5

Consumer protection for borrowers

Introduction

5.1 Robust consumer protection is vital for consumer confidence. Consumers need to be able to obtain appropriate information and disclosure if they are to effectively compare and chose products. The Bank of Western Australia (BankWest) stated:

> Consumers are more likely to shop around for products from a range of financial services providers if they are confident that they are dealing with reputable organisations and will have sufficient protection afforded them.[1]

5.2 The banking and non-banking industry relies heavily on disclosure to drive competition. Competition could be enhanced if better disclosure requirements existed at the point of purchase.

5.3 There is a wide range of products provided by the banking and non-banking sectors. The range currently available has significantly increased over the last ten to fifteen years. With such a wide range of products to choose from, it can be complicated and difficult for consumers to compare financial products.

5.4 Consumers need to have access to quality advice to enable them to make the right choices for their circumstances. Without adequate protections, consumers may receive inappropriate advice in relation

1 Bank of Western Australia Ltd, *Submission no. 29*, p. 8.

to mortgages and investment loans. Bad advice can lead to excessive levels of debt being taken on by consumers. In situations where interest rates and/or unemployment start rising, consumers who have taken on inappropriate levels of debt risk defaulting on payments and possible repossession. This pattern has an immediate impact on the families concerned and can also lead to financial instability as demonstrated by the US sub-prime crisis.

5.5 Effective disclosure regimes must be in place to ensure that an industry with a wide range of products is competitive. Additionally, where desired, consumers must have access to appropriate professional advice. The West Australian Department of Consumer and Employment Protection stated:

> Consumers have varying degrees of functional and financial literacy and even with effective disclosure regimes in place, some consumers may require professional advice as to the best loan products for their circumstances. This is especially the case as loan products become more complex and are increasingly interrelated with other financial products (including credit cards and offset accounts), investment options (including shares and real estate) and broader financial plans.[2]

5.6 However, some consumers struggle to understand the complexity of products on offer because information about products is not given in the way many potential customers assess products. The Brotherhood of St Laurence noted that:

> …market research shows that low-income people are more likely to assess affordability in terms of fortnightly loan repayments than interest rates and fees which are typically promoted.[3]

5.7 This chapter looks at various aspects of consumer protection in relation to the banking and non-banking industry, including Commonwealth regulation; mortgage brokers; financial literacy; how consumers can compare products; and disclosure requirements.

2 Department of Consumer and Employment Protection, Government of Western Australia, *Submission no. 38*, p. 6.

3 Brotherhood of St Laurence, *Submission no. 21*, p. 3.

Progress with Commonwealth regulation of credit

5.8 Responsibility for consumer protection in relation to consumer credit, including mortgages, is currently shared between the Australian Government (regulated by Australian Securities and Investments Commission (ASIC)) and the state and territory governments, through their respective Fair Trading Offices.

5.9 In September 2007, in its report *Home loan lending: Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, the committee recommended that 'the Commonwealth Government regulate credit products and advice. This includes the regulation of mortgage brokers and non-bank lenders'.[4]

5.10 Following the committee's recommendation, in July 2008, the Council of Australian Governments (COAG) reached agreement that the Commonwealth Government would assume responsibility for regulation of all consumer credit. COAG also formally agreed that the Australian Government would assume responsibility for regulating mortgages, mortgage brokers, trustee companies, non-bank lenders and margin loans, for the purpose of protecting consumers.

5.11 Following the July agreement, in October the Commonwealth Government was consulting with the states and territories to develop a plan to present to COAG on how the new agreement will be implemented.

5.12 The response by the Commonwealth Government to assume responsibility for regulation of consumer credit was welcomed by many stakeholders. For example, the Australian Bankers' Association (ABA) believes that, among other benefits, this decision will help to protect consumers from unequal treatment. It stated:

> The ABA has publicly welcomed the decision…to move the regulation of credit from the states to the federal sphere. …This will deliver efficiency benefits in addition to providing consumer safeguards against poor practices and ensuring customers are treated equally regardless of where they reside or where they undertake transactions.[5]

4 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Home loan lending: Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, September 2007, p.49.

5 Australian Bankers' Association Inc., *Submission no. 26* , p. 24.

5.13 Abacus, the Association of Building Societies and Credit Unions, noted that:

> A national framework will improve consumer protection and create a level playing field for credit providers…but we seek a regime that minimises compliance costs for ADIs.[6]

5.14 The Commonwealth Government's decision to assume responsibility for regulation of consumer credit is a positive step towards ensuring improved and adequate consumer protection for borrowers.

Mortgage brokers

5.15 In September 2007, this committee published a report which looked in detail at regulation of mortgage brokers.[7] This section examines the relationship between the mortgage broker and the consumer.

5.16 There is evidence that consumers value the services of mortgage brokers. Consumers' demand for advice on loan products has driven the increasing number of home loans arranged by finance brokers in recent years.[8] In 2003, twenty-five per cent of home loans were originated by mortgage brokers and by 2008, 'around thirty-five per cent of loans in Australia originated through the broker channel'.[9]

5.17 Australia is one of the few, if not the only country where trailing commissions are an intrinsic part of the broker commission structure and 'many brokers have built a very significant business on these trailing commissions'.[10] The commission structure that applies to mortgage brokers can be explained as follows, using a $250,000 loan as an example, as detailed by Fujitsu Consulting:

> An upfront commission is paid, which is between 0.65 per cent and 0.85 per cent of the loan value on day one. Then there is a trailing commission paid for each subsequent year that the loan is on the book, and that is between 0.15 per cent

6 Abacus Australian Mutuals, *Submission no. 42,* p. 8.

7 House of Representatives Standing Committee on Economics, Finance and Public Administration, *Home loan lending. Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, September 2007, p. 39-49.

8 Department of Consumer and Employment Protection, Government of Western Australia, *Submission no. 38,* p. 6.

9 Fujitsu Consulting, *Submission no. 9,* p. 3.

10 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

> and 0.25 per cent. …It is quite hard to be able to convert that into a single dollar number. Most of the brokers will be more attracted by the upfront commission, so they will be doing a quick calculation based on 0.6 per cent or 0.7 per cent of $250,000.[11]

5.18 However, although 'consumers believe they obtain "objective and independent advice" from brokers'[12] there is a disconnect between consumer expectations and broker behaviour. Fujitsu notes:

> The broker is not the agent of the consumer, nor the bank, and there is no obligation to provide best advice to consumers.[13]

5.19 Fujitsu Consulting recommended that revised regulation of brokers in Australia is required to protect consumers. The relationship between the mortgage broker, the consumer and the lender needs to be defined:

> …the right option is to make the broker the agent of the consumer and to impose an obligation of providing best advice to consumers. This would have significant benefits in terms of sharpening competitive tension in the industry, reducing the potential for predation, and defining the scope of disclosure.[14]

Should the customer pay the broker?

5.20 Evidence gathered over the course of the inquiry indicated that many people who speak to a broker believe that the broker will be providing advice to them in their best interests but this may or may not be the case. Some confusion exists as to whether brokers owe an obligation to the consumer or to the lender.

5.21 Fujitsu Consulting's research highlights that brokers tend to recommend loans from a small selection of panel lenders, maybe only three or four even if there is a broader range available, and brokers are heavily influenced by the commissions they receive. In a survey of ten per cent of brokers, Fujitsu found that:

11 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

12 Fujitsu Consulting, *Submission no. 9,* p. 3.

13 Fujitsu Consulting, *Submission no. 9,* p. 6.

14 Fujitsu Consulting, *Submission no. 9,* p. 7.

> …the upfront commission was the most significant element in influencing choice of lender. …This means that consumers may not be always getting the "objective and independent advice" they expect.[15]

5.22 Some witnesses disputed the allegation that brokers are influenced by the commissions they receive. The Mortgage and Finance Association (MFAA) stated:

> Until recently the commissions that have been available to [brokers] from lenders have been so similar that it would be hardly worth your while to recommend one rather than the other for the sake of a small difference in commission. Our members tell us the driving forces for recommending a particular lender are the service they provide and how quickly they approve the loan. …The driving force is to get a response quickly about whether or not the loan is approved. The lender who is first to approve the loan is the one that will get the business.[16]

5.23 Fujitsu Consulting, citing the United Kingdom where brokers are increasingly providing independent advice for a fee, suggested that the right model for best advice for Australia would be where brokers receive a payment from the consumer for advice, rather than a commission from a lender:

> It is difficult to envisage a situation where commissions if paid will not influence the advice. There is a question whether full disclose of commissions, including soft commissions and quotas are sufficient. In the UK, the proportion of Brokers who provide independent advice for a fee are rising. Brokers can choose this model, or be tied to lenders, in which case they cannot claim to provide best advice.[17]

5.24 Recent changes in Australia have seen both the major and minor lenders 'changed their commission structure considerably downward'[18]. The MFAA stated:

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15 Fujitsu Consulting, *Submission no. 9,* p. 4.

16 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

17 Fujitsu Consulting, *Submission no. 9,* p. 7.

18 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

> …brokers are looking at the idea of saying to consumers, 'We think we can add value to the process and we think that you should pay a fee for our services.' I think that will evolve, rather than happen overnight. [19]

5.25 Aussie Home Loans agreed that if customers paid a fee to brokers instead of brokers receiving a commission from lenders, the system would be a lot more transparent, however, it notes:

> …the fee would have to be a very significant fee to take into account the costs of your staff, valuations, costs, legal costs on the documentation, and the cost of running an operation.[20]

5.26 If brokers no longer received commission from lenders but were paid directly by the consumer, this would reduce the number of mortgage brokers in the industry. In the United Kingdom half the brokers left the industry within 18 months of regulation effecting this change. Fujitsu Consulting expects the number of mortgage brokers in Australia to fall 'from 11,000 to 6,000' if such regulation was enacted. [21]

5.27 If brokers were to start charging the loan seeker a fee, borrowers who are least able to pay could be disadvantaged and many would have no option but not to use a broker. The MFAA stated:

> A lot of borrowers who go to brokers are people who are not in the position of having extra cash to pay fees. The danger in that potentially is that a broker who has been dealing with borrowers who are borrowing medium or small loans but who do not have any extra cash to pay fees will be disqualified from the broker process. That is something the industry will have to work through.[22]

5.28 There was some discussion about the possibility of a grant being included as part of the first-time homeowner's grant for the specific purpose of allowing borrowers to seek financial advice. Fujitsu said:

> I would make it such that you could get an additional $300 or $400 from that [the first-time homeowner's] grant. …I can tell you that the scary thing for me…is how little they understood about what they were getting into. I genuinely believe that

19 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

20 Mr J Symond, Aussie Home Loans, *Transcript*, 14 August 2008, p. 60.

21 Fujitsu Consulting, *Submission no. 9,* p. 8.

22 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript*, 14 August 2008, p. 50.

> having better conversation up front, even if it is subsidised through the grant, would actually protect them and give them a better foundation to make the right decision and it would do all the positive things.[23]

Conclusions

5.29 Mortgage brokers may not always act in the best interests of the customer if they are working on commissions from lenders. Fujitsu Consulting proposed that mortgage brokers should be paid by the customer rather than the lender. This would help to ensure that mortgage brokers acted in the best interests of their client. Mortgage brokers generally receive an upfront commission and a trailing commission from a lender. These charges are not insignificant and many customers could not afford to pay these types of commissions. It was suggested in evidence that part of the first home buyers grant could be used by customers to pay mortgage brokers. However, many people seeking advice from a broker may not be entitled to the first home owner's grant and, therefore, if a new regulation was to force customer's to pay for advice up front, then these people may choose not to use a broker.

5.30 The committee notes that the Mortgage Finance Association believes that a system will evolve, and is in fact already evolving, that will result in two types of brokers: those who offer advice for a fee and who will be independent of lender's commissions, and brokers who will continue to charge no fee to the customer but will work on lender's commissions. Customers would be free to choose which type of broker suits their needs best.

Financial literacy

5.31 Consumers who are financially literate are better able to make effective and informed decisions about how they manage their money and, in the case of borrowing, about which products are most suited to their needs and their ability to repay.

5.32 Many consumers of banking and non-banking products, however, have low financial literacy and consequently, according to the Finance Sector Union:

23 Mr J North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 30.

> …there is a great need for this country, the banks in particular, to fund an increase in financial literacy education, as 90 per cent of the people in this country do not even understand what compound interest means. A number of people that we deal with and that we know financial counsellors deal with do not understand the consequences of what they are doing.[24]

5.33 People with a low level of financial literacy are more vulnerable to predatory lending. Predatory lending results in consumers being sold the wrong loans. Fujitsu Consulting explained that predatory practices can include:

- Excessively high set up costs, especially if financed as part of the loan;
- Excessive advice fees;
- Pressure to sign the documentation without proper explanation;
- High ongoing interest rates;
- Embedded conditional fees which are not transparent;
- Consumers advised to make false declarations on application forms (for example overstating income); and
- Pressure to refinance. [25]

5.34 To augment general financial literacy and better protect consumers against predatory lending, the Wesley Mission recommended that financial education in schools and beyond is needed:

> …at all different levels of the life cycle: in school, as young families are beginning to think about their future, and right through the cycle. …financial literacy education should be oriented to providing individuals with skills and tools to detect early warning triggers when there are financial difficulties—not just how do you handle a budget, but how do you handle a crisis when it happens.
>
> We recommend that measures to improve financial literacy should adopt a whole-of-life approach at appropriate stages.[26]

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24 Mr L Carter, Finance Sector Union, *Transcript,* 19 September 2008, p. 46.

25 Fujitsu Consulting, *Submission no. 9,* p. 5.

26 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 51.

5.35 There have been various initiatives by stakeholders to raise financial literacy in Australia over the last few years. For example, the Finance Sector Union provides a financial literacy program free of charge to anybody who wants it, however, it believes that financial literacy:

> …should be included in the teaching of reading and writing at primary and secondary school level. …just in the last 10 years, …certainly our innate level of financial literacy has declined. …We would love to see the consumer being educated to the point where they make an informed choice.[27]

5.36 Another initiative is the Australian Financial Literacy Assessment – a free and voluntary national online assessment available to Australian students in Years 9 and 10. It is an initiative of the Commonwealth Bank Foundation and is developed and delivered by Educational Assessment Australia. The Australian Financial Literacy Assessment is available online for Year 9 and Year 10 students and is designed to benefit student learning across a number of disciplines.[28]

5.37 The ANZ bank has also invested funds over many years in the area of financial literacy and consumer education and stated:

> …financial literacy is a very important aspect in empowering consumers to make the market work better. It is important because, since financial deregulation, things have got lots more complex than they used to be. …'empowered consumers' are very good for keeping we banks on our toes. …A financially literate consumer in conjunction with a good and sensible regulatory framework is the right way to go.[29]

5.38 The Brotherhood of St Laurence made the observation, based on its work in the community, that while financial literacy is important, it needs to be offered in conjunction with financial inclusion programs. It stated:

> …we are concerned that financial literacy can blame the victim a bit. It can be seen as saying, 'If we just give them the skills that will be okay.' Giving people the skills to work in a system that is excluding them and offers inappropriate products for them is probably of limited use. We would not want too much emphasis on financial literacy as the solution

27 Mr L Carter, Finance Sector Union, *Transcript,* 19 September 2008, p. 46-7.

28 http://www.eaa.unsw.edu.au/afla

29 Ms J Nash, ANZ Bank, *Transcript*, 8 August 2008, p. 41.

> but, certainly, insofar as it helps low-income people to be able to navigate the system, it is important.[30]

5.39 In 2005 the federal government responded to a perceived need for improved financial literacy among borrowers when it established the Financial Literacy Foundation.[31] The aim of the foundation was to give all Australians the opportunity to increase their financial knowledge and better manage their money.

5.40 On 1 July 2008, the functions of the Financial Literacy Foundation were transferred to ASIC. Following its transfer to ASIC, the Financial Literacy Foundation has been working with all state and territory education authorities to have financial literacy included in the curriculum for Years K-10 from 2008 onwards.

5.41 Extensive information about the Financial Literacy Foundation can be found on the Understanding Money website.[32] This website is separate from the consumer website of ASIC, which is known as FIDO (financial tips and safety checks).[33]

5.42 The committee heard from the Treasury that the government is currently trying to 'ensure that there is better information put before people'[34] to enable people to understand the products which are available. Documentation relating to financial transactions is being simplified and standardised. Treasury stated:

> This government is moving to try to standardise and simplify documentation that people will use when they are entering into financial transactions. The first step along the way has been this first home owners' scheme. They have standardised some very simple documentation and now the government … is looking at trying to track that across the board.[35]

5.43 Discussing its ideas for the development of an industry-wide set of standards, the Council of Mortgage Lenders suggested that 'standardised industry-wide information packs' would be an integral

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30 Ms G Sheehan, Brotherhood of St Laurence, *Transcript*, 8 August 2008, p. 63.

31 The Financial Literacy Foundation website can be accessed at: http://www.understandingmoney.gov.au/

32 Australian Government 'Understanding Money Website' viewed on 9 October 2008, <http://www.understandingmoney.gov.au/Content/Consumer/About/aboutflf.aspx>

33 ASIC consumer website can be accessed at: http://www.fido.gov.au/fido/fido.nsf

34 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 39.

35 Mr J Murphy, Treasury, *Transcript*, 14 August 2008, p. 38.

part of an overall set of standards which 'would allow consumers to make informed decisions about lending'.[36]

Conclusions

5.44 The committee supports the goals and objectives of the Financial Literacy Foundation and encourages it to build on the work it has already done.

5.45 Furthermore, the committee believes it could be most useful to people who are trying to understand the products which are available if there were a glossary of standardised financial terms in very simple language. This glossary could be placed on both the ASIC consumer website and the Understanding Money website.

Recommendation 9

5.46 **The committee recommends that the Australian Securities and Investments Commission includes a glossary of standardised financial terms in simple language on its consumer website and also on the Financial Literacy Foundation's website.**

Predatory practices relating to credit cards

5.47 It is common practice for banks and non-banks to send unsolicited offers of increased credit limits to customers holding credit cards. These offers often result in people with low financial literacy increasing credit limits on their credit cards without fully understanding the implications and which, in many cases, they have no way of repaying. The Consumer Action Law Centre pointed out the contradictory practice of many banks which are:

> …putting very bland information on their website about how to use credit responsibly and then sending something out to a pensioner saying, 'Increase your credit limit in the next two weeks—this is a short offer.'[37]

36 Mr P James, Council of Mortgage Lenders, *Transcript*, 14 August 2008, p. 72.

37 Ms C Bond, Consumer Action Law Centre, *Transcript*, 8 August 2008, p. 27.

5.48 The Consumer Action Law Centre recommended that lenders should be obliged, at the time they are providing the credit, to assess whether the individual can repay the increased amount. It cited several examples of clients who have been pushed to take on higher credit limits even though they would struggle to repay the credit, stating:

> …we have a couple of clients at the moment who have been on pensions for many years but have been receiving letters saying, 'Congratulations, you're pre-approved for more credit, for more credit, for more credit'. Their loans are both bank loans, and they have taken these people to over $30,000. In both cases, we are involved because we are concerned that their home is at risk. They are not isolated cases. We had someone ring us recently who said he went to apply for interest-free credit. He only wanted a fridge for $800, but the company sent him a credit card for $10,000. It then sent him letters urging him to use that credit—at 28 per cent, mind you. …We are seeing an increase in that sort of marketing. Those lenders in many cases are not really assessing whether the person has the ability to pay.[38]

5.49 The Wesley Mission related similar stories of hardship caused by easy access to credit which cannot be repaid, telling the committee:

> Through overly easy access to credit—personal loans, financing or credit cards—many of our clients in counselling services at Wesley Mission face the burden of loans that they can never pay back. When we have done our research, we have discovered people with handfuls of credit cards, almost like a pack of cards, and all of that raises questions about the easy access to certain levels of credit without proper financial planning.[39]

5.50 Wesley Mission believes that more needs to be done to ensure that people with little or no financial literacy understand the implications of increasing their debt. It stated:

> The challenge for providers is to fully embrace the principle [of truth in lending] and provide accurate, complete and easily comprehensible financial information to all clients.

38 Ms C Bond, Consumer Action Law Centre, *Transcript*, 8 August 2008, p. 20.

39 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 50.

That is, trustworthy, simple and non-biased financial information.[40]

Conclusions

5.51 The committee agrees that it is an undesirable practice for lenders to push people to increase their credit limits regardless as to whether or not those people are able to understand the implications of taking on more debt or if they will be able to repay the increased debt.

Recommendation 10

5.52 **The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government consider the feasibility of regulating unsolicited credit card limit increases.**

Sales targets and responsible lending

5.53 The Finance Sector Union of Australia noted its concern that sales targets for finance sector staff are increasingly used as the only way staff can access increased remuneration. All banks except 'some of the community banks'[41] – notably Bendigo Bank and St George – use a system of sales targets for staff which are 'designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring'.[42] Staff are under constant pressure to achieve sales which 'inevitably lead to some consumers being sold products that they may not be capable of repaying or even need'[43].

5.54 The Finance Sector Union recently surveyed 2,000 of its members who are predominantly in the established banking sector and found that:

- 52 per cent of workers felt obliged to try and sell debt products even when a customer didn't need them;

40 Rev Dr K Garner, Wesley Mission, *Transcript*, 21 August 2008, p. 52.
41 Mr L Carter, Finance Sector Union of Australia, *Transcript*, 19 September 2008, p.42.
42 Finance Sector Union of Australia, *Submission no. 39*, p. 5.
43 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

- 63 per cent felt that inappropriate sales targets are having a negative impact on their ability to provide responsible customer service; and
- 59 per cent felt pressured to make inappropriate sales to meet sales targets.[44]

5.55 While the Finance Sector Union does not object to the principle of performance pay for meeting targets it believes that targets should only exist within a system based on guaranteed CPI increases. It stated:

> If wages for finance sector employees cannot go backwards, then the pressure to meet sales targets will inevitably be lower.[45]

5.56 There is currently no regulatory body which oversees the impacts of performance pay and sales targets for bank staff. The Finance Sector Union believes that there needs to be a regulatory regime which:

> …should enshrine some form of principles to mandate 'responsible lending' practices. The FSU believes that such measure would ensure 'healthier' competition in the finance sector. In line with this belief the FSU has been developing a draft "Charter of Responsible Lending".[46]

Conclusions

5.57 The committee believes that the Finance Sector Union has a legitimate concern. It is possible that performance pay could lead to customers being disadvantaged if they are pressured into taking on more debt than they are able to repay.

5.58 An implication has been made by the Finance Sector Union that consumers could be disadvantaged by financial services staff who are pressured to sell products which may be inappropriate for the purchaser's needs and therefore the committee believes that ASIC should be requested to examine these claims.

44 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

45 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

46 Finance Sector Union of Australia, *Submission no. 39*, p. 5.

Consumer information to compare products

5.59 Consumers must have access to accurate, comprehensive, freely available information if they are to be able to compare banking products and ultimately chose the one which is most suitable to their needs and which they can afford over the long term.

5.60 Since the mid-1990s a range of tools to assist customers to compare the pricing and features of the available banking products have emerged. For example:

> …financial services research firms such as Infochoice and CANNEX provide searchable databases outlining the pricing and features of different banking products, and CANNEX also publishes reports that rate individual products against a range of key criteria.[47]

5.61 Some stakeholders, however, believe that the information published by some financial services research firms may not be giving consumers the full picture. Mates Rates Mortgages stated:

> Consideration should also be given to reviewing the appropriateness of advertising bureaus such as CANNEX, Money Magazine and Your Mortgage Magazine from promoting 'Best of' awards where these bureaus do not look beyond lenders that advertise with them.[48]

5.62 CHOICE told the committee that many products have become so complex that it is difficult for consumers to gain an adequate understanding of their features in order to compare one product with another:

> The mandatory comparison rate for loans is designed to address this problem. It is meant to give consumers a comparable snapshot of the total cost of competing loan products. But the rise and rise of exit fees, which are not included in the comparison rate, has rendered it less useful. We think it is time that the mandatory comparison rate gets an overhaul[49]

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47 Treasury, *Submission no. 32,* p. 11.

48 Mates Rates Mortgages, *Submission no. 22,* p. 8.

49 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 76.

5.63 It would be helpful for consumers to compare products if all banks and non-banks used standardised forms giving the same information. The Commonwealth Bank noted:

> …it would be good to have clear structures around how you describe and explain fees and things so that for customers there is a clear and open, transparent sort of process to be able to understand what they are getting into.[50]

5.64 It seems that 'at the moment neither institutions nor consumers are well served by the very conservative and legalistic disclosures that consumers are provided with'.[51] Non-standardised and unclear information is preventing people from being able to shop around effectively because they cannot compare terms, conditions and costings easily.

5.65 Fujitsu Consulting is 'absolutely of the belief that there should be better documentation provided to consumers at the time they purchase a loan'. It stated:

> Let us say the average loan life in Australia is three years. I would say, 'If you hold this loan for three years, this is the total cost over that three-year period.' It is a bit like a mobile phone plan. It is a dollar amount. You could then compare deal A to deal B and deal C. You cannot do that today. Brokers, even with their online tools, cannot give you a completely watertight comparison.[52]

5.66 The United Kingdom has addressed the problem of documentation and the consumer's ability to compare products by producing a 'key facts document'. Fujitsu Consulting explained that, while the UK's version is 'probably a bit long':

> …it does articulate a few things. It says, 'This is why this loan is right for you. These are all of the features, benefits and costs of the loan.' I am providing this advice to you because I represent either a bank or I am giving you independent advice, and so there is clarity about the basis on which advice is given, and there is some standard comparison data in there as well. I think a key facts document would help. The trick

50 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 24.

51 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 13.

52 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.

> here is not to make it too long and complicated, otherwise you just increase the costs of writing the mortgages. [53]

Conclusions

5.67 The committee notes that Treasury has established a Financial Services Working Group comprised of officials from Treasury, the Department of Finance and Deregulation and ASIC. The group is seeking to improve product disclosure requirements to make it easier for consumers to make informed financial decisions and compare products. The Treasury working group is described in some more detail below.

5.68 The committee believes that, in addition to the work Treasury is doing to improve product disclosure, there is a need in Australia for some sort of standardised 'key facts document', similar to the UK model, to help consumers to compare effectively mortgage products.

Recommendation 11

5.69 **The committee recommends that the Treasury develop a standardised key facts document for mortgage products, based on the UK model, to help consumers to compare financial products. The standardised key facts document must be provided to the committee within twelve months.**

Disclosure requirements

5.70 Competition would be stimulated in the banking and non-banking sectors if better disclosure requirements existed at the point of purchase, to allow consumers to understand the full costs of the agreement that they are entering into. Fujitsu Consulting noted that:

53 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.

> …at the moment the conditional fees and some of the other ancillary costs are not clearly disclosed, so it is really hard for a consumer to compare deal A to deal B and deal C. …we should be considering a more standardised approach to comparison rates. It should be more holistic. It should have all of the categories, all the costs and all of the interest flows at the rate today.[54]

5.71 CHOICE similarly notes that the industry relies heavily on disclosure to drive competition, but notes that if disclosure is going to work well 'then standardisation, in particular the naming of fees, …would be quite useful.' [55]

5.72 CHOICE also highlighted that financial institutions use different terms to describe one fee, as is the case with an early exit fee, and noted that steps taken in the UK to standardise financial terms stating:

> The approach taken in the UK for example has been to standardise the fee nomenclature. So all mortgage early exit fees are known as mortgage early exit fees. It does bring some transparency. This is something that ASIC has looked at in reviewing the mortgage entry and exit fees. …it only enhances disclosure and the capacity for consumers to compare products.[56]

5.73 Abacus, the peak industry association for Australian mutual building societies and credit unions, supports improving upfront disclosure to product information in clear and understandable terms for consumers but notes 'that is certainly not the situation we have at the moment with loan documentation'. Abacus told the committee that: [57]

> …at the moment in the documentation attached to home loans you would need to be a fairly dedicated consumer and reader of fine print to be able to track down exactly what fees you are paying in the first instance, and in the second instance how they are going to impact you if you wanted to terminate the loan early in the term. [58]

5.74 While disclosure requirements should not become so complex as to have too big an impact on the system, Abacus noted:

54 Mr M North, Fujitsu Consulting, *Transcript*, 15 August 2008, p. 26.
55 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 79.
56 Ms E Freeman, CHOICE, *Transcript*, 21 August 2008, p. 79.
57 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.
58 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

> …we think that having a clear and upfront comparable outline of what fees you would incur in a number of set standard circumstances and bringing that forward in terms of disclosure for consumers would be a very beneficial outcome.[59]

5.75 According to the Treasury, the federal government is aware of the need for better disclosure and it is currently seeking to improve product disclosure requirements to make it easier for consumers to make informed financial decisions and compare products. The Treasury, in conjunction with the Department of Finance and Deregulation and ASIC, are working to 'develop short, concise and readable product disclosure documents that are effective for consumer decision making and for business in managing cost and legal requirements.'[60]

5.76 The Commonwealth Bank cautioned that more disclosure is not necessarily better, citing the Financial Services Reform Act (FSRA), the bank stated:

> …it has not helped with some government legislation like FSRA, which was overly weighty and it created the opposite effect of what it was trying to do. It created more disclosure, which meant more confusion. I think less is more is often quite a good principle when you go into legal documents and explanation of customer rights.[61]

5.77 Furthermore, it is the Commonwealth Bank's view that if competition is to be strong people must be allowed to be competitive and to do different things and be innovative:

> …if it becomes overly prescriptive you lose competition in the market because people cannot try and do different things or are constrained.[62]

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59 Ms L Petschler, Abacus Australian Mutuals, *Transcript*, 21 August 2008, p. 7.

60 Treasury, *Submission no. 32,* p. 11.

61 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 24.

62 Mr J Sheffield, Commonwealth Bank of Australia, *Transcript*, 25 September 2008, p. 25.

Conclusions

5.78 The committee is of the opinion that the work of the tripartite Financial Services Working Group, under Treasury's guidance, is timely and will produce better disclosure requirements for banking and non-banking products.

5.79 The committee commends the work being done by the Financial Services Working Group to improve disclosure at the point of purchase. The committee supports and encourages the continuation of this work.

External dispute resolution

5.80 CHOICE told the committee that a key reform which is needed to improve competition in the banking and non-banking sectors is mandatory membership of external dispute resolution schemes for all financial services providers.[63] CHOICE stated that:

> Since their creation 15 or so years ago external dispute resolution (EDR) bodies have provided access to low cost and effective dispute resolution for customers of Authorised Deposit-taking Institutions (ADIs) and other scheme members. Developments in the Banking Code of Practice and practices of ASIC approved external dispute resolution schemes have also cemented better standards for dispute resolution between members and their customers.[64]

5.81 Currently, with the exception of ADIs, there is no legal obligation for other providers of credit or financial advice associated with credit, to belong to an external dispute resolution scheme, although some voluntarily belong to such schemes.[65]

63 CHOICE, *Submission no. 23,* p. 2.

64 CHOICE, *Submission no. 23,* p. 7.

65 CHOICE, *Submission no. 23,* p. 7.

5.82 In its recent report on Australia's Consumer Policy Framework, the Productivity Commission noted:

> Gaps in the regulation of credit providers and intermediaries providing advice on credit products mean that some consumers face excessive risks and have no guaranteed access to alternative dispute resolution.[66]

5.83 The Productivity Commission went on to note that:

> Amongst other things, the new national credit regime should include a national licensing system for finance brokers, and a licensing or registration system for credit providers that would give consumers guaranteed access to an approved dispute resolution service.[67]

5.84 External dispute resolution schemes were developed because of the almost insurmountable barriers in taking small and medium value consumer finance disputes to ordinary courts. CHOICE notes that currently there are four ASIC approved external dispute resolution schemes which deal with complaints about financial institutions and consumer credit. Where a credit provider is a member of one of these schemes consumers have access to an effective dispute resolution in relation to most disputes. The existing schemes are:

- the Financial Ombudsman Service (FOS);
- the Credit Union Dispute Resolution Centre (CUDRC);
- the Credit Ombudsman Service (COSL); and,
- the Financial Co-operative Dispute Resolution Scheme (FCDRS).[68]

5.85 In its submission CHOICE argued that all providers of consumer credit and advice related to consumer credit should be members of an ASIC approved external dispute resolution scheme.[69] Challenger Financial Services Group also supports the need to 'give people access to an external dispute resolution system'[70].

66 Productivity Commission, *Review of Australia's Consumer Policy Framework, Inquiry Report, Volume 1 – Summary, No. 45,* 30 April 2008, p. 59.

67 Productivity Commission, *Review of Australia's Consumer Policy Framework, Inquiry Report, Volume 1 – Summary, No. 45,* 30 April 2008, p. 66.

68 CHOICE, *Submission no. 23,* p. 7.

69 CHOICE, *Submission no. 23,* p. 8.

70 Mr D Cox, Challenger Financial Services Group, *Transcript*, 15 August 2008, p. 90.

5.86 The committee received many submissions from mortgage brokers, many of which stated that:

> An effective and efficient regulatory regime should require brokers to be a member of an external dispute resolution scheme to give borrowers access to an inexpensive and efficient mechanism for resolving complaints.[71]

5.87 An external dispute resolution body to which all licensed lenders must belong will soon be in existence as part of the government's recently flagged reform of the financial services regulatory regime. Reform will include the development of a single national system which will regulate consumer credit in order to establish a 'consistent and robust consumer credit regulation framework.'[72] The new framework will include a comprehensive national licensing regime to be administered by ASIC that will cover all credit providers, brokers and advisers.

5.88 Safeguards will be built into the new scheme, including the provision that all borrowers will be able to appeal to an external dispute resolution body to which all licensed lenders must belong. In this respect, Senator Sherry recently stated:

> The Corporations Act will be extended to cover margin lending products and trustee corporations. Organisations which extend margin loans will have to provide product disclosure statements similar to those provided for the First Home Saver Accounts.

5.89 The first phase of the new regime, including the provision for an external dispute resolution body for all licensed lenders, will be in place in commonwealth, state and territory legislation by the end of June 2009.

Conclusions

5.90 The committee notes that there is currently no legal obligation for providers of credit or financial advice associated with credit, other than ADIs, to belong to an external dispute resolution scheme, although some non-ADIs voluntarily belong to such schemes.

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71 See, for example, All Home Loans (Queensland) Pty Ltd., *Submission no. 46.* p. 2.

72 Senator the Hon N Sherry, Opening address to Evaluating Financial Services Regulation Summit, Sydney, 30 October 2008, as cited at: http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/035.htm&pageID=005&min=njs&Year=&DocType=1

5.91 In view of the concerns expressed by CHOICE and other stakeholders, the committee welcomes and supports the creation, as part of government reforms of the financial services regulatory regime, of an external dispute resolution body to which all licensed lenders must belong, to be introduced by mid-2009.

Recommendation 12

5.92 **The committee recommends that, as part of its adoption of responsibility for the regulation of credit, the government make it compulsory for all credit providers to be a member of an external dispute resolution scheme approved by the Australian Securities and Investments Commission, as is currently the case for deposit-taking institutions.**

Craig Thomson MP
Chair
13 November 2008