13 July 2018

Finance and Expenditure Committee
Parliament Buildings
Wellington
New Zealand

By email: fe@parliament.govt.nz

SUBMISSION on briefing from the Reserve Bank and FMA on the outcomes of the Australian Royal Commission into banking

1. Introduction

1.1. Thank you for the opportunity to make a submission on the briefing on the outcomes of the Australian Royal Commission into banking (the Royal Commission). This submission is from Consumer NZ, New Zealand's leading consumer organisation. It has an acknowledged and respected reputation for independence and fairness as a provider of impartial and comprehensive consumer information and advice.

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1.2. We would like the opportunity to speak to our submission.

2. General comments

2.1. The Australian Royal Commission has uncovered evidence of unconscionable behaviour by banks and financial institutions. This behaviour includes bribery, fraud, failure to verify customers' living expenses before providing loans and selling consumers insurance policies they cannot afford.

2.2. New Zealand banks have denied practices identified by the Royal Commission are used here. However, given the lack of scrutiny of our banking industry, consumers have little assurance this is the case. Both our research and consumer complaints indicate there are problems in the market that require investigation.

3. **Sales practices**

3.1 Each year, we carry out a survey to assess consumer experience in the banking industry.[1] Banks' sales practices were among the issues we investigated in this year's survey.

3.2 The survey found 27 percent of consumers had received unsolicited offers from their bank for financial products.[2] The products offered included:

- Credit cards and increases in credit card limits
- Life, contents and house insurance
- Personal loans
- Mortgage protection insurance
- Personal loan repayment insurance
- Credit card repayment insurance
- Mortgage top-ups.

3.3 Our major concern with these offers is that, in many cases, the product offered is not appropriate and may result in the consumer unnecessarily increasing their debt or purchasing products that provide poor value.

3.4 Fewer than half of those who received an offer considered it was a good option for them and suited their needs (see Table 1).

Table 1: Response to unsolicited offers

Financial product	**% who agreed the product suited their needs**
Credit card	37%
Increase in credit card limit	35%
Life insurance	21%
Personal loan	33%
Contents insurance	14%
House insurance	19%
Mortgage protection insurance	15%
Personal loan repayment insurance	40%
Credit card repayment insurance	48%
Mortgage top-up	32%

3.5 Complaints to our office also provide evidence consumers are being offered inappropriate products. For example:

- In a recent case, a 25-year-old consumer with no dependents was sold a life insurance policy by his bank when he signed up for Kiwisaver. He purchased the product because he was led to believe by bank staff it was required as part of joining Kiwisaver.

- In another instance, a superannuitant was paying for credit card repayment insurance, sold to her by her bank. However, she had very limited ability to

[1] https://www.consumer.org.nz/articles/bank-satisfaction-survey

[2] Customers of ANZ and ASB were significantly more likely to report unsolicited offers of financial products. Thirty-two percent of ANZ customers and 34 percent of ASB customers said they'd been offered unsolicited products by their banks.

make a claim under the policy because it restricted cover for anyone over age 65.

3.6 We believe the promotion of inappropriate products is being encouraged by banks' use of sales targets and other sales incentives. These incentives are inconsistent with banks' responsible lending obligations and expose consumers to the risk they will be sold products that provide poor value and don't meet their needs.

4. Other complaints data

4.1 Case studies published by the Banking Ombudsman Scheme provide additional examples of banks' selling practices.[3] One recent case involved a woman struggling with debt who approached her bank to consolidate card debts. The bank declined her request but the woman was subsequently offered two unsolicited increases in her credit card limit.[4]

4.2 Research by the Financial Markets Authority (FMA) has also highlighted instances of concerning sales practices in regard to Kiwisaver. Banks manage significant Kiwisaver assets. In a 2015 report on Kiwisaver sales practices, the FMA stated:

Many businesses were unable to show us how they explicitly balanced conflicts of interest, such as incentives for sales staff versus customers' interests. Many were also unable to demonstrate how they help their customers to make informed decisions based on a product's risk profile.[5]

4.3 Other evidence of inappropriate conduct by banks include:

- ASB, ANZ and Westpac misrepresenting interest rate swaps between 2005 and 2012.
- ANZ misleading investors about the degree of investment risk when promoting and marketing the ING Diversified Yield Fund and the ING Regular Income Fund.

5. Mortgage market

5.1 One of the most concerning practices uncovered by the Royal Commission is banks overstating income and understating expenses in order to offer larger mortgages to consumers. The extent to which the same practice may be occurring here isn't known because there is little scrutiny of the mortgage market.

5.2 A significant gap is the lack of oversight of the relationship between banks and mortgage brokers. The amount of commission a broker receives is directly proportional to the value of the loans they sell. Brokers may therefore seek to sell larger loans to consumers to maximise their commissions.

5.3 This risk was identified in a recent report by the Australian Securities and Investments Commission, which found commissions could encourage consumers to take out bigger loans when doing so was not in their best interests. The report

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[3] Complaints to the Banking Ombudsman are likely to represent a very small portion of problems experienced by consumers as awareness of the scheme is low.

[4] https://bankomb.org.nz/guides-and-cases/case-notes/37210/

[5] https://fma.govt.nz/assets/Reports/151117-Sales-and-advice-report.pdf

recommended moving away from the standard commission model so payments were not linked to the amount a customer borrowed.

5.4 This recommendation was aimed at reducing the risk that brokers might attempt to inappropriately maximise their commissions by encouraging consumers to take larger loans. The report also recommended moving away from bonus commissions, bonus payments and soft-dollar benefits, which increase the risk of poor consumer outcomes.

5.5 About 40 percent of mortgages in New Zealand are arranged through brokers. In most cases, consumers are unaware of how much their broker earns in commission payments from recommending a particular lender. In our 2017 survey of the industry, 62 percent of consumers who'd used a broker were not informed of how much the broker earned in commission.

6. Summary

6.1 On the basis of the issues set out above, we believe a significant increase in scrutiny of the banking industry is needed. For consumers to have confidence the market is operating fairly, active monitoring by regulators is required. In our view, this is not happening at present.

Thank you for the opportunity to make a submission. If you require any further information, please do not hesitate to contact me.

Yours sincerely

Sue Chetwin
Chief Executive