

## **FINANCIAL SYSTEM INQUIRY**

**Legal Aid NSW submission**

**March 2014**

### **Introduction**

#### **The Legal Aid NSW perspective**

Legal Aid NSW welcomes the opportunity to provide a submission to the Financial System Inquiry. Our comments are based on our experience in assisting disadvantaged and vulnerable clients with consumer law problems.

Consumer law matters constitute the largest category of the civil law advice and minor assistance work we undertake. In 2013, Legal Aid NSW assisted 8558 people with consumer law advice and minor assistance and consumer law matters represented a significant proportion of the legal aid civil law grants.<sup>1</sup> The strong emphasis on consumer law in our work, particularly in the area of credit and insurance products, is indicative of the difficulties and barriers that consumers, particularly disadvantaged and vulnerable consumers, can face when engaging with the financial system and financial products.

In our work, we see the adverse effect of irresponsible lending, unsafe products and underinsurance on a daily basis. A bank's refusal to allow a temporary hardship variation of mortgage repayments can lead to a home being repossessed; the refusal of an insurance claim to rebuild a home following a flood can lead to homelessness. Financial products need to be safe and appropriate for consumers to ensure that the market operates effectively and efficiently without the need for government intervention to address consumer detriment and market failures. More information about the consumer law work Legal Aid NSW does is set out at Attachment B.

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<sup>1</sup> Refer to Attachment A for further detail

This submission seeks to highlight key issues that impact upon disadvantaged and vulnerable consumers when they interact with the financial system and outline a reform agenda from the consumer perspective.

In our view, to 'future proof' Australia's financial system, we need to have in place:

- safe financial products
- consumer protections from complex or inappropriate financial products
- systems such as external dispute resolution (EDR) to 'level the playing field'
- appropriate regulation and appropriately funded regulators
- monitoring and enforcement by regulators when the law is breached, and
- adequately funded legal services to assist disadvantaged and vulnerable people to engage with the financial system.

### **Disadvantaged people and their interaction with the Financial System**

The ACOSS Poverty in Australia report indicates that 'in 2010, after taking account of housing costs, an estimated 2,265,000 people or 12.8% of all people, including 575,000 children (17.3% of all children), lived in households below the most austere poverty line widely used in international research.'<sup>2</sup> This poverty line is \$358 per week for a single adult, and \$752 for a couple with two children.<sup>3</sup> A key issue for the financial and justice system is how it will respond to increasing demand for assistance with 'poverty-related' legal issues, many of which will relate to consumer law problems.

Financial exclusion is also a growing problem in Australia. Financial exclusion occurs when people are not able to access appropriate and affordable financial services and products.<sup>4</sup> People who are excluded from the mainstream financial system are often forced to engage with the 'fringe market' to access financial products and services. The *Measuring Financial Exclusion in Australia* report published by the Centre for Social Impact shows that 'around 17.7% of the adult population in Australia were either fully excluded or severely excluded from financial services in 2012. This figure comprises 1.1% of adults who were fully excluded (they had no

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<sup>2</sup> Australian Council Of Social Service, *Poverty in Australia* 2012 report (2012) <[www.acoss.org.au/policy/poverty](http://www.acoss.org.au/policy/poverty)>

<sup>3</sup> Australian Council Of Social Service, *Poverty in Australia* 2012 report (2012) <[www.acoss.org.au/policy/poverty](http://www.acoss.org.au/policy/poverty)>

<sup>4</sup> The Centre for Social Impact, *Measuring Financial Exclusion in Australia* (2013) <[http://csi.edu.au/media/content/download/file/Measuring\\_Financial\\_Exclusion\\_In\\_Australia\\_June\\_2013](http://csi.edu.au/media/content/download/file/Measuring_Financial_Exclusion_In_Australia_June_2013)>

financial services products) and 16.6% of adults who were severely excluded (they only had one financial services product).<sup>5</sup> This is an increase on the 2011 data.

The Legal Aid NSW consumer law client base invariably consists of people who are severely excluded from the mainstream financial system and very financially and socially disadvantaged.<sup>6</sup> Legal Aid NSW clients' level of disadvantage is such that they struggle with complex products and within complex systems, including the financial system and legal system. Our clients often find themselves overwhelmed and overpowered by aggressive sales practices and unable to advocate for themselves when approached by a debt collector or when a bank commences possession action. They frequently have difficulty understanding the complexities of insurance policies and can find themselves underinsured and in crisis. Our clients, particularly our Aboriginal clients, are often targeted and sold unsafe products that do not meet their needs and expose them to unmanageable debt. It is not uncommon for our clients to fail to make sound financial decisions about the appropriateness of a product for their needs, and decide to enter into unsafe contracts for funeral insurance or 'payday loans'.

## Recommendations

The recommendations Legal Aid NSW makes to the Inquiry are summarised below.

### Consumer policies

**Recommendation 1:** That the Inquiry is mindful of the 2013-2015 *COAG Strategic Agenda for an integrated and harmonised approach to consumer protection* when reviewing the Australian financial system.

### Legal assistance services

**Recommendation 2:** That legal aid services are provided with adequate funding to assist socially and economically disadvantaged people with consumer law problems.

### Insurance

**Recommendation 3:** That home insurers are required to bring to the attention of their customers at the time the product is purchased key information that would significantly affect the

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<sup>5</sup> The Centre for Social Impact, *Measuring Financial Exclusion in Australia* (2013) <[http://csi.edu.au/media/content/download/file/Measuring\\_Financial\\_Exclusion\\_In\\_Australia\\_June\\_2013](http://csi.edu.au/media/content/download/file/Measuring_Financial_Exclusion_In_Australia_June_2013)>

<sup>6</sup> Although, our disaster recovery work often services a broader client base, including clients who are vulnerable at a particular point in time, but are not ordinarily socially and financially disadvantaged.

cost of a rebuild, such as whether the home is in a flame zone, so customers can make an informed choice about what level of cover to choose.

**Recommendation 4:** That the Government considers the value of addressing product safety issues in insurance with:

- (a) market-based, 'supply side' solutions such as 'fit for purpose' or 'not unsuitable' tests as well as unfair terms provisions; and
- (b) industry-based solutions such as codes of practice where there currently are none and disaster response protocols

**Recommendation 5:** That the Government considers the Natural Disaster Insurance Review recommendations for a new integrated system to address the availability and affordability of flood insurance.

**Recommendation 6:** That the Government facilitates a discussion about how innovative solutions that are financially viable can be developed to enhance financial inclusion in the insurance market.

**Recommendation 7:** That an obligation for businesses to deal fairly and equitably with all consumers is introduced to prohibit unfair trading in the provision of financial service products.

**Recommendation 8:** That financial services legislation is amended to close the 'loop hole' that allows general insurance products which are 'expenses only' to be excluded from the *Corporations Act 2001* and Life Insurance regulation.

**Recommendation 9:** That funeral insurance premiums are capped at an amount which is relative to the 'benefit' of the product, that is, the actual cost of a funeral.

**Recommendation 10:** That in their product disclosure, funeral insurance companies are required to outline the true cost of the product, including the amount that they can expect to pay in premiums if they live to the average Australian life expectancy and the average cost of a funeral.

#### Credit

**Recommendation 11:** That the Government considers further legislative reform to ensure lenders offer loans on terms that are reasonable and affordable. This should include considering capping interest rates at a lower level and lowering the current cap on fees.

**Recommendation 12:** That the Government regulates indefinite and short term leases and introduce enhanced consumer protections, such as responsible lending provisions and mandatory external dispute resolution membership, for these types of leases.

**Recommendation 13:** That government, industry and consumer groups collaborate to develop innovative, safe microcredit products that service the low-income section of the market.

#### ASIC

**Recommendation 14:** That the Inquiry considers whether ASIC should receive some funding through a 'user pays' model supported by the businesses that it regulates.

## 1. Sound consumer policies should underpin the Australian financial system

It is important for sound consumer policies to underpin the Australian financial system. The 2013-2015 *COAG Strategic Agenda for an integrated and harmonised approach to consumer protection* sets out the national consumer policy objective 'to improve consumer well being through consumer empowerment and protection fostering effective competition and enabling confident participation of consumers in markets in which both consumers and suppliers trade fairly'.<sup>7</sup> This Strategic Agenda is supported by six operational objectives:<sup>8</sup>

- to ensure that consumers are sufficiently well-informed to benefit from and stimulate effective competition
- to ensure that goods and services are safe and fit for the purposes for which they were sold
- to prevent practices that are unfair
- to meet the needs of those consumers who are most vulnerable or are at the greatest disadvantage
- to provide accessible and timely redress where consumer detriment has occurred; and
- to promote proportionate, risk-based enforcement

These objectives should be at the forefront of the Inquiry's mind when reviewing the Australian financial system.

**Recommendation 1:** That the Inquiry is mindful of the 2013-2015 *COAG Strategic Agenda for an integrated and harmonised approach to consumer protection* when reviewing the Australian financial system.

## 2. The economic value of legal assistance services

When vulnerable clients suffer consumer detriment, it can lead to a vicious cycle of vulnerability involving health problems, inability or disruption to work, loss of income, non-payment of rent,

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<sup>7</sup> COAG Legislative and Governance Forum on consumer affairs and Consumer Affairs Australia and New Zealand, *Charter 2013-2015* (2013)

<[http://www.consumerlaw.gov.au/content/mcca/downloads/CAF\\_charter\\_20130515.pdf](http://www.consumerlaw.gov.au/content/mcca/downloads/CAF_charter_20130515.pdf)>

<sup>8</sup> COAG Legislative and Governance Forum on consumer affairs and Consumer Affairs Australia and New Zealand, *Charter 2013-2015* (2013)

<[http://www.consumerlaw.gov.au/content/mcca/downloads/CAF\\_charter\\_20130515.pdf](http://www.consumerlaw.gov.au/content/mcca/downloads/CAF_charter_20130515.pdf)>

eviction and homelessness. If a vulnerable consumer is spending their available income repaying a 'payday loan' at 48% interest, for example, they may not be able to pay their electricity bill or their rent and in extreme cases, may find themselves homeless because of the flow-on effect of their 'consumer law' problem. The existence of a 'civil' or 'consumer' legal problem can also trigger further legal problems, including criminality, child protection and family violence.

Legal assistance to resolve and prevent escalation of legal problems reduces the avoidable economic and social costs that would otherwise be experienced by the individual, community and government. Access to legal assistance can have powerful enabling effects for disadvantaged clients and assist them to avoid further problems or negative any consumer detriment.

A number of studies have explored the economic value of legal assistance services. For example, the Price Waterhouse Cooper 2009 study of the Economic value of legal aid found the provision of duty, litigation and dispute resolution services for family law matters has a net positive efficiency benefit for the justice system, outweighing the cost of providing these services, with a return of \$1.60 to \$2.25 for every dollar spent.<sup>9</sup>

In addition the study found that these efficiency benefits are magnified through the provision by legal aid of legal education, information and advice services as these services reach a broader group of clients and are likely to lead to appropriate and efficient pathways through or diversion from the justice system. It found that the benefits from quality and effective justice outcomes and resolution of matters, achieved through legal assistance, accrue to both individuals and the community.<sup>10</sup>

The key finding of the study was that there is a strong economic case for appropriately and adequately funded legal aid services, based on the magnitude of the quantitative and qualitative benefits this funding can return to individuals, society and government.

Many 'consumer law' issues experienced by clients are 'everyday problems' with a legal component. Consumer detriment and unresolved legal problems can have significant flow-on

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<sup>9</sup> Price Waterhouse Coopers, *Economic Value of Legal Aid*, Analysis in relation to Commonwealth Funded matters with a focus on family law (2009) <<http://www1.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/a-z-docs/fmsdownload15a6.pdf>>

<sup>10</sup> Price Waterhouse Coopers, *Economic Value of Legal Aid - Analysis in relation to Commonwealth Funded matters with a focus on family law* (2009) <<http://www1.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/a-z-docs/fmsdownload15a6.pdf>>

economic effects for the individual and potentially for the community. Our consumer law work at Legal Aid NSW, whilst traditionally provided as a late intervention response to market failure in the financial system, has in more recent times focused on early intervention techniques which often act as enabling tools for the most disadvantaged to *continue* to interact in that system in a more healthy and positive way.

However, as the following case study demonstrates, it is still important for people to be able to access their legal rights if the matter cannot be resolved with the assistance of the FOS and EDR, and proceeds through the court.

**Case study – Ms Wales (*Commonwealth Bank of Australia v Wales* [2012] NSWSC 407)**

When the bank served Ms Wales, who was in financial hardship, with a statement of claim seeking to repossess her home, she contacted the Financial Ombudsman Service (FOS) for help.

The bank contacted Ms Wales in order to resolve the dispute, and the parties made an agreement which reflected little concession to hardship. There was no reduction in the amount of payments (in fact, the repayment schedule increased) and seemingly there was no extension of the period of the contract.

The bank did not direct Ms Wales to its designated procedure for considering hardship variations, and did not even explain that there was a designated procedure. Legal Aid NSW took the matter to the Supreme Court. The Court found the bank did not appropriately invoke the hardship application determined by the FOS or the Court. The Court set aside the default judgment entered against our client for possession of her home.

This precedent decision has implications at a national level for lenders who fail to adhere to their obligations to consider customer's financial hardship. Also for the first time, external dispute resolution was acknowledged by the Court as a central forum for the resolution of financial hardship disputes.

**Recommendation 2:** That legal aid services are provided with adequate funding to assist socially and economically disadvantaged people with consumer law problems.



### 3. Insurance

#### Product Safety

Under-insurance is a recurrent problem across all disasters, although it was most pronounced in the Queensland floods in late 2010 and early 2011 as many policy holders did not have flood cover. Underinsurance can result in severe social and economic losses which can significantly impede the rebuilding and recovery process following a disaster.

In response to the Blue Mountains bushfires Legal Aid NSW assisted approximately 300 clients and found that underinsurance was a widespread problem. We observed numerous cases of clients who purchased general insurance that was simply *not fit for the purpose* in that they were not covered for the total cost of rebuilding their home. In some cases the gap in cover was so significant – up to half the cost of a rebuild - that customers were in effect sold an *unsafe* product.

Historically in Australia consumers have been asked to bear much of the burden and risk in determining the level of cover they need for their homes. In our view, attention also needs to be paid to the role that insurers should play in determining the level and type of cover for their customers. Information that would affect the cost of a rebuild, such as whether the home is in a flame zone, should be brought to the attention of their customers at the time the product is purchased.

#### Case study – Martha

Martha is an elderly woman whose home was insured for \$270,000. After losing her home of 40 years at the Blue Mountains NSW bushfire in 2010, the insurance assessor estimated the cost of rebuilding her home to be \$580,000. She and her husband built their home in 1971. She held a home and contents insurance policy with the same insurer since 1976. Every year, her sum insured was increased - as suggested by the insurer - under a renewal notice. Martha thought that she was adequately covered because at the time she first purchased insurance, she relied on the actual cost of building her home. In recent years, she has had numerous telephone conversations with her insurer about issues surrounding her amount of sum insured for her home building cover. At no time did the insurer suggest to Martha to reassess her sum insured, nor did they warn her that because she lives in a bushfire prone area, she may need to consider any additional cost involved in rebuilding to meet the Building Code of Australia 2010. The

insurer did not provide Martha with any information about the impact of Bushfire Attack Levels on rebuilding cost, even though the insurer would have or ought to have known this information.

### **Case study – Tom**

Tom, an elderly man purchased a home & contents insurance policy in 2001 when he purchased his home. At the time of purchase, he asked the builder conducting the building inspection to provide him with an estimated cost of rebuild for the purpose of insurance. Each year since that time, Tom had allowed the amount of sum insured to increase as suggested by the insurer's renewal notice. In 2012, he noticed a sudden increase in premium, but did not take active steps to address this concern. In 2013 when he received the insurance renewal notice which suggested an increase of sum insured to \$405,000, he was again shocked by the high premium. He called the insurer to ask about this. The insurer made suggestions as to how Tom could reduce his premium, such as increasing excess amount. The insurer also offered to conduct an over-the-phone questionnaire to check his amount sum insured. After completion of the questionnaire, the insurer suggested that Tom reduced his sum insured to \$220,000. Given the huge discrepancy, Tom reduced his sum insured to \$350,000. After having lost his house entirely at the bushfire, the insurer has estimated that the cost of rebuild is at least \$482,860, and could cost up to \$600,000 depending on the applicable fire zone rating.

### **Case Study – Peter**

Peter and his family lost their home in the Blue Mountains NSW bushfire in October 2013. Their home building was insured for \$367,500. Peter has worked as a handyman for many years, and with his basic knowledge and experience in the industry, he was confident that this amount adequately covered him for the cost of rebuilding his home. Unfortunately, this was not so. His most recent quote from the builder for the cost of rebuild was \$660,000. He was underinsured by almost \$300,000. He and his family are absolutely devastated by this news and are struggling to come to terms with the scale of loss they have suffered. Given his background in the building industry, Peter could not believe how he got his family in this situation of being significantly underinsured. On the information provided by the insurer, it seems that the cause of underinsurance is the additional cost involved to meet the building regulations in a bushfire prone area following the introduction of a new building code in 2010. Amongst the many questions Peter has, he wants to know whether his insurer took into account the additional cost of meeting the new building code when setting the building insurance premium, and if so, why

was he never informed of these important factors so he could make informed choices as a consumer.

In the experience of Legal Aid NSW, there are significant product safety issues in insurance more generally that need to be addressed with market-based, 'supply side' solutions.

In our view, these solutions could include:

- Considering incorporating from credit a 'not unsuitable' test, or simply allowing the s 12ED 'fit for purpose' test to apply to insurance markets to protect against insurance products being sold that are simply not fit for their purpose and are a danger to those who have purchased them
- Introducing the supply side market based solution of unfair terms in standard form insurance contracts to lift the standard of drafting of key terms in such policies to community standards of fairness
- Unfair trading provisions which would protect against business models designed to unfairly take advantage of the most vulnerable

We are also interested in industry-based solutions to market asymmetry and raising standards of market practice, including:

- Industry Codes of Practice – General Insurance has a Code but no Code currently exists in Life Insurance
- Disaster Response Protocol – opportunities exist to leverage off the back of innovative and responsive work of general insurers to ensure consistently good standards of claims handling are achieved across the sector for consumers in disaster events.

**Recommendation 3:** That home insurers are required to bring to the attention of their customers at the time the product is purchased key information that would significantly affect the cost of a rebuild, such as whether the home is in a flame zone, so customers can make an informed choice about what level of cover to choose.

**Recommendation 4:** That the Government considers the value of addressing product safety issues in insurance with:

(a) market-based, 'supply side' solutions such as 'fit for purpose' or 'not unsuitable' tests as well as unfair terms provisions; and

(b) industry-based solutions such as codes of practice where there currently are none and disaster response protocols.

### **Affordability of insurance products**

Some clients decide not to purchase certain types of insurance cover, often because of its significant cost, despite being exposed to considerable risk of floods or fire. Others do not pay close enough attention to the terms of the insurance or do not understand the product and the details of the cover. The Natural Disaster Insurance Review into flood insurance and related matters observed that:<sup>11</sup>

Whenever there are disasters that cause homes to be total losses, the level of under-insurance becomes visible. This phenomenon is most evident in bushfires. In both the 2003 Canberra bushfire and the 2009 Victorian bushfires the levels of under-insurance were severe, typically 30 per cent or more, except for homeowners whose policies offered replacement cover.

The Natural Disaster Insurance Review made four pivotal recommendations for a new integrated system to address the availability and affordability of flood insurance:<sup>12</sup>

- That an agency sponsored by the Commonwealth Government be created to manage the national coordination of flood risk management and to operate a system of premium discounts and a flood risk reinsurance facility, supported by a funding guarantee from the Commonwealth.
- That all home insurance, home contents and home unit insurance policies include flood cover.
- That a system of premium discounts is introduced so that most purchasers of home insurance, home contents and home unit insurance policies in areas subject to flood risk are eligible for discounts against the full cost of flood insurance.
- The Commonwealth Government guarantees the payment of claims by ensuring that, whenever a funding shortfall occurs in the reinsurance facility through claims exceeding the funds held in the facility, the Commonwealth would meet the shortfall *and* the

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<sup>11</sup>National Disaster Insurance Review, *Inquiry into flood insurance and other matters* (2011)  
<[http://www.ndir.gov.au/content/report/downloads/NDIR\\_final.pdf](http://www.ndir.gov.au/content/report/downloads/NDIR_final.pdf)>

<sup>12</sup>National Disaster Insurance Review, *Inquiry into flood insurance and other matters* (2011)  
<[http://www.ndir.gov.au/content/report/downloads/NDIR\\_final.pdf](http://www.ndir.gov.au/content/report/downloads/NDIR_final.pdf)>

Commonwealth would seek reimbursement of a portion of the shortfall from the State or Territory government in whose jurisdiction the flood occurred.

**Recommendation 5:** That the Government considers the Natural Disaster Insurance Review recommendations for a new integrated system to address the availability and affordability of flood insurance.

## Non-insured Australians

A significant number of people cannot afford mainstream insurance products and have difficulty accessing and maintaining insurance. Disadvantaged people who find themselves in this position are usually exposed to greater risk and have less ability to absorb any losses.<sup>13</sup> The Good Shepherd discussion paper on *Insurance for Low-Income Australians* provides that:<sup>14</sup>

Limited availability, access to, and understanding of, insurance are significant contributing factors in financial exclusion for many Australians. It is generally understood that insurance is vital for protecting assets and securing a resilient future. Without insurance, it is not possible to accumulate assets safely and confidentially or use everyday essentials such as a motor vehicle. Non-insurance also places huge burdens on society.

The report further states that the 'economic benefits of increased economic inclusion and financial mobility have been estimated to be \$75 billion, and insurance is a vital aspect of this, to protect and replace assets and increase resilience to losses.'<sup>15</sup>

The benefits for government in making insurance more accessible to low-income consumers include:<sup>16</sup>

- More resilient population, especially in times of disaster
- Reduced disaster recover costs
- Reduction in impoverishment due to the market providing a 'safety net'

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<sup>13</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

<sup>14</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

<sup>15</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

<sup>16</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

- Reduced welfare burden

Government has a role to play in working with industry, social organisations and consumer advocacy groups to consider innovative responses to the problem of non-insurance. One of the key options being put forward as a way to address the problem of non-insurance is microinsurance. StepUP Insurance was an example of a microinsurance product that was developed by NAB, Allianz and Good Shepherd Microfinance, although the product was discontinued because it was not a market success.<sup>17</sup> Another option recommended by the NDIR panel is a system that enables low-income consumers to pay insurance premiums through Centrepay and 'insurance with rent' schemes for Australian social housing tenants.<sup>18</sup> There is an important role for government in facilitating a discussion about how innovative solutions that are financially viable can be developed to enhance financial inclusion in the insurance market.

**Recommendation 6:** That the Government facilitates a discussion about how innovative solutions that are financially viable can be developed to enhance financial inclusion in the insurance market.

## Funeral insurance

Funeral insurance is invariably purchased by vulnerable consumers who can least afford it. Unlike other insurance products, funeral insurance is taken out to insure against an inevitable risk, while other insurance is taken out to insure against a possible risk or damage. It is questionable whether many types of funeral insurance, including funeral expenses insurance, as it is currently developed and sold, is an appropriate and safe product for the Australian community to meet the relatively small cost of a funeral. Research conducted by the Combined Pensioners and Superannuates Association (CPSA) of NSW found that '[a] fifty year-old will end up paying over \$140,000 for a funeral worth \$6,000 today by the time their premium liability ceases.'<sup>19</sup> Most consumers will pay well in excess of the actual cost of a funeral if they purchase a funeral insurance product. Further, if a consumer defaults on their premium payments, they lose all of the money that they have put towards their premiums to date. The CPSA observes

<sup>17</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

<sup>18</sup> Good Shepherd, *Insurance for low-income Australians: taking innovative action – a discussion paper* (2013) <<http://goodshepherdmicrofinance.org.au/news-and-media/publications>>

<sup>19</sup> Combined Pensioners and Superannuants Association of NSW, *The \$140,000 Funeral – Pitfalls of Funeral Insurance* (2011) <<http://www.cpsa.org.au/funerals/funerals-submissions>>

that '[t]he only way in which a policy holder will get more out of their funeral insurance than the premiums they pay, is by dying soon after they take out cover. In other words, in order to come out on top with funeral insurance, a policyholder must bet against themselves living to their life expectancy.'<sup>20</sup>

Our casework experience working with Aboriginal communities in the Money Counts project has been that funeral products sold to families often do not suit their needs. Common issues we have found include:

- Policies that pay out only on certain aspects of a family's funeral expense but fail to provide any level of financial security for the family into the future
- Customers fundamentally misunderstanding the nature of the product and wrongly believing after years of commitment that they have been paying into an endowment fund
- Policies being terminated after years of contributing and payouts not made because payments have been missed
- Payouts being refused because of the fine print of the contract
- Policies costing families an inordinate amount of money that could be spent on basic expenses, including policies taken for children, sometimes from birth

#### **Case study – Sasha**

Sasha, an Aboriginal woman, lost her young son in 1996 when she was 22 years old. Paying for the funeral was a financial strain on her and her family. Having to urgently find between \$5000 and \$10000 can be a significant cause of hardship for families on low incomes. In 2002 with three children under 8, Sasha signed up to a funeral insurance product when a salesperson came to her door. It was not clear to her that her premiums would go up, and that she would only get a set benefit amount. She thought she was putting money in and she would get that money back. She was not told what would happen if she stopped paying. By 2013 she had made almost \$8000 in payments but was forced to stop paying the premium due to lack of income. She is now considering options to pay for her funeral that don't require her to pay more than the cost of the funeral over her lifetime.

A suitability test or regulations requiring businesses to deal fairly and equitably with consumers could prohibit unfair funeral insurance products that are counter to consumers legitimate

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<sup>20</sup> Combined Pensioners and Superannuants Association of NSW, *The \$140,000 Funeral – Pitfalls of Funeral Insurance* (2011) <<http://www.cpsa.org.au/funerals/funerals-submissions>>

interests. The UK has already enacted such legislation in the Consumer Protection from Unfair Trading Regulations 2008. The Regulations introduce a general duty not to trade unfairly and seek to ensure that traders act honestly and fairly towards their customers. In Australia, we have no protection against trading business models which unfairly take advantage of the most vulnerable people in our communities.

The Government could also introduce reforms to address the specific problems with funeral insurance products. Firstly, financial services legislation should be amended to close the 'loop hole' that allows general insurance products which are 'expenses only' to be excluded from regulation. Further, funeral insurance premiums should be capped at an amount which is relative to the 'benefit' of the product, that is, the actual cost of a funeral. Product disclosure should also outline the true cost of the product, including the amount that they can expect to pay in premiums if they live to the average Australian life expectancy and the average cost of a funeral.

**Recommendation 7:** That an obligation for businesses to deal fairly and equitably with all consumers is introduced to prohibit unfair trading in the provision of financial service products.

**Recommendation 8:** That financial services legislation is amended to close the 'loop hole' that allows general insurance products which are 'expenses only' to be excluded from the *Corporations Act 2001* and Life Insurance regulation.

**Recommendation 9:** That funeral insurance premiums are capped at an amount which is relative to the 'benefit' of the product, that is, the actual cost of a funeral.

**Recommendation 10:** That in their product disclosure, funeral insurance companies are required to outline the true cost of the product, including the amount that they can expect to pay in premiums if they live to the average Australian life expectancy and the average cost of a funeral.

#### 4. Credit

Credit is a financial tool that enables consumers to access essential items that they can't afford to purchase outright. As highlighted by the Centre for Social Impact, credit 'can also play a significant role in smoothing consumption and protecting against income shocks and financial



stress.<sup>21</sup> In practice, some credit products result in low-income consumers acquiring an unsafe amount of debt that is unserviceable.

Legal Aid NSW through its casework has noticed a healthy decline in high risk lending practices in home lending. We attribute much success in this area to a number of factors including most notably the introduction of the new responsible lending provisions in the *National Consumer Protection Act 2009*, including the 'not unsuitable' test. We also consider the access rights available to all consumers to free EDR services like FOS and COSL have been crucial in affecting market behavior in a positive way.

However, it is still the case that the people who can least afford it, are paying the most for credit. People excluded from the mainstream financial system are pushed into the fringe market where they are able to loan small amounts of money at very high interest rates. An unserviceable debt, such as a pay day loan, can be a catalyst for low-income Australians to spiral into poverty. Sometimes lenders will withdraw money from the borrower's account on their pay day, ensuring that they receive their money before other essential needs, such as groceries and rent are met. Consumers can also decide to prioritize their loan repayments and fall behind with their utility bills and rent. In the worst case scenario, people can find themselves homeless.

#### **Case study – Joan**

Joan approached a homeless service in the Riverina for financial assistance and was referred to a Legal Aid NSW lawyer who provided regular outreach services at the Centre. Joan had outstanding debts with a payday lender, a large utility account that she was unable to pay, and a number of other debts. Joan sought assistance to pay these debts so that she could afford to pay her rent and therefore remain in her tenancy.

The Outreach Lawyer obtained documentation from the payday lender and sought to challenge the loan on the basis of maladministration, as it appeared that the client was unable to service the loan at the time of her application. The lawyer negotiated a repayment of \$900 to the client and a release from further obligations under the loan. The Outreach Lawyer liaised with the utility provider and had the client accepted under their hardship program. The Outreach lawyer also discovered that although the client had been paying some money to the utility company through Centrepay, it was insufficient to cover her usage, which would have resulted in the

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<sup>21</sup> The Centre for Social Impact, *Measuring Financial Exclusion in Australia* (2013)  
<[http://csi.edu.au/media/content/download/file/Measuring\\_Financial\\_Exclusion\\_In\\_Australia\\_June\\_2013](http://csi.edu.au/media/content/download/file/Measuring_Financial_Exclusion_In_Australia_June_2013)>

client incurring another large utility bill. This was adjusted. In relation to her debt for past energy use, the lawyer was negotiating with the utility provider to seek a reduction.

In the meantime the client was advised to seek energy financial assistance vouchers from her local charity provider. The client's case worker at the homeless service also arranged for the client's home to be assessed under the Home Saving Program to reduce future energy expenditure. The client was also referred to a financial counselor for advice and support on budgeting. The outcome for this client was substantially reduced overall debt and an improved awareness of how to appropriately budget in the future.

### **Case study – Mandy**

Mandy approached Legal Aid NSW for assistance because she was unable to afford the repayments on a personal loan of \$5000. She had borrowed the money for basic needs and education costs when her children were starting school at the beginning of the year. Her Legal Aid NSW lawyer advised Mandy that the loan had a 29% interest rate and did a quick calculation on how much interest she would pay on the loan. The client had not understood what this meant until it was explained to her.

The payday lending regulations which took effect in July 2013 introduced a range of important safeguards for consumers by limiting the fees and interest that payday lenders can charge. Under the new regulations, payday lenders are still able to charge interest up to 48% for loans between \$2000 and \$5000, as well as additional annual fees of \$400. In our view, there is further scope for reform to ensure lenders offer loans on terms that are reasonable and affordable. Interest rates should be capped at a lower level and there should also be a lower cap on fees.

Household rentals or 'unregulated leases' can also expose vulnerable consumers.

### **Case study – Alison**

Alison lives in a remote Aboriginal community in far western NSW. She is 58 and functionally illiterate. A rental company visited her community and she enquired about renting a bed, dining table and chairs for her house. The company told her how much she was going to pay each fortnight, but they didn't otherwise explain the terms and conditions. In particular, she was not told how much she would have to pay over the life of the agreement and what the retail cost of the goods was. When she spoke to a Legal Aid NSW lawyer she was struggling to make the

payments and didn't know how much she still owed them. She had asked a sales representative but had been told she would need to visit the shop, 280km away, for that information. Legal Aid NSW is currently negotiating with the company on behalf of the client.

We welcome the Assistant Treasurer's recent announcement that 'the Government is concerned that consumers are disadvantaged by the use of unregulated leases'<sup>22</sup> and the Government's acknowledgement that '[t]here are cases where it appears that fringe lessors have targeted classes of consumers who are particularly vulnerable, such as where consumers are on Centrelink, pensions or low incomes and have few or no other alternative sources of finance.'<sup>23</sup> In our view, there is a clear need for Government regulation of indefinite and short term leases and enhanced consumer protections, such as responsible lending provisions and mandatory external dispute resolution membership, for these types of leases.

There is significant scope for the government, industry and consumer groups to collaborate and develop innovative, safe microcredit products that service the low-income section of the market. The No Interest Loan Scheme (NILS) is an example of a successful microfinance product that enables people to purchase essential goods and services with a loan of between \$300 and \$1200 with affordable and realistic repayments. STepUp Loans enable people to loan a higher amount (between \$800 and \$3000) for personal or household purposes. No fees apply and interest is charged at fixed low rate. The National Australia Bank, in partnership with Good Shepherd Microfinance is leading the way in microfinance but there is scope for other lenders to service this section of the market.

In recent times Legal Aid NSW has had the opportunity to work with industry in a market-based solution to empowering the most vulnerable consumers who have no assets and are in long term financial hardship, via the Bulk Debt project. Over the course of the Project, close to \$20 million in unrecoverable debt has been waived by creditors, who have recognised the lack of commerciality of seeking to enforce such debts. As the Project comes to the end of its natural

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<sup>22</sup> The Hon Arthur Sinodinos, 'Addressing Consumer Credit Protection Shortfalls' (Media Release, 012-2014, 26 February 2014, 1

<sup>23</sup> The Hon Arthur Sinodinos, 'Addressing Consumer Credit Protection Shortfalls' (Media Release, 012-2014, 26 February 2014, 1

life, other new and innovative solutions are evolving from that work, including the National Hardship Register<sup>24</sup>.

**Recommendation 11:** That the Government considers further legislative reform to ensure lenders offer loans on terms that are reasonable and affordable. This should include capping interest rates at a lower level and lowering the current cap on fees.

**Recommendation 12:** That the Government regulates indefinite and short term leases and introduce enhanced consumer protections, such as responsible lending provisions and mandatory external dispute resolution membership, for these types of leases.

**Recommendation 13:** That government, industry and consumer groups collaborate to develop innovative, safe microcredit products that service the low-income section of the market.

## 5. The role of the regulator

Legal Aid NSW continues to support the current model in which there is regulator specialisation for the financial service sector. Financial products can at times be complex and unsafe, financial markets unstable and volatile. Expertise and a steady hand is needed to navigate the appropriate balance of enforcement and intervention to respond to market failure. The regulator can have a powerful effect on the market by identifying patterns of conduct, driving law reform and testing the law. ASIC is well placed to identify and investigate systemic issues, particularly those that impact upon disadvantaged and vulnerable consumers and enabling an inclusive financial services market.

Consumer protection regulators also have an important role to play in monitoring and enforcing compliance where breaches of the law are identified. As identified in the Regulator Watch report prepared by the Consumer Action Law Centre:<sup>25</sup>

Non-compliance with consumer laws may also contribute to anti-competitive outcomes – some businesses may comply with the law, but others will not in the knowledge that the risk of being

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<sup>24</sup> The National Hardship Register is a trial project that is being developed between industry and consumer groups (including financial counselors), which seeks to 'wash' the details of unrecoverable debts through the books of debt-buyers and debt sellers.

<sup>25</sup> Consumer Action Law Centre, *Regulator Watch – the Enforcement Performance of Australian Consumer Protection Regulators* (2013) < <http://consumeraction.org.au/>>

found in breach is low. Robust enforcement by consumer regulators can protect individual consumers as well as contribute to fairness within markets.

ASIC should continue to investigate rogue or fringe lenders that have a disproportionate impact on vulnerable consumers, even though there is not a large amount of money involved in these transactions. We also support initiatives led by ASIC to engage industry and consumer groups to address consumer law issues particular to vulnerable and disadvantaged consumers, such as the current work being done around Indigenous access to superannuation.

In order to carry out this important work, regulators need appropriate resourcing and funding. We encourage the Inquiry to consider whether ASIC should receive some funding through a 'user pays' model supported by the businesses that it regulates. There is a precedent for this model - the Financial Conduct Authority in the United Kingdom is funded entirely from the businesses that it regulates.

**Recommendation 14:** That the Inquiry considers whether ASIC should receive some funding through a 'user pays' model supported by the businesses that it regulates.

## 6. Financial Ombudsman Service – External Dispute Resolution

External Dispute Resolution (EDR) promotes stability of financial service markets and is an integral part of a healthy and mature financial services sector. In our view, EDR should continue to remain the forum of first choice in the resolution of consumer disputes. EDR mechanisms provide informal, low cost and highly specialist dispute resolution, while access to courts and tribunals enables resolution of complex issues of statutory interpretation and clarifies the operation of law. The use of EDR results in quicker, more efficient and less costly dispute resolution, without compromising fairness and equity. Benefits of EDR include early intervention, and effective and efficient use of resources. The advantages of EDR include:

- Expertise of decision makers. In EDR processes people do not need to be experts as the scheme's decision makers are specialists in the area of law.
- Flexibility and informality, with user-friendly modes of lodging and resolving complaints.
- Value for money. Schemes are designed so that people don't need legal representation, except for the most vulnerable.
- Innovative resolution of systemic issues.

As EDR processes are informal and user friendly there is no need for lawyers, except for the most vulnerable clients. EDR can also save on the costs imposed by the opposing party, as the mortgagee lawyer cannot charge their legal fees as enforcement costs while the matter is at EDR. In addition, it is the experience of Legal Aid NSW that FOS is extremely effective in identifying and resolving consumer disputes at a systemic level.

Legal Aid NSW understands that Financial Service Providers (FSPs) sometimes hold concerns that EDR Schemes are too easily subject to abuse by vexatious or frivolous complaints, which result in delay and high cost to members. However, these concerns should not be overstated given the various safeguards that are built into the two-tiered complaints process that limits this potential, and that must be weighed against the net benefit of the service generally.

It is noted that a consumer should generally take their complaint through a FSP's Internal Dispute Resolution Scheme (IDR Scheme) as a prerequisite to access the EDR complaints process. We are generally supportive of IDR processes as they provide the FSP and the consumer with an opportunity to address any issues and resolve matters in a timely and cost-efficient way. However, IDR processes must be considered in the context of substantive rights for consumers, including ongoing access to justice concerns.

The independent Review of the Financial Ombudsman's Service conducted by Cameron Ralph Navigator identifies the issue of timeliness and delay as a major issue. In our view, the timeliness issues addressed in the report can be attributed to the resourcing issues and the report outlines a workable plan to address the current issues with delay.

We continue to support the current EDR system operated by the FOS. In particular, that the system should remain free for consumers of the service as an important enabling tool for consumer's rights in the marketplace. In our view, any significant departure from the current model could impact upon disadvantage people's ability to access EDR.

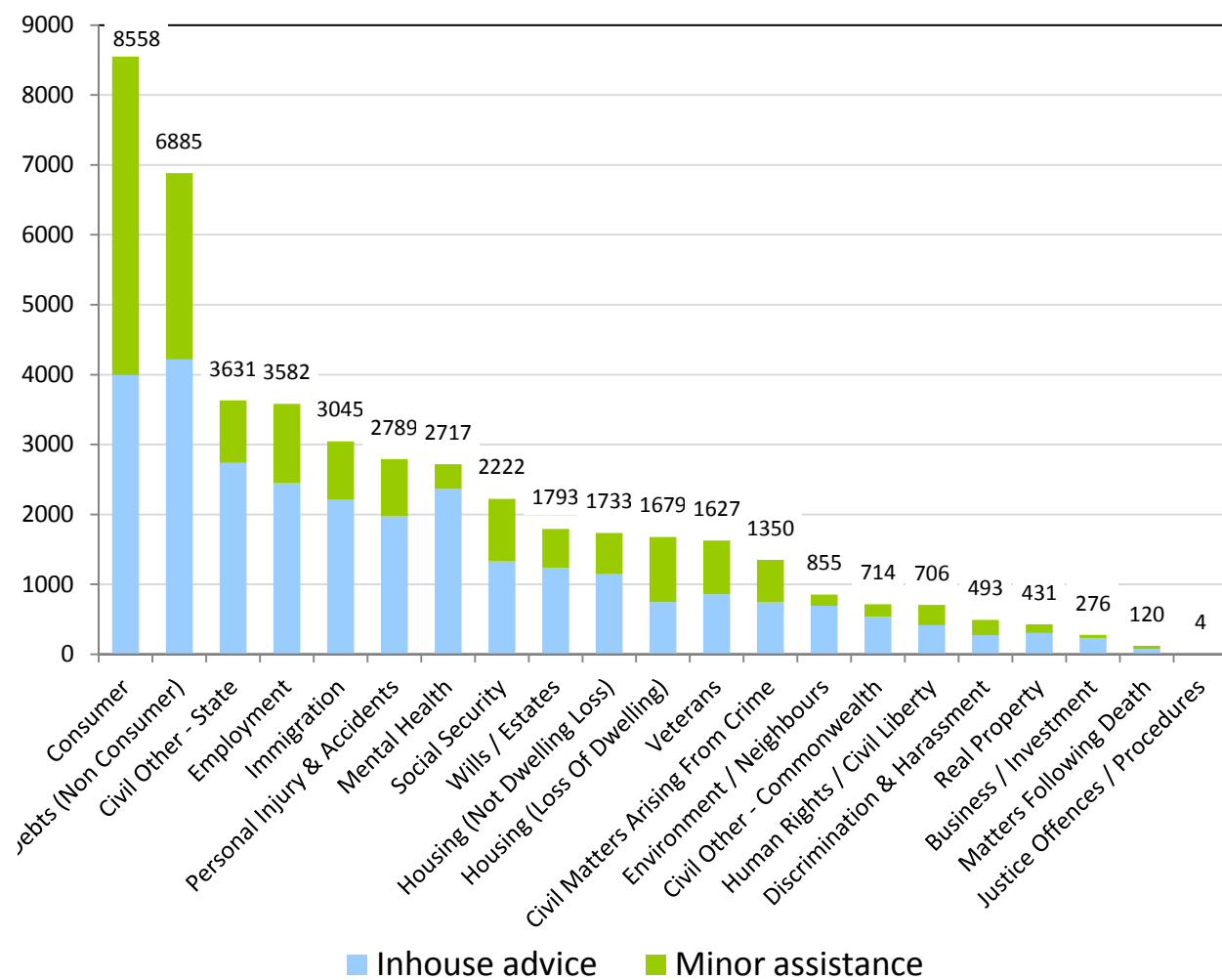
## **Conclusion**

Financial service markets are important sources of wealth creation and stability for the Australian economy. At their best, they can be innovative and dynamic in their ability to service consumer need. However, without adequate competition, consumer protection and regulation they can sometimes gravitate toward solutions and products that do not completely serve the needs of the markets they serve. Consumer protection and regulation that focuses on improving market asymmetry and market failure, such as unfair trading protection and product safety

protection in insurance, would encourage and promote greater competition and improve the product offering for all Australians.

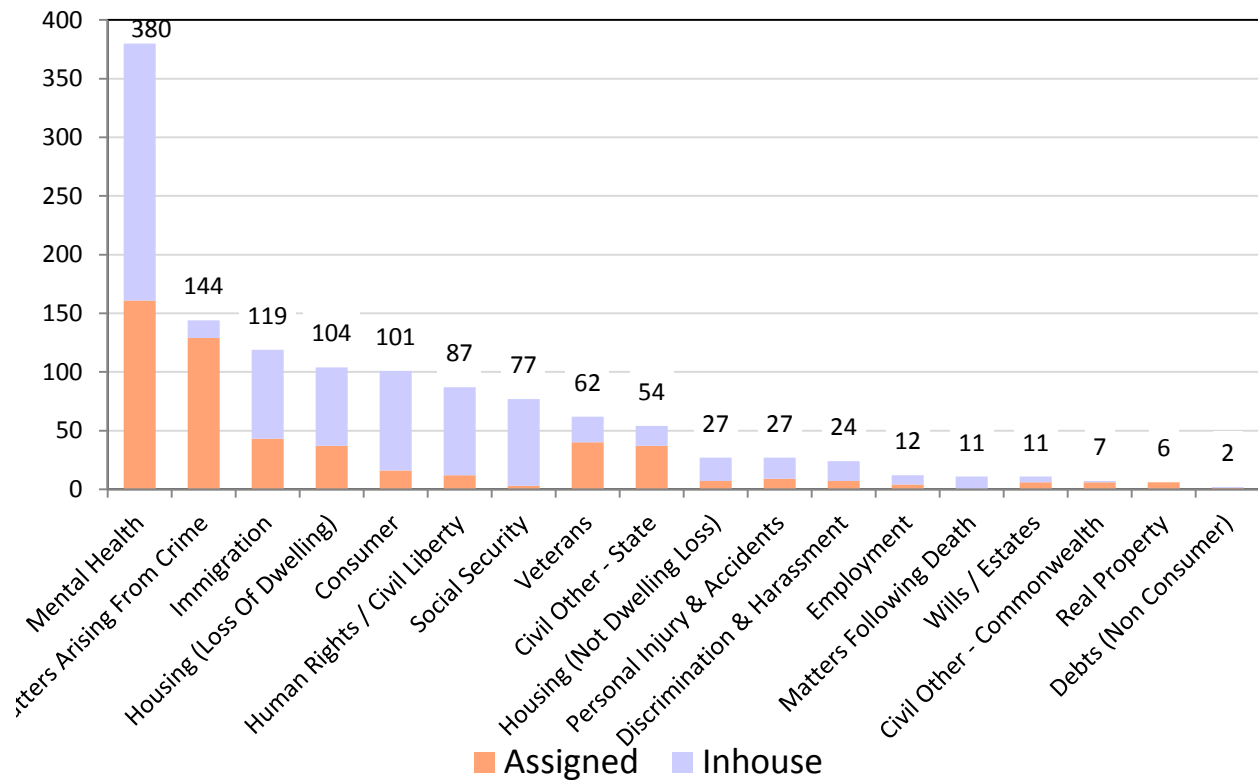
Thank you for the opportunity to make these submissions. If you would like further information, please contact David Coorey, Solicitor, Civil Law at [David.Coorey@legalaid.nsw.gov.au](mailto:David.Coorey@legalaid.nsw.gov.au) or 9219 5824 or Dara Read, Solicitor, Legal Policy at [Dara.Read@legalaid.nsw.gov.au](mailto:Dara.Read@legalaid.nsw.gov.au) or 9219 5714.

## Civil Law Advice and Minor Assistance by Matter Group 2013 Calendar Year





## Civil Law Grants by Matter Group 2013 Calendar Year



### **Highlights of Legal Aid NSW consumer law work**

Legal Aid NSW and the Consumer Credit Legal Centre established the **Mortgage Hardship Service** to assist people in mortgage stress and at risk of mortgage default. Solicitors work closely with financial counsellors to establish the borrower's true financial position and their capacity to repay their mortgage in the short, medium and long term. They can also attempt to negotiate alternative arrangements with credit providers. Legal assistance is also provided to obtain hardship variations to loan contracts, or where borrowers have no capacity to repay their mortgage within a reasonable period, to negotiate time to sell the property to avoid the negative impact on sale price arising from a mortgage sale.

**Money Counts** is a new short term casework-focused project that provides targeted legal assistance to Aboriginal communities on consumer law issues to increase the capacity of consumers and community workers to deal with consumer law problems as they arise. Money Counts lawyers assist Aboriginal consumers with a range of consumer law problems including debts, payday loans and other credit, renting or buying household goods and electronics, paying for funerals, Centrepay deductions, problems accessing insurance benefits, issues arising from door to door sales, phone and energy bills and superannuation.

Legal Aid NSW is also the key legal agency that coordinates and **responds to disasters** in NSW. In the aftermath of a disaster, Legal Aid NSW coordinates ongoing legal advice and assistance for those affected, mainly in relation to consumer disputes in home and contents insurance as well as credit hardship. Most recently, we assisted with disaster recovery work in the Blue Mountains in October 2013. We also support other states to deliver legal services when they are affected by natural disasters. In 2011 we assisted Legal Aid Queensland in response to the Queensland floods and we assisted Legal Aid Tasmania following the Hobart bushfires in 2013.

### **Insurance – General & Life**

Insurance can have a very direct and substantial impact on the lives of consumers, including their ability to get back on their feet after a disaster event. Significant consumer detriment can result if consumers do not have a safe or appropriate insurance product. For some time we have held concerns about particular insurance products such as life insurance and funeral plans, particularly those targeted at disadvantaged people and Aboriginal communities. We

have also noticed a recurring theme in our Disaster work, where the reasonable expectations of consumers to be indemnified for the full value of their loss have not been met.

### **Disaster response work**

Our disaster response work has highlighted recurrent themes of product safety and underinsurance with general insurance products. Increasingly, we have found that the general insurance product offered to consumers is not suitable for their needs and does not effectively cover their risk.

We have also seen the effects of insurance being the only market where consumers do not receive the benefit of a 'supply side' solution<sup>26</sup> to market failure as unfair terms obligations are not a market requirement for standard form insurance contracts. Various inquiries and commissions have already investigated this particular and unusual gap in consumer protection - and all have concluded that there are good grounds to enact such consumer protection in this country today.<sup>27</sup>

Equally, Section 12ED of the *Australian Securities and Investments Commission Act 2001* outlines the range of implied warranties that apply to the supply of financial services, including a 'fit for the purpose test' - but section 12ED(3) of the Act specifically excludes contracts of insurance from the operation of this section. In our view, further investigation should be made whether the application of s12ED would be an ideal 'supply side' solution to product safety in insurance markets.

Our disaster response work has also led us to observe that:

- There can be significant barriers for consumers in enforcing and protecting their rights in general insurance – *consumers face barriers accessing IDR and EDR or are often not aware that they have a right to lodge a dispute*
- Multi-tiered claims handling processes need to be simplified, sped up and made more transparent – *consumers often get lost in the process of IDR*

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<sup>26</sup> Unfair terms regulation is a supply side solution that actively seeks to prevent harm *before it occurs* by requiring traders to review their standard form consumer contracts before they enter the marketplace, to ensure they comply with community standards of fairness. Despite various recommendations on point, insurance remains the only industry where consumers do not receive the benefit of this supply-side solution.

<sup>27</sup> This includes the Senate and Economics Committee on Trade Practices Amendment Bill (ACL Bill) 2009, The House of Representative Committee Inquiry into the Operation of the Insurance Industry during Disaster Events 2011 and National Disaster Insurance Review 2011

- There is a need for ongoing regulation and monitoring of systemic issues in general insurance – *loss of basic rights by many consumers can be significant and widespread, particularly in disaster events*

The following case study is an example of the type of assistance that Legal Aid NSW provides clients following a disaster.

#### **Case Study – John**

The Riverina Homeless Outreach Lawyer assisted a client who was originally seen by Legal Aid NSW through the Disaster Recovery Centre in Wagga Wagga during the floods of March 2012. His property was damaged as a result of flooding in the area. John had made a claim with his insurer which was denied on the basis that his policy had an exclusion clause in relation to flooding. John was an elderly man living in the property with his wife, daughter, son-in-law and teenage grandson. As a result of the property damage, they were all evacuated from the property and initially resided in temporary accommodation, then returned to live in their shed on the property. John was hospitalised with pneumonia as a result of the shed's poor conditions.

John's son-in-law advised the Riverina Homeless Outreach Lawyer that he phoned the insurer prior to the flood, and recalls being told by a customer service officer that he would be covered for floods. The Riverina Homeless Outreach Lawyer requested a copy of this telephone conversation and sought a review of the decision of the insurer based upon representations made to the client's son-in-law. The insurer agreed to pay the client under the policy, which means the family was able to commence rebuilding their house.