealership amounts to unconscionable conduct under section 12CB of the ASIC Act. Ms Thiruvangadam gave evidence about how the car salesperson pressured her into taking out two insurance policies with Allianz, including hanging up her telephone when she tried to call Allianz.[80]

6.7. We consider that it is also open to the Commission to conclude that the salesperson's failure to mention the motor equity insurance policy in these circumstances constitutes misleading and deceptive conduct by omission under section 12DA of the ASIC Act.

6.8. We refer to Exhibit NDT-9 of Ms Thirivangadam's witness statement. It appears Allianz failed to provide a copy of the Product Disclosure Statement (**PDS**).[81] Based on our casework, in our view this may be a systemic issue for Allianz. We submit that it is open to the Commission to conclude Allianz has systemically failed to provide PDSs to customers, in breach of section 1012B of the Corporation Act.

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[78] Exhibit #1.109, RCD.0021.0001.0262.
[79] Transcript of Proceedings (Day 6, 19 March 2018), 570–1.
[80] Witness Statement of Nalini Thirivangadam, Exhibit #1.138, WIT.0001.0012.0001 [21].
[81] As required by s 1012B of the *Corporations Act 2001* (Cth).

6.9. Finally, it is open to the commission to find that Westpac has engaged in unconscionable conduct under section 12CB of the ASIC Act, because it has not identified and remediated customers who paid more for their car loans due to the unconscionable conduct of salespeople who were paid flex-commissions. These customers paid more for their loans irrespective of the product features or their lending risk profiles. who were paid flex-commissions. These customers paid more for their loans irrespective of the product features or their lending risk profiles.

6.10. *Available findings of conduct falling below community standards and expectations*

6.11. We support Ms Orr's closing submissions in relation to available findings of conduct falling below community standards and expectations in relation to flex-commissions. However, we submit that on the evidence, additional available findings of conduct falling below community standards and expectations are:

- Westpac (and other car financiers) continuing to pay volume-based commissions to car dealerships; and
- Westpac (and other car financiers) continuing to rely on the 'point of sale exemption'[82] distribution model, despite the unacceptable risk of poor consumer outcomes these practices create.

6.12. Ms Thiruvangadam's case study shows that sales incentives are inconsistent with consumer interests and that insurers are not adequately supervising the people selling their products. This has led to unfair sales conduct and consumer harm. We submit that this type of sales conduct is systemic and driven by incentives and profits derived from add-on insurance.

6.13. *Effectiveness of mechanisms for redress*

6.14. In addition to Ms Orr's submissions, we note that on 17 January 2018, ASIC announced that Allianz would refund $45.6 million in add-on insurance premiums.[83] Ms Thiruvangadam's case study demonstrates that this remediation is incomplete in that it only ensures compensation for customers for whom it is apparent from the documentation that the product was of little or no value to them. It does not address situations where the customer has purchased the policy solely as a result of the salesperson's unconscionable or misleading and deceptive conduct, as was the case for Ms Thiruvangadam.

6.15. *Questions for written submissions in response*

6.16. *Structural arrangements*

6.17. We submit that evidence presented during the hearings supports a finding that structural arrangements between banks and car dealers for the provision of car loans to consumers are likely to result in contraventions of the banks' responsible lending obligations under the National Credit Act. The reliance on the 'point of sale exemption' distribution model is central to this problem.

6.18. ASIC gave evidence that its inquiries have indicated that the majority of car dealers operate within the point of sale exemption, rather than operating as credit licensees or credit representatives. Car dealers operating within the point of sale exemption are not required to comply with the National Credit Act. This means they are not subject to responsible lending and disclosure obligations, among others. Westpac gave evidence that the 'overwhelming majority' of its car loans are originated by dealers.[84] The Commission heard evidence that suggested Westpac had effectively subcontracted its responsible lending obligations to dealers.[85] Despite the absence of conduct standards for dealers operating within the point of sale exemption and risk of poor customer outcomes as demonstrated by Ms Thiruvangadam's case study, Westpac gave evidence that it remains 'heavily committed' to the point of sale exemption distribution model.[86]

6.19. The Commission heard additional evidence of poor customer outcomes resulting from the point of sale exemption distribution model from ANZ. ANZ has identified 547 customers impacted by dealer fraud, although

[82] *National Consumer Credit Protection Regulations 2010* (Cth) r 23.
[83] ASIC, 'Allianz refunds $45.6 million in add-on insurance premiums' (Media Release, 18-008MR,17 January 2018).
[84] Transcript of Proceedings (Day 8, 21 March 2018) 734.
[85] Transcript of Proceedings (Day 8, 21 March 2018), 769.
[86] Transcript of Proceedings (Day 8, 21 March 2018), 734 and 784.

only 324 of these customers will receive remediation.[87] ANZ has also paid more than $750,000 in remediation to customers as a result of its 'guarantor swap incident'.[88] We submit that it is open to the Commissioner to make findings that a root cause of misconduct in both the Westpac and ANZ case studies is the inadequate conduct standards for and supervision of intermediaries operating within the point of sale exemption.

6.20. *Remuneration and incentives*

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

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

6.22. Westpac gave evidence that it paid three types of remuneration to car dealers, which included flex-commissions and payments linked to the aggregate volume of loans. Westpac admitted that flex-commissions gave the dealer an interest in maximising the margin between the base rate and the interest rate charged to the consumer in order to earn more commissions. Until August 2016, Westpac did not impose any maximum cap upon the amount of flex-commission that could be charged to a customer.[89]

6.23. The Commission heard evidence that an internal Westpac audit report identified significant weaknesses in the design of this remuneration scheme and concluded that 'current practices significantly increase the risk of unfair consumer outcomes'.[90] Despite this observation, Westpac continues to pay dealers volume-based commissions and flex-commissions.[91] Customers are not informed about this commission structure. Westpac gave evidence that it will continue to pay flex-commissions until ASIC's legislative instrument banning flex-commissions comes into effect in November 2018.

6.24. The conflicts of interest created by commissions in the car lending industry were also apparent in ANZ's evidence. ANZ admitted that its flex-commission arrangements gave an incentive to car dealers to increase the price of credit in a way that did not relate to credit risk, but instead demined by a consumer's financial sophistication and capacity to negotiate.[92]

6.25. These remuneration and incentive structures clearly create an unacceptable risk that dealers will prefer their own interests to the interests of customers, and that customers will suffer detriment in the form of unsuitable loans or higher interest rates as a result. We submit that it is also open to the Commissioner to make findings that misconduct in the Westpac and ANZ case studies is attributable to the conflict of interest created by conflicted remuneration payments.

7. Case Studies 6 and 11: CBA personal overdrafts and credit cards

7.1. *Questions for written submissions in response*

7.2. *Policies to ensure compliance with responsible lending obligations*

7.3. We submit that the evidence presented at the hearings supports a finding that credit providers do not have adequate policies to ensure that they comply with their responsible lending obligations under the National Credit Act when offering personal overdrafts, credit cards and credit card limit increases to consumers, insofar as those policies require them to:

- make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract;
- make reasonable inquiries about the consumer's financial situation; and
- take reasonable steps to verify the consumer's financial situation.

[87] Transcript of Proceedings (Day 9, 22 March 2018), 842.
[88] Transcript of Proceedings (Day 9, 22 March 2018), 835.
[89] Transcript of Proceedings (Day 8, 21 March 2018), 753.
[90] Transcript of Proceedings (Day 8, 21 March 2018), 756.
[91] Transcript of Proceedings (Day 8, 21 March 2018), 758.
[92] Transcript of Proceedings (Day 9, 22 March 2018), 818–9.

7.4. As set out in Part 1 of our submission to the Commission,[93] the use of automated systems to process and approve applications for unsecured credit is particularly problematic. CBA gave evidence that it automatically assessed customers as eligible for credit limit increases simply by reference to whether a person's monthly average repayments over the last 6 months were equal to or greater than 2 percent of the proposed new limit.[94] Further, CBA gave evidence that no inquiries or verification of expenses were conducted as part of the credit limit increase offer processes. The Commission also heard evidence that CBA's current processes still would not protect consumers such as Mr Harris who had battled with gambling addiction and for whom a credit limit increase would not meet his requirements or objectives.

7.5. *Policies and access to information*

7.6. In terms of policies that might be appropriate to ensure that reasonable inquiries are made into consumers' discretionary expenditure, we submit that banks have adopted policies that preference automation or administrative convenience over compliance with the law. For example, CBA provided evidence that it did not take steps to verify the expenses of an applicant for an overdraft, even if it held that information, but that it nevertheless complied with its obligations under responsible lending 'taking into account scalability'.[95] We submit that banks appear to take the view that if lending is unsecured or for small amounts, they are not required by the responsible lending obligations to verify expenses of a loan applicant.

7.7. With respect to the obligations of credit assistance providers, Davies J has stated that "reasonable" inquiries about the consumer's requirements and objectives must be such inquiries as will be sufficient to enable the credit assistance provider to make an informed assessment as to whether the credit contract will meet the consumer's requirements or objectives. Similarly, "reasonable" inquiries about, and "reasonable" steps to verify, the consumer's financial situation must be such inquiries and steps as will be sufficient to enable the credit assistance provider to make an informed assessment as to whether the consumer will be able to comply with the consumer's financial obligations under the contract without substantial hardship.[96]

7.8. Further, ASIC guidance states that certain factors are relevant to the scalability of the reasonable inquiries and verification obligations, including the potential impact on the consumer of entering into an unsuitable credit contract. ASIC states that more extensive inquiries are likely to be necessary if the size of the loan is large *relative* to the consumer's capacity to repay the loan: "this is because even a small loan can cause financial difficulties for a consumer on a low income; therefore, in this situation, we expect that you will need to make more inquiries in order to meet your responsible lending obligations".[97]

7.9. We submit that CBA and other banks continue to err in their approach to scalability. Particularly in circumstances where a bank has access to information about a customer's spending, by reason of the fact that the customer has other accounts with the bank or the customer's bank statements are easily available, we submit that is necessary for bank to inquire into the expenses incurred in respect of those accounts to comply with its responsible lending obligations under the National Credit Act.

8. Case Study 12: Westpac credit cards

8.1. *Questions for written submission in response*

8.2. *Assessing unsuitability*

8.3. The very nature of a high interest, revolving credit card facility is problematic. For many borrowers, it is an inherently dangerous product. This was supported by Westpac's evidence, which admitted that there is an incentive for the bank to maximise the number of 'revolving customers' who do not default entirely, but pay interest and charges.[98]

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[93] Consumer Action, Submission to Royal Commission Part 1 [2.6].
[94] Transcript of Proceedings (Day 9, 22 March 2018) 886.
[95] Transcript of Proceedings (Day 7, 20 March 2018) 595.
[96] *ASIC v The Cash Store (in liquid)* [2014] FCA 926 [28].
[97] ASIC, *Regulatory Guide 209 — Responsible lending conduct*, 5 November 2014, RG209.22.
[98] Transcript of Proceedings (Day 10, 23 March 2018) 908.

8.4. In terms of assessing the unsuitability of a revolving credit card facility, there are some basic steps that banks should be making to ensure this product meets the customer's requirements and objectives:

- Inquiring about the customer's desired maximum credit limit, and not providing credit limits in excess of this amount;
- Asking about the purpose of the credit card. If the credit card is being used for a large purchase that will be repaid over a longer term, then it is likely that a lower interest credit product such as a personal loan would be more suitable;
- Make appropriate inquiries (and verify) the customer's financial situation, and assess affordability based on repaying the entire limit over a short-term period. Credit card limits that are only affordable if repaid with significant interest over a lengthy period of time are not suitable; and
- When assessing affordability and suitability, consider the customer's spending patterns on current credit cards. If the customer is not repaying the full balance every month, then a high interest rewards credit card may not be suitable.

8.5. In relation to balance transfers, if the customer cannot repay the transferred balance in the balance transfer or 'teaser' period, or if the customer intends to make new purchases, then the card is unlikely to be suitable. Balance transfers are particularly problematic when they are marketed as a 'debt solution'. For example, NAB's website states that "Balance transfers are one way to help consolidate your credit card debt and give you some breathing space."[99] However, often the original credit card(s) are not cancelled and it leads to an increase in overall debt and financial stress.

8.6. Fundamental to the debt trap created by credit cards is the minimum repayment amount. Currently, very low mandatory minimum repayment amounts tend to encourage consumers to carry balances over from month to month. In behavioural terms, the invoiced figure on credit card statements is often perceived as the "bill" amount due for that month, rather than as a payment towards clearing a debt. This is described as the 'anchoring effect'.[100]

8.7. We consider that increasing minimum repayment amounts would provide a powerful tool to lower credit card indebtedness and reduce credit card-related financial hardship. We note that some credit card providers have already increased their minimum repayment amounts. For example, the minimum repayment for ING Direct's Orange One credit card is now 10% of the closing balance.[101]

8.8. Implementing this measure would not necessarily result in a wave of consumer defaults, particularly when hardship variations and the other proposed reforms are considered. If a consumer is at risk of falling into default, then a hardship variation can be put in place by the credit provider to manage that situation. There could also be a lead-up phase where consumers are warned for a 6-month period, for example, that minimum payment percentages are increasing from a certain date and that they should take steps to reduce, or not increase, their outstanding balance in anticipation of these changes. Even if higher minimum repayments were considered too onerous for existing customers, they could still be implemented for prospective credit card customers.

8.9. *Period of repayment*

8.10. We consider that the appropriate level and period of repayment that ought to be taken into account, having regard to the legislative reforms that are to take effect from 1 January 2019, is two years.[102] A two-year assessment rule should provide a sufficient amount of credit for consumers to use credit cards for necessary

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[99] National Australia Bank, *Balance Transfers* <https://www.nab.com.au/personal/banking/credit-cards/balance-transfers>.
[100] Benjamin Keys and Jailan Wang, 'Minimum payments and debt paydown in consumer credit cards' (Working Paper 22742, National Bureau of Economic Research, October 2016), 35 <http://www.nber.org/papers/w22742>.
[101] ING Direct, *Orange One Terms and Conditions,* (21 April 2017) 6, <https://www.ing.com.au/pdf/orangeone/Orange%20One%20Terms%20and%20Conditions.pdf>.
[102] *The Treasury Laws Amendment (Banking Measures No. 1) Act 2018* (Cth) tightens responsible lending obligations for credit card providers by requiring affordability assessments to be based on whether a consumer can repay the full credit limit within a reasonable period. S 160F of the *National Consumer Credit Protection Act 2009* (Cth) now empowers ASIC to determine the length of the reasonable period.

purposes, while at the same time preventing debts from growing to the point where they become an unmanageable long-term debt obligation.

8.11. Two years is a generous timeframe for the affordability assessment and would see consumers paying a significant amount of interest. Someone who borrowed $10,000 from a Commonwealth Bank Gold Awards credit card with an interest rate of 20.24% per annum would pay more than $2,000 in interest over two years, even if they do not incur any additional debt.[103]

8.12. Our concerns about timeframes for repayment are comparable to those expressed by the Centre for Responsible Credit (**CfRC**) and the New Economic Foundation (**NEF**) in the United Kingdom in its response to the Financial Conduct Authority's (**FCA**) proposed new rules to help people in 'persistent credit card debt'. Under the FCA's definition, credit card customers are in persistent debt if they have paid more in interest and charges than they have repaid of their borrowing, over an eighteen-month period.[104]

8.13. *Automated systems*

8.14. We agree with concerns raised by ASIC and the Code Compliance Monitoring Committee about banks utilising automated systems. As set out above, in our experience automated systems raise serious compliance issues. This was also demonstrated by Westpac's evidence at the hearings, which showed the bank had approved 183,143 credit limit increases using automated systems. Westpac admitted that it did not inquire about those customers' employment, income or non-Westpac debts as part of this process.[105]

8.15. The Commission received evidence about ASIC's concerns with highly automated processes. In its letter to banks ASIC said, "*the use of highly automated processes, while arguably efficient for industry, creates a potential tension with responsible lending obligations that require assessment of each individual consumer's needs, objectives and financial capacity*".[106] While automated process perhaps offer additional 'administrative convenience', they are unlikely to be compliant. In fact, they are simply allowing more mistakes to be made quicker.

9. Additional available findings

9.1. *Available findings of misconduct - Breach of contract and the Banking Code of Practice*

9.2. Breaches of the Banking Code of Practice (**Code**) were raised in closing submissions in relation to Case Studies 4, 5 and 9. We submit that it is open to the Commission to find that a breach of the Code may also be a breach of the lender's contractual obligations, subject to the terms and conditions of the contract. That is, if the lender has adopted the Code and the obligations under the Code form part of the terms and conditions of the loan contract (*Doggett v Commonwealth Bank of Australia* [2015] VSCA 351 [104] McLeish JA (with whom Whelan JA and Garde JA agreed); *National Australia Bank v Rose* [2016] VSCA 169 [40] Warren CJ and McLeish JA), then a breach of these obligations is also a breach of the contract. In such cases, therefore, the corresponding remedies are available to remediate any loss or damage caused by the breach to the consumer.

9.3. We submit that it is open to the Commission to go further and find that the terms of the Code form part of the loan contract by reason of the bank's adoption of the Code alone (adopted most recently by all major banks on 1 February 2014). Alternatively, the Commission may find that the Code should be given statutory force, as has been done with the Franchising Code (*Competition and Consumer (Industry Codes—Franchising) Regulation 2014*) or that the Code form part of a 'co-regulatory' model as proposed by the ASIC Enforcement Review Taskforce.[107]

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[103] Interest repayments calculated using: Commonwealth Bank, *Credit card repayment calculator,* accessed 22 August, <https://www.commbank.com.au/digital/calculators/credit-card-repayments/how-long>.
[104] Financial Conduct Authority, 'FCA proposes new credit card rules to help millions of customers get out of persistent debt' (Press Release, 3 April 2017) <https://www.fca.org.uk/news/press-releases/fca-proposes-new-rules-help-customers-persistent-debt-credit-cards>.
[105] Transcript of Proceedings (Day 10, 23 March 2018), 919.
[106] Transcript of Proceedings (Day 10, 23 March 2018) 927.
[107] ASIC Enforcement Review Taskforce, 'Industry codes in the financial sector' (Position and Consultation Paper No 4, June 2017).

9.4. *Available findings of misconduct - Breach of directors' duties*

9.5. Section 180 of the Corporations Act imposes duties of care and diligence on directors and officers of a corporation. These are civil penalty provisions, to which corresponding civil penalties attach.[108] Section 206C provides that the Court has the power to disqualify persons from managing corporations who have contravened a civil penalty provision.

9.6. In the recent cases of *ASIC v Cassimatis (No 8) [2016] FCA 1023* (**Storm**), *ASIC, in the matter of Sino Australia Oil and Gas Limited (in liq) v Sino Australia Oil and Gas Limited (in liq)* [2016] FCA 934 and *ASIC, in the matter of Padbury Mining Limited v Padbury Mining Limited* [2016] FCA 990 (**Padbury**), directors of the corporations were found to have breached their duties of care and diligence by unreasonably exposing the company to sanctions, civil liability or reputational damage. This has been called the "stepping stone" approach to liability. In Padbury, two directors were disqualified for three years and pecuniary penalties of $25,000 were imposed along with costs orders of $200,000.

9.7. The aforementioned cases provide that while a breach of relevant laws is not in and of itself sufficient to establish director liability, a director can breach their duty of care and diligence by exposing the company to risk of harm. The test 'involves consideration of all circumstances including the foreseeable risk of harm to any of the interests of [the company] and the magnitude of that harm, together with the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question, and any burdens of further alleviating action' (Storm [675]). Importantly, all of a company's interests—including reputation—are relevant when considering the risk of harm (Storm [478],[480-1],[483]).

9.8. We submit that where the Commission finds misconduct or conduct that falls below community expectations, and that conduct exposes the company to significant risk of harm (including harm to its reputation) — for example, where the causes of the conduct amount to a systemic failure in a company's policies and processes — it is open to the Commission, subject to consideration of all the circumstances, to also make a finding that the directors have breached their duties of care and diligence under the Corporations Act. Such a finding is important to ensure there is accountability among the leadership (including directors and senior management) for misconduct or conduct that has fallen below expectations.

9.9. *Example: NAB Introducer Program*

9.10. In relation to the first case study, being the NAB Introducer Program (**Program**), we support the findings recommended in closing submissions that NAB breached the National Credit Act and the Corporations Act, engaged in misleading and deceptive and unconscionable conduct and failed to comply with ASIC's guidance and the Banking Code of Practice. We further submit that it is also open to the Commission to find that persons in positions of power of corporations such as NAB in such circumstances ought to be individually liable for the misconduct.

9.11. The Program concerned unlicensed third parties introducing potential home loan customers to NAB between 2013 and 2016 for a commission. NAB acknowledged misconduct including the falsifying of loan documents, dishonest application of customer signatures on forms approving introducers' commissions and provision of unsuitable loans by more than 60 employees, most of whom were branch managers.[109] NAB has so far identified approximately 1300 affected customers.

9.12. NAB commenced an investigation into the misconduct in October 2015 following two whistle blower disclosures and reported to ASIC in February 2016 despite having been aware of it in April 2015. Of the employees involved, 10 were dismissed, 10 left NAB and 32 were subject to other changes in their employment. At this time, not all affected customers have been identified and no customers have been remediated. During the life of the Program, NAB brought in more than $24 billion in home loans.

9.13. While there is evidence that causes of this misconduct are attributable to the culture and governance practices at NAB including catastrophic failures of NAB's internal policies and processes, there is no evidence that

[108] *Corporations Act 2001* (Cth) s 1317E.
[109] Transcript of Proceedings (Day 10, 23 March 2018) 970.

those in positions of power at NAB have faced any consequences. When taken together with the lack of timely investigation and reporting of the conduct to ASIC, delays in identification and remediation of affected customers and continued use of a similar remuneration and incentives schemes which risk poor consumer outcomes, it appears that the NAB leadership is at the very least tolerant of very serious misconduct.

9.14. *Adequacy of existing laws and policies – Penalties*

9.15. We submit that it is open to the Commissioner to make a finding that the penalties for misconduct identified above are inadequate to incentivise compliance and deter misconduct. These concerns were reflected in the recent ASIC Enforcement Review consultation on strengthening penalties for corporate and financial sector misconduct.[110] The consultation paper recommended increasing the maximum civil penalty amounts in the Corporations Act and National Credit Act to:

- for individuals, 2,500 penalty units ($525,000); and
- for corporations, *the greater of*: 12,500 penalty units ($2.625 million), or three times the benefit gained (or loss avoided) or 10% annual turnover.

9.16. This would represent a significant increase from the current penalties for misconduct, being increases from $200,000 (individuals) and $1 million (corporations) in the Corporations Act and 2,000 penalty units ($420,000) for individuals and 10,000 penalty units ($2.1 million) for corporations in the National Credit Act.

9.17. We submit that in assessing the adequacy of penalties, a comparison can be drawn with proposed increases in maximum penalties for consumer law breaches, being $10 million, the value of the benefit obtained from the offence, or 10% of annual turnover for corporations.[111]

9.18. Noting that such maximum civil penalties are arbitrary and may not be sufficient to provide appropriate compliance incentives to very large corporations, we also support recommendations for ASIC to be empowered to seek disgorgement remedies (removal of benefits illegally obtained or losses avoided) in civil penalty proceedings brought under the Corporations, National Credit and ASIC Acts.[112] For example, consider Westpac's evidence about non-FCA credit card limit increase invitations. It estimated that its net profit in the period from March 2011 to November 2014 was approximately $23 million. Westpac provided remediation to customers of $11.3 million plus a $1 million contribution over four years to support financial counselling and literacy. This represents a profit from this breach of $10.7 million.[113] It is critical that ASIC can recoup these ill-gained profits.

9.19. We also support increased maximum terms of imprisonment and fine amounts for criminal offences, as recommended by the ASIC Enforcement Taskforce.[114] However, it has been very difficult to prove the personal culpability of senior management and directors at banks for misconduct, which reduces the impact of maximum terms of imprisonment. We therefore consider penalties targeted at senior management and directors, including disqualifications, as additional important penalties.[115]

9.20. *Available findings of conduct falling below community standards and expectations - Product design and marketing*

9.21. We submit that it is open to the Commissioner to make a finding that product design and marketing practices, particularly in relation to credit cards and add-on insurance, have not met community expectations and standards. As set out above, fundamental to fair treatment 'is the concept that financial products and services should perform in the way consumers expect or are led to believe.'[116] The design of inherently unsuitable,

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[110] ASIC Enforcement Review Taskforce, 'Strengthening penalties for corporate and financial sector misconduct' (Positions Paper No 7, October 2017), <https://treasury.gov.au/consultation/c2017-t229819/>. position 9.
[111] Treasury Laws Amendment (2018 Measures No. 3) Bill 2018 (Cth) [1.20]
[112] ASIC Enforcement Review Taskforce, 'Strengthening penalties for corporate and financial sector misconduct' (Positions Paper No 7, October 2017), <https://treasury.gov.au/consultation/c2017-t229819/>.
[113] Transcript of Proceedings (Day 10, 23 March) 953, 958.
[114] ASIC Enforcement Review Taskforce, 'Strengthening penalties for corporate and financial sector misconduct' (Positions Paper No 7, October 2017), <https://treasury.gov.au/consultation/c2017-t229819/>.
[115] ASIC Enforcement Review Taskforce, 'ASIC's power to ban senior officials in the financial sector' (Position and Consultation Paper 6, 6 September 2017); *Treasury Laws Amendment (Banking Executive Accountability and Remuneration) Act 2018* (Cth).
[116] Paragraph 3.3 of this submission.

poor value products or unsafe products that are marketed in a way that suggests they will assist people to achieve financial security goes against these principles.

9.22. For example, cards that offer frequent flyer points or other rewards would generally be unsuitable for consumers who are unable to repay their account balance in full each month, as the interest charges would outweigh the value of any reward points. Balance transfer cards that offer zero-interest for 12 months are also unlikely to be suitable for consumers who are unable to repay their balance within 12 months or will continue to use the card for new purchases, as such cards are likely to charge higher rates of interest than on previous cards. The current responsible lending obligations have not precluded these products from being sold to these groups.

9.23. Westpac's credit card webpage says its credit cards offer customers 'freedom and convenience',[117] and Citibank markets its credit cards as allowing customers to 'say yes to life's opportunities'.[118] ANZ tells customers that its 'great promotional balance transfer rates for new customers could help you reduce your debts sooner."[119] However, for many people in financial stress, these credit cards will not necessarily improve their financial situation or reduce their debts. Some customers might also believe that being 'pre-approved' for a credit card limit increase, as marketed by CBA and Westpac, indicates the bank is confident they can afford that increase, when in fact the offer was made on the basis they could afford only 2 percent of the total limit (plus a buffer of 0.5 percent) without proper consideration of their current financial situation.[120]

9.24. We submit that it is also open to the Commissioner to make a finding that the proposed design and distribution obligations (**DADOs**) are currently inadequate, and should be extended to credit[121]. Our Centre has assisted many consumers who have been sold poorly designed and targeted consumer credit products, including interest-only mortgages, credit cards, payday loans and consumer leases. The Treasury justified the exemption for regulated credit products on the basis that there is a 'potential overlap with the responsible lending obligations that already apply to credit products'. However, we submit that responsible lending obligations offer different (and lesser) protections to consumers than the DADOs.

9.25. Responsible lending obligations apply only at the point of sale and are limited to assessing whether a product is 'not unsuitable' for a consumer. In contrast, the DADOs would apply during product design, distribution and post-sale. The obligations would require firms to design safe and suitable credit products and distribute them accordingly—this would be an important additional protection for borrowers.

9.26. *Effectiveness of mechanisms for redress – consumer lending remedies*

9.27. The current approach to consumer lending remedies adopted by banks and the Financial Ombudsman Service (**FOS**)[122] does not fully compensate consumers where a bank advances an irresponsible loan.

9.28. The current approach effectively remediates the loan on the basis that it is an unjust transaction and the loan is set aside.[123] This approach ignores the alternative civil penalty regime available to private litigants under the National Credit Act[124] where a licensee has breached a civil penalty provision such as the responsible lending provisions which could, arguably, give consumers greater redress.[125]

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[117] Westpac, *Credit Cards* <https://www.westpac.com.au/personal-banking/credit-cards/>.
[118] Citibank, *Credit Cards* <https://www.citibank.com.au/cards/search/triplepage.htm?plat=P1N1ZYB1&clas=S1N1UYE1&sim=71N1UYE1&cid=PS-Google-PlatTrio-CC012018&gclid=Cj0KCQjw-uzVBRDkARIsALkZAdkxzw67aGksHgLQPgHhoB0mCQo7Ioxe8w8aWhCqS-agEaM2Df1chvgaAiOJEALw_wcB&gclsrc=aw.ds>.
[119] ANZ, *Credit Cards* <https://www.anz.com.au/personal/credit-cards/balance-transfers/>.
[120] Transcript of Proceedings (Day 9, 22 March 2018) 882; Transcript of Proceedings (Day 10, 23 March 2018) 917.
[121] Treasury, *Design and Distribution Obligations and Product Intervention Power – Draft Legislation* (December 2017) <https://treasury.gov.au/consultation/c2017-t247556/>.
[122] Financial Ombudsman Service, *The FOS Approach to Responsible Lending Series: how we work out a consumer's loss* <https://www.fos.org.au/custom/files/docs/fos-approach-to-responsible-lending-assessing-consumer-loss.pdf>.
[123] *National Credit Code* ss 76–7.
[124] Sections 178 and 179 of the *NCCP Act*, which are analogous to sections 1317H, 1317HA and 1325 of the *Corporations Act 2001* (Cth); Revised Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) [4.49], [4.86].
[125] See Example 4.2 of how a remedy under s 179 of the *NCCP Act* would operate, in the Revised Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) ss 135–6 [4.91].

9.29. However, the key limitation of the current approach to remedies for irresponsible lending is that banks (and FOS) require consumers to repay any "unwarranted benefit"[126] as a precondition to setting aside the loan. In practice, this means that banks (and FOS) will offer to waive fees or charges (and sometimes interest) charged to the loan, however the consumer is liable to repay the principal of the loan. The perception is that if the consumer did not account for the "benefit" they received from an irresponsible or unjust loan, this will cause an injustice to the bank.[127] However this approach does not appreciate the significant harm caused to consumers who experience financial hardship as a result of an irresponsible loan.

9.30. Creating a default position where consumers need to "account for the benefit" undermines the objectives of the National Credit Act and the Code and castrates consumer redress. The requirement to account for the benefit was developed outside of the consumer credit regime under general equitable doctrines.[128] The objective of the Code is to ensure strong consumer protection through truth in lending principles.[129]

9.31. Banks profit from consumer loans, whether irresponsible or not. The current law enables the banks to recoup the principal debt plus interest with the meagre threat of losing the fees and charges. There is little disincentive not to lend irresponsibly. Banks will make a calculated risk as to the cost of compliance versus profitability and the likelihood of consumers (or regulators) impugning the loan.

9.32. *Example: Nalini Thiruvangadam*

9.33. Westpac breached its responsible lending obligations by advancing the car loan to Ms Thiruvangadam. Westpac concedes that Ms Thiruvangadam's loan should not have been approved.[130]

9.34. Ms Thiruvangadam, by her solicitors Consumer Action Law Centre, requested that Westpac compensate her by refunding all payments made under the loan ($31,802.37) and releasing her from future liability from the loan, and Ms Thiruvangadam would surrender the Ford Focus.[131] Westpac made an offer to settle Ms Thiruvangadam's dispute on two alternative bases. It stated that it "*must consider what has to be done to put Ms Thiruvangadam in the position she would have been in had this loan not been approved*."[132]

9.35. Westpac's evidence is that in determining the settlement amount it took into account (among other things) the "benefit" that she had derived from having the use of the car, which was calculated as the difference between the purchase price and the current retail price of the car.[133] Westpac's evidence is that their offer was consistent with the FOS' calculation of the consumer's loss on a car loan.[134]

9.36. Ms Thiruvangadam settled her dispute with Westpac on the basis that Westpac pay her $20,000 and she kept the vehicle.

9.37. We accept that Westpac's offer is consistent with the FOS approach to responsible lending and calculating consumer loss. However Westpac's settlement offer does not provide full compensation to Ms Thiruvangadam because it does not account for:

- The financial stress Ms Thiruvangadam endured for 5 years while the loan was on foot before she sought legal advice;
- The benefit that Westpac received of having the use of Ms Thiruvangadam's loan payments over 5 years;

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[126] *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 184 CLR 102; *Maguire v Makaronis* (1996) 188 CLR 449.
[127] *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482; *First Mortgage Managed Investments Pty Limited v Pittman* [2014] NSWCA 110.
[128] It was also developed under the *Contract Review Act 1980* (NSW).
[129] Revised Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth) 6.
[130] Letter from Bank of Melbourne to Consumer Action Law Centre dated 1 November 2017, Exhibit NDT-16 to Witness Statement of Nalini Thiruvangadam, Exhibit #1.138, RCD.0014.0003.0061.
[131] Letter from Consumer Action Law Centre to Bank of Melbourne dated 4 October 2017, Exhibit NDT-15 to Witness Statement of Nalini Thiruvangadam, Exhibit #1.138, RCD.0014.0003.0058.
[132] Letter from Bank of Melbourne to Consumer Action Law Centre dated 1 November 2017, Exhibit NDT-16 to Witness Statement of Nalini Thiruvangadam, RCD.0014.0003.0061.
[133] Witness Statement of Phillip Godkin, Exhibit #1.142 WIT.900.002.0001 [46].
[134] Financial Ombudsman Service, 'The FOS Approach to Responsible lending series: how we work out a consumer's loss', Exhibit #1.142.21, WBC.104.001.9049.

- The debt collection practices of Westpac which caused her to become depressed and have suicidal thoughts;[135]
- Her financial hardship which resulted in her landlord taking action to evict her for rental arrears as well as her pawning sentimental jewellery;
- The condition of the car as it jerks while it drives and the manufacturing faults are now subject to an ACCC proceeding and a class action;[136] and
- Consequential loss such as repair and maintenance costs.[137]

9.38. Ms Thiruvangadam should not have been required to account for the "benefit" she received under the car loan. Whilst Westpac's settlement offer aligned with the FOS approach to responsible lending, the compensation Ms Thiruvangadam received fell below community standards.

9.39. The focus on consumer redress needs to shift from a compensation regime to one which has an element of penalty against the lender. For that regime to work, it needs to be accessible by consumers. This could be achieved by prescribing some form of civil penalty to ensure that not just financial losses are accounted for, but also but the inconvenience and high level of stress associated with irresponsible loans.

9.40. The current approach by FOS (and therefore the banks) is that the consumer to demonstrate each category of loss as a separate head of compensation.[138] This burden of proof is too high and is inaccessible to vulnerable consumers who do not have access to legal advice. Therefore what is required is a simple regime where consumers are provided with an easily calculable penalty which compensates them for the significant stress that irresponsible lending causes. Waiver of debt and release of security would provide such simplicity.

9.41. *Effectiveness for mechanisms for redress – responding to financial hardship*

9.42. The Commission heard evidence that banks failed to adequately respond to consumers' application for hardship in Ms Thiruvangadam, Mr Regan and Mr Harris' case studies.[139] We agree with the Commission's observations with respect to Mr Regan that ANZ's mechanisms for redress have been inadequate having regard to its failed application.

9.43. The evidence also establishes that where a consumer applies for hardship within a short timeframe from being approved for the loan, the credit provider does not re-assess the loan to ensure that the loan was suitable. Its response is limited to responding to the hardship request. Requiring lenders to re-assess and remediate irresponsible loans early in the loan term could prevent consumers suffering significant and long term of having to make payments under an irresponsible loan.

9.44. Further, we submit that evidence presented in each of the case studies during the hearings also indicated potential breaches of the requirements under section 912A of the Corporations Act, section 47 of the National Credit Act, and ASIC Regulatory Guide 165 to have adequate dispute resolution systems in place.

9.45. *Effectiveness of mechanisms for redress - Access to legal assistance and financial counselling*

9.46. As set out in Part 2 of our submissions to the Commission,[140] the availability of legal advice and representation for low-income consumers who have been impacted by misconduct is inadequate. The recipients of free legal assistance typically face a number of barriers to accessing the civil justice system, and if left unresolved, can deepen and complicate existing problems. While access to external dispute resolution services such as CIO and FOS have certainly improved access to justice, there are many instances where consumers still need guidance and representation in order to get fair outcomes.

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[135] Witness statement of Nalini Thiruvangadam, Exhibit #1.138, WIT.0001.0012.0001 [43]–[44].
[136] Witness statement of Nalini Thiruvangadam, Exhibit #1.138, WIT.0001.0012.0001 [59].
[137] Witness statement of Nalini Thiruvangadam, Exhibit #1.138, WIT.0001.0012.0001 [58].
[138] See Financial Ombudsman Service, *Terms of Reference* (1 January 2010) (as amended 1 January 2015) [9.3].
[139] Transcript of Proceedings (Day 5, 16 March 2018) 445–6, Transcript of Proceedings (Day 8, 21 March 2018) 724, Transcript of Proceedings (Day 9, 22 March 2018) 867.
[140] Paragraph 3.41 onwards.

9.47. This was demonstrated by Ms Thiruvangadam's case study, whereby she struggled for five years in serious financial hardship to make car loan repayments. Despite seeking assistance from Westpac multiple times, Ms Thiruvangadam did not achieve a resolution until Consumer Action's lawyers were engaged.[141]

9.48. While improvements to dispute resolution within banks is critical, it is also necessary for legal advice and financial counselling to be sufficiently resourced to support people suffering from all losses associated with financial services, whether that is credit, insurance or investments who are unable to afford assistance.

9.49. *Effectiveness and ability of regulators - ASIC powers and resources*

9.50. As demonstrated by Westpac and other banks during the hearings, often it takes regulator intervention before misconduct and poor practices are addressed. For example, ASIC evidence during Westpac hearings: "*Across DCIs multiple dealings with Westpac, there is a sense that they only tell us about issues when they think we are likely to find out about them through other means… Westpac refused to change its practices until faced with a very direct threat of legal action*".[142]

9.51. It is therefore critical that ASIC has adequate powers and resources to enforce compliance with responsible lending obligations. In particular, it is critical that ASIC can intervene effectively before widespread harm to consumers occurs. The proposed product intervention power[143] is welcome. However, under the current proposal interventions would be limited to 18 months, and involve significant consultation with affected parties. The proposal should be strengthened in several areas in order to properly protect consumers, including:

- permitting interventions to continue until deemed appropriate to remove by ASIC or the Minister;
- empowering ASIC to make a broader range of interventions, particularly in relation to remuneration and training;
- specifying that the extent of ASIC's consultation is to be commensurate with the assessed risk of detriment to consumers and the need for prompt intervention; and
- ensuring that affected consumers are appropriately notified in the event of an intervention.

9.52. ASIC's product intervention power, if properly implemented, will allow the regulator to respond in a flexible and timely fashion to emerging harmful practices. Much of the consumer harm that has been uncovered during the Royal Commission hearings has been occurring for many years, and much of it has been drawn to the attention of Government and regulators. However, the slow cogs of government mean that much of this harm has been left unaddressed while waiting for legislative reform. In the meantime, consumers have continued to suffer harm and problematic industry practices have become normalised and more intractable.

9.53. ASIC also requires the resources and skills to effectively enforce responsible lending obligations, and use the proposed product intervention power. We note the findings of the ASIC Capability Review, which found that ASIC required a cultural shift 'to become less reactive and more strategic and confident'.[144] We consider ASIC's ability to act proactively has not necessarily been restricted by cultural problems, but rather by restrictions on its powers and resources. Realistic long-term funding is essential. However, we agree that ASIC must be strategic and confident in its enforcement activities, including the proposed product intervention power. The power must be used in a pre-emptive, preventive and timely manner to protect consumers from harm, and shift industry culture and practices.

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[141] Witness Statement of Nalini Thiruvangadam, Exhibit #1.138, WIT.0001.0012.0001.
[142] Transcript of Proceedings (Day 10, 23 March 2018) 947.
[143] Treasury, *Design and Distribution Obligations and Product Intervention Power – Draft Legislation* (December 2017) <https://treasury.gov.au/consultation/c2017-t247556/>.
[144] Treasury, *Fit for the future: A capability review of the Australian Securities and Investments Commission,* Report to Government (December 2015), <https://treasury.gov.au/publication/fit-for-the-future-a-capability-review-of-the-australian-securities-and-investments-commission/>.