Consumer Credit
Legal Centre NSW

March 2013

Submission in relation to the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012*

by the

Consumer Credit Legal Centre (NSW) Inc

Consumer Credit Legal Centre (NSW) Inc ("CCLC") is a community-based consumer advice, advocacy and education service specialising in personal credit, debt, banking and insurance law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. We provide legal advice and representation, financial counselling, information and strategies, referral to face-to-face financial counselling services, and limited direct financial counselling. CCLC took over 18,000 calls for advice or assistance during the 2011/2012 financial year.

A significant part of CCLC's work is in advocating for improvements to advance the interests of consumers, by influencing developments in law, industry practice, dispute resolution processes, government enforcement action, and access to advice and assistance. CCLC also provides extensive web-based resources, other education resources, workshops, presentations and media comment.

Thank you for the opportunity to comment on the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* ("**Phase 2 Reforms**").

National Consumer Credit Protection Amendment Bill 2012

General Comments

The Consumer Credit Legal Centre (NSW) Inc ("**CCLC**") would first like to congratulate you on introducing a comprehensive national regime for the regulation of credit, and thoroughly supports the Phase 2 Reforms. We are particularly supportive of the anti-avoidance and private lending reforms as this is an area where systemic avoidance of applicable credit legislation has been rife, causing considerable harm to vulnerable consumers. As part of our submission we would like to emphasize our support for these reforms and to encourage you to continue to push for their passage in the upcoming legislative session.

Although the CCLC is extremely supportive of the Phase 2 Reforms as a whole, we submit that there are discrete changes to certain legislative language that are still needed before this bill can be passed into law.

Our priorities are, in descending order:

- Schedule 6: Anti-avoidance provisions
- Schedule 4: Extension of Credit Act requirements to private lenders
- Schedule 3: Introduction of responsible lending obligations to some classes of investment lending
- Schedule 5: Extension of Credit Act requirements to short term leases

Detailed Submissions

Schedule 6: Anti-avoidance provisions

The CCLC strongly supports the anti-avoidance provisions as they are drafted in the Phase 2 Reforms. We believe that the national regime for the regulation of credit cannot comprehensively protect consumers without provisions extending the coverage of the *National Consumer Credit Protection Act 2009* (the Credit Act) to cover transactions where there is deliberate avoidance by lenders. Historically, lenders have developed a number of methods of delivering credit that avoided regulation under state credit codes and they have continued to avoid regulation under the new Commonwealth law. It is vital that these lenders are brought squarely within the new regime as soon as possible, in the interests of protecting vulnerable consumers and the broader economy.

While the lenders that are avoiding regulation only represent a small segment of the credit market as a whole, we emphasize that consumers who enter into contracts with these entities are likely to be the most vulnerable consumers who can't access mainstream lenders. Consumers who enter into contracts with these fringe lenders will have significantly fewer statutory rights than most consumers of financial services. Over the years state credit laws have been continually amended to address loopholes as fringe lenders innovate new ways of avoiding the application of all or part of the legislation. This is an inefficient and relatively ineffective way to address avoidance as each amendment is usually made redundant within a short time as new avoidance measures emerge.

The avoidance provisions as drafted in the Phase 2 Reforms give courts and regulators the power for quick intervention into new ways of avoiding the credit law before there is much detriment to consumers. These provisions should be enacted as a priority, even if that means separating the current proposals.

<u>The CCLC is **particularly supportive** of the following anti-avoidance provisions:</u>

- **323A(1) Purpose Test**

    - <u>Objectivity of purpose test:</u> *"...it would be <u>reasonable</u> to conclude that the purpose ... was to avoid the application of ... this Act"*
        - We strongly support an objective test because the use of a subjective test would create an insurmountably high evidentiary burden by forcing plaintiffs to prove the subjective intentions of each defendant. In addition, courts and regulators are familiar with the use of objective purpose tests as they are standard for civil provisions.

    - <u>Breadth of purpose test</u>
        - In the current draft, a scheme will breach section 323A(1) without proof that the conduct was for a dominant or predominant purpose of avoiding the law. CCLC strongly supports this approach. A 'predominant purpose' test or something similar it would make it too easy to develop a scheme to avoid the Act simply by pointing to additional objectives.
        - The CCLC further recommends amending 323(1) to read '...it would be reasonable to conclude that the purpose, or one of the purposes whether or not it is the dominant purpose' to ensure that 323A(1) is not limited by a dominant purpose test when interpreted by a court.

    - <u>No limitations as to which provisions are avoided</u>
        - Section 323A(1) is breached if a scheme is for the purpose of any provision of the relevant Acts. We are strongly supportive of the fact that 323A(1) is <u>not</u> limited to avoidance of only certain provisions which are considered more serious or important, or that would generally allow some kind of advantage or benefit. Section 323A(3) already allows the court to consider whether the defendant may benefit from the scheme in deciding whether the conduct has breached the avoidance provisions.

- **323A(e): 'Connected Person' Element**
    - This subsection provides that 323A is breached if the purpose of a scheme is to avoid the application of the Act by either the defendant or a connected person. Without this element, the s323A would be far too easy to evade. For example, previous avoidance techniques commonly use a connected person (such as a sham broker).

<u>The CCLC recommends the following **discrete changes** to section 323A and other related sections of the Act:</u>

- **Section 180 Orders are not an adequate consumer remedy for a breach of 323A**
  - While provisions 180 (and 178 and 179 to the extent they may be applicable), provide available court orders for affected consumers, it could be particularly onerous for consumers to prove their losses over a series of many small amount short term contracts. Further, it is very difficult to assess the loss resulting from the range of provisions that are avoided when the whole Act is being avoided (e.g. requirements to be licensed, to disclose required information, to warn about high cost lending, assess hardship, etc.)
  - Instead, the **CCLC recommends that once it has been established that certain conduct breaches of 323A there should be an <u>automatic order</u> that the consumer is refunded any amount paid above the amounts he or she received (actual cash in hand).** Any additional compensation claims could be specifically argued on the merits.
  - Similarly ASIC can seek compensation or other orders (contract void or unenforceable etc.) for consumers but only if they have their prior consent in writing (178, 179, & 180). This is very impractical when the consumers involved may be very marginalised and unlikely to respond to initiatives like advertising. The CCLC submits there should be a process whereby ASIC can (in addition to seeking orders for specific consumers from which they have written consent) seek a declaration of a breach and give general orders which could then be enforced by other consumers individually through a practical and accessible mechanism.
  - Finally, in the other amendments section (s 180), "that activity" should be replaced with "that conduct" in subsections (c), (d) and (e) for consistency's sake.

- **Amendments to section 323A(3) Factors**
  - <u>323A(3)(i)</u> should read that the court may have regard to any representation 'whether express or implied' in considering whether a scheme meets the test at 323A(1).
    - It is often the accumulation of subtle factors which create a misleading impression in a consumer rather than one explicit misrepresentation. It is important to leave the option open for the court to consider implicit misrepresentations.
  - <u>323A(3)(k)</u> should be amended to "whether the lender considered the consumer's income and/or property available from which to recover any debt arising from the contract";
    - The CCLC notes that escaping responsible lending is one of the key drivers of avoidance of the credit law (along with licensing, EDR and costs caps). Concern for whether the consumer can

afford the repayments may be notably absent. On the other hand, the lender will usually have either made sure the consumer has property (real or personal) against which to enforce the debt in the case of larger loans, or an income stream against which to take a direct debit or employer authority in the case of small amount contracts.

- 323A(3)(l) should read 'any change in the conduct of a person or a connected person following or in anticipation of amendments'
  - currently paragraph (3)(l) only applies to conduct following amendments, however it is likely that any business seeking to avoid regulation would change practice before new amendments were introduced.
- 323A(3)(n) should read 'any other relevant matter whether or not of the same type as those matters listed above' to be clear that paragraph (n) is not intended to be restrictive and to ensure that 323A(3) captures a broad range of avoidance activity

Schedule 4: Extension of Credit Act requirements to private lenders

The CCLC is very supportive of the extension of the Credit Act requirements to private lenders. Consumers who enter into private lending arrangements, such as solicitor-arranged lending, have significantly fewer rights, including no mandatory pre-contractual disclosures and no rights to request variations for financial hardship. Third parties that arrange these private loans are unregulated by the Credit Act, and often arrange private lending products on the basis of conflicted or fee-driven advice to consumers.

Some of the many risks associated with private lending are that consumers are unable to compare similar products and can be misled about costs, entering into contracts they can't afford. Consumers have no rights to seek a variation under these agreements because of financial hardship, and have no access to external dispute mechanisms. ASIC lacks the power to exclude bad lenders from operating in this industry, and finally, many of these loans function as equity stripping operations when consumers should really be selling their homes if they cannot afford the mortgage payments.

The CCLC supports the submission by the Consumer Action Law Centre (VIC) ('CALC') relating to 'Vendor terms arrangements.' These types of private lending arrangements exemplify our concerns described above, and we agree with CALC's assessment that the current drafting of section 5(1)(d) may not catch them if they are structures as rent-to-buy or lease-option contracts. We agree the code should be amended to ensure that vendor terms arrangements that are structured in this way (but otherwise meet the requirements of amended section 5(1)(d)) are captured by the Credit Act.

Schedule 3: Investment lending

While outside our specific service delivery remit, investment lending has been instrumental in facilitating some spectacular investment failures with catastrophic results for many consumers, including self-funded retirees who have lost their homes and their life savings. We commend the Government for attempting to strike the right balance between avoiding stifling funding for investment through excessive regulation and providing a level of protection for investment borrowers in those circumstances which have posed the greatest risks in the past. We particularly support the Phase 2 Reforms' inclusion of investment lenders into EDR schemes.

Specific concerns

- The CCLC is concerned that the drafting is extremely convoluted and difficult to follow.

- The CCLC is concerned that the provisions do not go far enough in relation to protecting borrowers with *Regulated product (home-secured) investment credit contracts*. The provisions in relation to *Unregulated product investment credit contracts* (whether home-secured or not) require that licensees make reasonable enquiries about a borrower's financial situation and take reasonable steps to verify information provided by the borrower. Such contracts will be unsuitable if the borrower could not meet his or her obligations under the contract without substantial hardship. None of these requirements apply to *Regulated product (home-secured) investment credit contracts*. The CCLC submits that this is inadequate. **The sum total of these provisions is that a loan could be unaffordable for the consumer from the very outset (in so far as the proposed return from the investment plus any other available income is insufficient to meet the repayments under the loan and default is inevitable without any poor performance of failure of the investment), and yet the loan would not fall foul of the law.**

  The difference between the two scenarios – regulated investment product and unregulated investment product, where both involve putting the consumer's principal residence at risk, should only be the extent to which the lender (or credit assistance provider) can take into account the income stream from the proposed investment without making further enquiries as to its reliability. Specifically, *Regulated product (home-secured) investment credit contracts* should also be the subject of both enquiries and verification of financial circumstances, but the lender should be able to include the proposed investment return in the calculation (subject to any risk discounting the lender may apply for its own prudential purposes).

- The CCLC is also concerned that the requirements to both explore the consumer's requirements and objectives and to enquire about the consumer's preparedness to lose ownership of their principal place of residence will be reduced to a pro forma and be rendered meaningless.

<u>Schedule 5</u>: extension of Credit Act requirements to short term leases.

It is our understanding that the purpose of these amendments is to ensure that short term or indefinite term leases are regulated under the Credit Act. The CCLC strongly supports that objective. Short term and indefinite leases have been used unscrupulously by some lessors to avoid complying with the consumer protections provided under the Credit Act. In The CCLC's experience, the most vulnerable consumers have ended up in these types of arrangements to obtain basic household goods.

It has to be stated again (as in previous submissions) that a major problem with consumer leases is that they are in many circumstances really a sale of goods by instalments. There is an implicit (and sometimes explicit, (for example rent – to buy arrangements) agreement between the parties that the lessee will own the goods (or has the right to own the goods) at the end of the agreement. Research has indicated that the agreements and the marketing practices of lessor companies are often misleading and exploitative.

> "A number of financiers have discovered some inventive methods of inferring a right to purchase (in some cases even giving a right to "keep") while maintaining that there is no such right and that the agreement is a lease – not a loan." [1]

The CCLC agrees with the submission by CALC that subsection 170A(3) should be redrafted so that it does not apply to Rent to Own arrangements, because these arrangements should be regulated as credit contracts. The current drafting of this subsection allows "Rent to Own" arrangements to fit within a category of consumer leases, which in essence, legitimises a well-known credit regulation avoidance technique. Please see the CALC submission for a more detailed explanation of this issue.

In the CCLC's casework experience (including arguing this point before the Consumer Trader & Tenancy Tribunal) it is very difficult to argue that the lessor believed (or had the requisite belief) that a consumer wanted to own (or use) the goods. In our experience, the lessor will almost always:

1. State that the staff member who arranged the lease has left
2. They can't remember but their procedures say X
3. Deny that is what happened.

In practice, establishing "requisite belief" will be almost impossible. Further, EDR would be completely unhelpful on this point as they don't take evidence on oath. In effect, the access to justice for lessees seeking to establish jurisdiction of the Credit Act would be poor. **The CCLC therefore remains concerned that this loophole has not been effectively closed.**

[1] Micah Law Centre, 'A Loan in Lease Clothing', available at: http://consumeraction.org.au/wp-content/uploads/2012/07/A-Loan-in-Lease-Clothing-report-Micah-Law-Centre.pdf

Thank you again for your support of these reforms.

Yours faithfully,

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