

Financial Services and Credit Reform Green Paper
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Submission into Green Paper on Financial Services and Credit Reform (June 2008)

The Finance Sector Union of Australia (FSU) welcomes the opportunity to contribute to the consultation process regarding the Commonwealth Government's inquiry into Financial Services and Credit Regulation reform.

Our union represents 50,000 members employed in the finance sector across Australia. Accordingly, our submission focuses primarily on the recommendations relevant to finance sector staff as well as consumers of financial services.

The FSU and its members support the need for regulation that protects consumers and promotes their participation in fair, transparent and competitive markets. Our members have a vested interest in the financial services market being professional and ethical, and having appropriate mechanisms for redress on occasions when it is not.

Regulation of Mortgages, Mortgage Broking, Non-Deposit Taking Institution and Other Credit Products

The FSU supports the proposal for the Commonwealth Government to assume regulation of mortgages, lenders and brokers; however we believe that this does not go far enough to ensure adequate consumer protection. In this regard, we support the option in Chapter 6 that all credit be regulated by Commonwealth legislation, and believe that this should be enacted without delay. The market for credit is national – the regulatory regime should reflect this.

We believe that a move from a cross jurisdictional model under the Uniform Consumer Credit Code (UCCC), to a uniform national approach under the Commonwealth is the best solution to preserve the reputation of our industry and the financial welfare of our citizens and community. The UCCC obviously aims to create a uniform national regime, to properly fulfil this aim it is only logical that the Commonwealth Government be given this responsibility.

We note that the arguments for credit regulation to be handled by the Commonwealth has been supported by numerous inquiries and agencies such as the House of Representatives Standing Committee on Economics, Finance and Public Administration¹, the Productivity

¹ "Home loan lending Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty", House of Representatives Standing Committee on Economics, Finance and Public Administration, September 2007.

Commission,² and ABACUS, the industry body for credit unions and mutual building societies.³

Recommendation 1. The Commonwealth Government should assume responsibility for all credit products.

Whilst the Australian economy has not been greatly affected by the sub-prime mortgage crisis stemming from the United States, the FSU does not necessarily accept this is an automatic endorsement of the Australian finance industry and regulatory regime.⁴ For example, instances of fringe players involved in equity stripping (through the charging of excessive fees to refinance borrows into unfordable loans), the recommendation of loans with higher commissions and the practise of ‘fiddling’ with figures so borrows qualify for larger loans with commissions for the broker.⁵

Viewing this in the context of the exponential growth of Australia’s level of personal debt (with personal debt as a proportion of GDP at 156% in 2007 from 50% in 1981, and with predictions that it will reach 200% by 2015),⁶ the FSU advocates that a uniform, consistent and truly national regime for the regulation of consumer credit is vital and overdue.

As part of the transfer we advocate that all financial service providers and intermediaries be licensed and participate in an ASIC approved alternative dispute resolution schemes. The FSU believes that this would create greater consistency in the regulation of financial products and help to ensure that customers have the same level of protection and avenues of redress regardless of what state they reside in and what financial service they have purchased. Furthermore, the FSU supports the adoption of national legislation to regulate the conduct of finance brokers within the marketplace.

Recommendation 2. All credit providers and finance brokers should be licensed nationally, covered by a dispute resolution scheme and subject to regulatory audits.

The need for better information regarding people who experience mortgage stress and/or repossession of their homes has been previously acknowledged.⁷ Unfortunately the data that are available tend to show an increase in the number of people experiencing difficulties. A recent report by Fujitsu predicted that the number of households experience ‘mortgage stress’ in June 2008 was approximately 750,000 with over 300,000 of those experiencing severe mortgage stress.⁸ In Treasury’s evidence to the current Senate inquiry into housing affordability it was stated the home repossessions have

² “Review of Australia’s Consumer Policy Framework”, Productivity Commission Inquiry Report (pg. 107) (08/05/08)

³ “Credit Reforms Need to Go Further”, ABACUS Media Release (03/06/08)

⁴ “Financial Services and Credit Reform – Green Paper”, The Treasury (06/08), (pg. 7)

⁵ “Centralised regulation the key to investor protection”, Sydney Morning Herald, (07/06/08)

⁶ Keen, S, “Deeper in Debt – Australia Addition to Borrowed Money”, September 2007

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

⁸ “Anatomy of Australian Mortgage Stress”, Fujitsu, 2008.

doubled in the past four years, rising to approximately 10,000 homes repossessed in 2007.⁹

Better data can only lead to better public debate and consequently improved policy outcomes. In this regard the FSU believes it would be extremely useful to have statistics regarding people who experience difficulties with a major lender, refinance with a 'second tier' lender then (unfortunately) repeat this process which, anecdotally at least, seems to lead inexorably towards the 'predatory' lending sector.

Given the increase in people experiencing difficulties we believe that any regulatory regime for credit should enshrine some form of principles to mandate 'responsible lending' practices. In line with this belief the FSU has been developing a draft "*Charter of Responsible Lending*" which has been included under *Attachment 1* of this submission.

We note the comments of the Financial Stability Forum in April of this year who observed in relation to the US sub-prime crisis that:

"The combination of weak incentives, an increasingly competitive environment, low interest rates and rapidly rising house prices led originators and mortgage brokers to lower underwriting standards and to offer products to borrowers who often could not afford them or could not bear the associated risks."¹⁰

We submit that a legislated regime for responsible lending will help to ensure that Australia can never head down the sub-prime path.

Recommendation 3. All loans and credit products must be based on a genuine assessment of the consumer's needs, the suitability of the product to meet those needs, and demonstrated capacity to meet the repayments.

Disclosure and sales targets

The FSU and its members are acutely aware that competition in the finance industry is constantly increasing and this has been accompanied by greater pressure on finance sector staff. This pressure often takes the form of sales targets that must be achieved to gain pay rises. Unfortunately these targets are increasingly used as the only way staff can access increased remuneration.

We stress that the FSU does not object to the principle of performance pay or bonuses. The FSU's policy on performance pay and targets¹¹ is that they should only exist once a system based on a guaranteed CPI increase is in operation. If wages for finance sector employees cannot go backwards, then the pressure to meet sales targets will inevitably be lower.

The FSU believes that the trend towards linking all pay increases to sales targets is disturbing, particularly when it is coupled with systemic psychological bullying of staff by management to meet these targets. These factors encourage and even compel staff to

⁹ Senate Select Committee on Housing Affordability in Australia, 1 April 2008 Canberra.

¹⁰ "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", Financial stability Forum, 7 April 2008.

¹¹ FSU Policy" – Regulation on Performance Based Pay – 2007 (www.fsunion.org.au)

sell products to meet their own job and financial security needs rather than those of the consumer.

A recent survey of FSU members, predominantly in the established banking sector, found that:

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

The principle and practice of disclosure is widely accepted, particularly in the financial services marketplace. There may not be the same direct link between the individual sale and the specific financial incentive that exists in other areas; however the fundamental issue is that targets do create a link which should be made transparent to the consumer.

Regardless of whether sales targets are linked to pay increases, bonus schemes, commissions, trailing commissions or other remuneration implications, the FSU recommends that serious consideration be given to some form of disclosure to the consumer that a financial incentive exists for the employee to sell them a product.

Recommendation 4. Consumers must be informed of any commissions, bonuses, incentives or remuneration implications that those making the sale may receive as a result of selling a financial product.

FSU is broadly supportive of an improved credit reporting regime to the extent that it would promote better credit decisions by lenders; however the use of such information must be strictly protected and should not be simply used as a tool for more targeted aggressive marketing. To help ensure that such a regime is not misused, the FSU recommends that some form of "opt-out" mechanism be made available to consumers to indicate they do not wish to be offered any unsolicited products whenever interacting with their financial institution. This would make sure consumers do not feel harassed by constant unwanted offers and ensure that finance sector employees do not have to persistently make such offers. This mechanism would be similar to the 'do not call' register that was recently established by the Australian Government and could be used by finance sector companies as a way of marketing themselves as offering 'superior' customer service.

Recommendation 5. Consumers must be allowed to 'opt-out' of receiving unsolicited product offers in their dealings with their financial institution

Training and Compliance

Related to the discussion of disclosure and the movement toward the use of sales targets as the primary method of calculating remuneration for employees within the finance sector, is the need for consistent minimum standards for staff training, accreditation and licensing across the industry. The FSU believes that the Commonwealth Government should consider the following issues in any examination of the regulation of the Financial Services sector.

The FSU believes that Australian Securities and Investment Commission (ASIC) should play a stronger role in ensuring that RG146 compliant training actually ensures that staff are appropriately trained to provide financial advice. The ASIC Training Register (ATR) needs to provide more information regarding the content and quality of RG146 compliant courses – thereby providing more transparency and assistance to industry. The FSU argues that in its current form, the ATR encourages compliance over capability and doesn't currently ensure the quality of advice that RG146 was meant to encourage.

An unfortunate example was brought to the attention by FSU in the use of online training modules that do not outline the reasons why a candidate fail, and allow for the haphazard use of different combinations of answers until they pass. This method would have been used for the assessment of thousands of finance employees. This situation highlights the divergence between achieving compliance and being capable of providing advice for consumers in the manner envisaged by the recommendations of the Financial System Inquiry (FSI).

Furthermore, we advocate a stronger alignment between the Australian Qualifications Framework (AQF) and RG146 to provide the best possible linkage between RG146 compliance and the development of industry recognised portable qualifications. For example, if someone does compliance training within the AQF, they can subsequently build on this training to achieve an industry recognised qualification that leads to other industry acknowledged learning pathways. However, if an individual undertakes compliance training outside the AQF then it is unlikely they can use this as a step towards gaining an industry recognised qualification. Their training is isolated from the broader training framework and although it may be RG146 compliant, it often holds no other significant value within the industry.

A broader review should also examine whether the intent of the legislation is potentially compromised by increased workloads due to FSRA requirements and the industry's failure to address these issues through appropriate staffing levels. Unfortunately some companies have provided additional training to staff and then used this as an excuse to increase sales pressures on staff, a process that would seem to run counter to the intent of the legislation to minimise inappropriate sales. We recognise that the Australian Government and the relevant regulators have no direct control over staffing levels and sales targets, however, we believe they can and should play a valuable role in helping to encourage a culture of compliance with the letter and spirit of the law.

Disclosure and off-shoring

The Commonwealth Government would be well aware that there has been an increasing global trend for companies to relocate various parts of their operations to locations outside the country where the service is being delivered. This practice is often referred to as 'off-shoring' and has become widespread in the finance sector.

In Australia there is currently no requirement to disclose whether services are being provided from off-shore locations and consumers are often not aware that calls to customer service centres are being handled in a different country. The FSU and other unions have advocated that consumers should be informed when services are being

provided from an overseas location¹² – this has often been referred to as the ‘right to know’ and has been adopted in France¹³ and introduced into several State legislatures in the USA¹⁴.

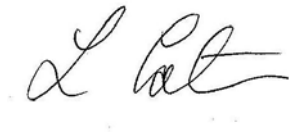
Research undertaken for the FSU¹⁵ has shown that consumers strongly support a legislative regime that would require financial institutions to disclose whether they store and/or process data or provide services from overseas locations.

A logical comparison for the ‘right to know’ in relation to services is labeling laws for products where companies must state the ‘country of origin’ so that consumers can make informed purchasing decisions.

We understand that this issue is not strictly within the scope of the issues in the green paper, however if there are to be reforms to the disclosure regime for credit and other products then we believe this issue should be considered.

If you have any questions in relation to this submission please contact James Bennett on (02) 6247 7172 or Louise Vergara on (02) 9273 8248.

Yours sincerely



Leon Carter
National Secretary

1 July 2008

¹² “Offshoring : A joint policy paper by the Finance Sector Union of Australia, Australian Services Union, Communications Electrical and Plumbing Union (Communications Division) and the Community and Public Sector Union” (June 2006)

¹³ “Outsourcing Victory in France” Press Release 18 October, 2004

¹⁴ For more information see <http://www.nfap.net/researchactivities/globalsourcing>

¹⁵ Attitudes to Offshore Labour – Report Prepare for Aservice Unions of Australia – May 2006”, McNair Ingenuity Research

**Finance Sector Union – Charter of Responsible Lending
DRAFT - June 2008**



The Finance Sector Union of Australia calls on all members of the finance industry and the Australian Government to adopt, implement and adhere to a national Charter of Responsible Lending. The key principles and regulatory initiatives underpinning the Charter are as follows:

- A consistent Commonwealth regulatory regime covering the provision of financial products should apply to all credit products and providers; incorporating on the highest standards of disclosure and procedural fairness, access, and affordability of redress for consumers,
- All loans and credit products must be based on a genuine assessment of the consumer's needs, the suitability of the product to meet those needs, and demonstrated capacity to meet the repayments;
- No unsolicited pre-approved credit offers should be made to consumers;
- Sales targets for finance industry staff should only be linked to remuneration if a living wage and across the board, guaranteed minimum salary increases are already in place;
- Consumers must be informed of any commissions, bonuses, incentives or remuneration implications that those making the sale may receive as a result of selling a financial product;
- Consumers must be allowed to 'opt-out' of receiving unsolicited product offers in their dealings with their financial institution;
- Information about assistance mechanisms for people facing financial hardship must be made easily available;
- All institutions must be members of an alternative dispute resolution scheme with the powers to resolve disputes without redress to the courts;
- Financial literacy and education programs must be encouraged and supported by the industry and governments and provided to the community, particularly to vulnerable or disadvantaged groups.
- Financial institutions will improve their credit risk management by developing comprehensive programs, and contributing capital, to enable consumers to reschedule credit repayments during periods of short-medium term cash flow asymmetries.

Attachment 1

Background

The finance industry plays an essential role in Australian society as a provider of capital, insurance, investment, personal credit, financial advice, assessment and deposit taking. In Australia, the finance industry makes up approximately 40% percent of the value of our stock market and employs around 400,000 people.

The people and practices in the finance industry determine public goodwill and confidence in its reputation and sustainability – without these it could unravel causing enormous damage to the Australian economy.

The Finance Sector Union (FSU) accepts and understands that the finance industry must be a very competitive industry; however finance products can have serious or long term implications if sold inappropriately.

Purchasing any financial product is a serious matter, especially a home loan which will usually be the biggest financial commitment a person makes in their lifetime. Financial institutions should always try to ensure that products are appropriate to a persons circumstances and do not result in people becoming overly financially committed.

Australia's level of personal debt is at record highs and continues to rise. In 1981 personal debt as a proportion of GDP was 50% by early 1999 it had risen to 100% and in 2007 it was 156%. If the current trend continues, it will reach 200% of GDP by 2015.¹⁶ Given this trend the FSU advocates that all financial institutions adopt and that Government's enact the necessary regulation to give affect to this Charter of Responsible Lending to preserve the good reputation of our industry, the financial welfare of our citizens and the economy of our community.

Regulatory arrangements

Under the current national regulatory regime, most financial service providers are required to hold an Australian Financial Services (AFS) licence. This includes banks, credit unions, insurance companies and financial advisors. Licensing conditions include training requirements and membership of an industry alternative dispute resolution scheme.

However, the provision of credit is regulated under the Uniform Consumer Credit Code which is enacted through State based legislation. Under this regime credit providers are not automatically required to hold an AFS licence and consequently may not be members of a dispute resolution scheme.

The FSU also calls for the regulation of credit to be brought into a Commonwealth regulatory regime, consistent with other financial products to ensure that consumers have the same level of protection and avenues for redress. In addition there should be national legislation to regulate the conduct of finance brokers in the marketplace.

¹⁶ *Deeper in Debt - Australia's Addiction to Borrowed Money*, Dr Steve Keen September 2007.

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As part of such a regulatory regime, all providers of credit must be members of an alternative dispute resolution scheme.

Credit assessment and increases

Institutions must not sell credit products to a customer unless they have carried out a genuine assessment of the customer's needs and capacity to repay the credit product.

This process must sufficiently consider the debtor's financial situation to satisfy a diligent and prudent credit provider that the debtor has a reasonable ability to repay the amount of credit provided or to be provided.

Institutions should obtain information about the customer's financial position with specific regard to:

- level and type of income; and
- all credit accounts and applicable limits and balances;
- other repayment commitments; and
- credit history.

If this process suggests that a consumer will have difficulty meeting the repayments then approval should not be given unless changes are made that would ensure the consumer has sufficient capacity to make repayments.

Institutions should not increase the amount of credit available unless the consumer has requested the increase in writing, and the credit provider has carried out a satisfactory assessment as previously outlined.

Where credit limit increases are offered they should include details about what the new minimum repayments would be if the consumer accepted the increased limit.

Unsolicited offers of credit, including credit cards and increasing credit card limits must not be made.

Sales targets and finance sector employees' remuneration

The FSU is concerned that the industry is increasingly moving towards a culture of sales targets and incentive based remuneration for employees. Achievement of targets is now explicitly linked to remuneration outcomes – unfortunately, achieving targets is now becoming the only way employees can access pay increases.

The culture of sales targets is, by definition, designed to maximise sales which (even inadvertently) will lead to a higher risk of inappropriate sales occurring. The FSU policy on performance pay¹⁷ clearly states that sales targets or performance hurdles should only be linked to remuneration outcomes where across the board, minimum pay adjustments

¹⁷ FSU Policy - Regulation of Performance Based Pay, 2007 – www.fsunion.org.au

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already exist to provide employees with sustainable cost of living and real wage growth increases. Base salary levels should reflect the professional nature of the service being provided and reflect the need to attract and retain a skilled and responsible workforce.

In addition, consumers must be informed of any commissions, bonuses, incentives or remuneration implications that finance sector employees may receive as a result of selling a financial product.

'Opt out'

Financial institutions that wish to offer superior customer service should offer consumers an 'opt-out' mechanism. Under such mechanisms, customers can indicate they do not wish to receive unsolicited offers of products either when dealing directly or indirectly with their financial institution. This would ensure that consumers who are not interested in additional products do not feel pressured by constant unwanted offers and ensure that finance sector employees do not have to persistently make such offers.

Assistance for people facing financial hardship

A proportion of consumers will experience financial difficulty at some stage of their lives. In many cases this will be temporary and institutions can help consumers to manage these periods if they have policies and procedures in place to provide assistance, advice and information.

These procedures should include:

- clear contact points for people experiencing financial difficulty;
- discretion to grant relief mechanisms such as deferred repayments or penalty waivers;
- contacting customers who appear to be having difficulty managing their repayments;
- referral to free and independent financial counselling where appropriate; and
- information regarding dispute resolution procedures.

Financial Literacy and Education

Given the increasing complexity and essential nature of financial services it is critical that people have access to education and information to increase their level of financial literacy. This is particularly important for young people and other potentially vulnerable groups. Industry should take a leading role along with Government in providing these education programs and include them as part of the mainstream curriculum in secondary schools.