Consumer Credit
Legal Centre NSW

Green Paper: Financial Services and Credit Reform - Improving, Simplifying and Standardising Financial Services and Credit Regulation

Submission 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 and banking law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We provide legal advice, financial counselling, information and strategies, and referral to face-to-face financial counselling services, and limited direct financial counselling. Last financial year we took over 11,000 calls for advice or assistance.

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 website resources, education resources and workshops, and media comment.

We appreciate this opportunity to comment on the Green Paper: Financial Services and Credit Reform – Improving, Simplifying and Standardising Financial Services and Credit regulation ("**The Green Paper**"). We will confine our comments to those issues with which we have considerable knowledge and experience, specifically parts 1. Mortgages, Mortgage Broking and Non-Deposit Taking Institutions, and 6. Other Credit Products.

Summary

1. The Commonwealth Government should not take over mortgage credit and advice only because:
    a. The overwhelming majority of credit problems that consumers present to CCLC and the Credit and Debt Hotline with do not involve mortgage credit
    b. Mortgage and other "non-mortgage" credit products cannot be so easily distinguished from one another
    c. Many lenders, and in fact all Authorised Deposit Taking Institutions, offer a range of mortgage and non-mortgage products and would therefore need to comply with two regulatory systems
    d. Brokers often advise on a range of products including mortgages and other credit products
    e. Mortgages and other credit products interact in complex ways
    f. Consumer protection principles in relation to credit are not product specific and can be best delivered by a single regulatory regime.

2. Credit should not be simply rolled into the current FSR regime without modification

3. Whether it is done through the licensing regime or the UCCC (or subsequent legislation) or both, responsible lending should be central to any effective regulatory regime for the benefit of not only borrowers, but also the broader community.

4. The following should be done in the short term:
    a. <u>All credit providers</u> should be required to be licensed and to be members of an ASIC approved EDR scheme as a matter of urgency;
    b. The Finance Broker Regulation that has been developed by the intergovernmental working party should be finalised and enacted as soon as possible with ASIC as the licensing authority;
    c. The UCCC should be retained, and the most recent amendments under consideration by, or approved by MCCA, should continue to be enacted via the Queensland Parliament; and
    d. The Commonwealth should support the State Governments to respond to the immediate challenges presented by historically high numbers of housing repossessions.

5. In the longer term the UCCC should be reviewed with a view to being enacted as Commonwealth legislation. Specifically such a review should consider:
    a. Whether the UCCC should cover a wider range of products, including small business and investment lending;
    b. Assessment of capacity to repay
    c. Incorporating anti-avoidance provisions; and
    d. Interest-rate caps.

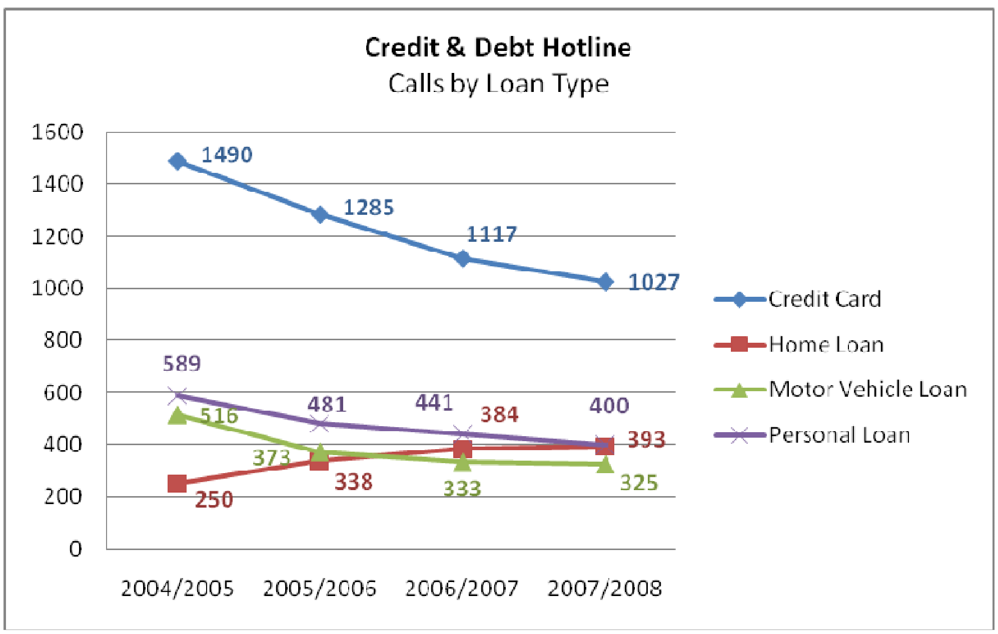
6. Other issues of concern to CCLC in the light of the Federal Government taking over the regulation of credit include:
    a. Access to low cost tribunals and realistic options for enforcing hardship variation rights granted under the UCCC;
    b. Access to compensation for consumers when other redress mechanisms fail;
    c. Adequate resourcing for ASIC; and
    d. Funding for financial counselling and legal services in relation to credit.

1. The Commonwealth Government should not take over mortgage credit and advice only.

a. The overwhelming majority of credit problems that consumers present to CCLC and the Credit and Debt Hotline with are not mortgage credit.

The overwhelming majority of credit problems that consumers present to CCLC and the Credit and Debt Hotline with are not mortgage credit but other forms of credit including credit cards, store cards, personal loans (including a significant proportion from suburban fringe lenders often referred to as "pay day lenders"), motor vehicle loans and leases, linked credit arrangements for the purchase of goods and services, lease/rental/rent-to-buy arrangements for household goods, and pawnbroker loans. While mortgages represent 86% of the personal credit market by value[1], they represent a much smaller proportion of consumer problems created by credit.

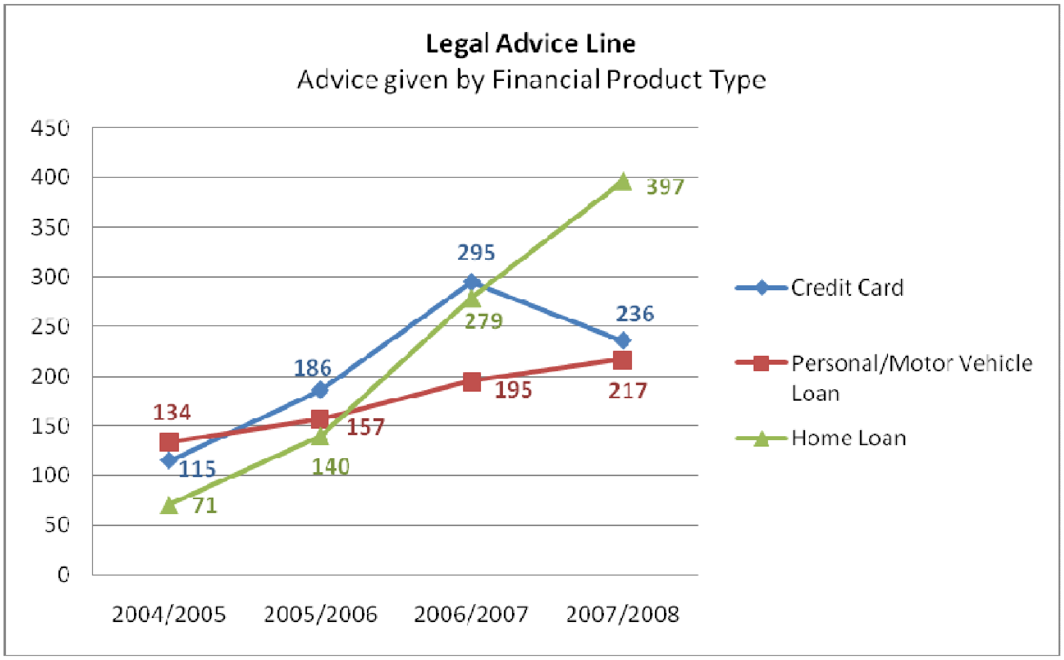
Credit and Debt Hotline Statistics – calls by Loan Type



Note: Details of types of loans are not taken for all calls. As the total calls have grown throughout the period above, it appears that the percentage of calls for which such details are captured has decreased due to time pressure on the call operators who are dealing with the increased demand. Nonetheless, the graph clearly demonstrates that mortgage problems, while growing significantly and alarmingly, are clearly outweighed by problems with other forms of credit.

Legal Advice statistics - Advice given by Financial Product Type

[1] Green Paper: Financial Services and Credit Reform - Improving, Simplifying and Standardising Financial Services and Credit Regulation, 1. Mortgage, Mortgage Broking and Non-Deposit Taking Institutions, Page 2



Note: Home loans have featured enormously in CCLC's legal advice (and casework) in recent years. Many of the calls overlap with the Credit and Debt Hotline calls as a result of receiving advice from both a financial counsellor and a solicitor as CCLC. This is more likely to happen with home loans at an advanced stage in the recovery process. Despite this, personal loans, motor vehicle loans and credit cards together, outnumber home loans problems, although the margin has been rapidly decreasing.

Despite a significant growth in the number of consumers presenting with home loan problems in the past 2-3 years (as demonstrated by the above statistics, most markedly in the legal advice line statistics), credit cards remain overwhelmingly the most frequent source of financial difficulty for caller to the Credit and Debt Hotline. In the last financial year non-mortgage credit enquiries overall outweighed mortgage credit enquiries to the Credit and Debt Hotline by over four to one. Further, it is anticipated that the current crisis in the mortgage market, evidenced by record numbers of repossessions, is temporary and that clients presenting with mortgage credit problems may return to pre-2005 levels within 3-4 years.

b. Mortgage and non-mortgage products cannot be so easily distinguished from one another

The delineation between mortgage and non-mortgage products is not so easily made as suggested by the Green Paper. Obvious problems are presented by mortgage accounts that have features such as linked credit cards. Other problems also arise, such as loans taken out to pay mortgage arrears, or other non-mortgage expenses, that involve a caveat being placed over the person's home (which may or may not be subject to a registered first mortgage). CCLC has also assisted clients who have borrowed $1,000-$5,000 from fringe lenders, with the loan secured by a bill of sale over the person's house or home unit, or subject to an unregistered equitable mortgage. It is not immediately clear whether these products should be classified as mortgage or non-mortgage products and/or whether there is any point to be served by distinguishing between them in this way.

c. Many lenders, and in fact all Authorised Deposit Taking Institutions, offer a range of mortgage and non-mortgage products.

Most banks and other authorised deposit taking institutions offer not only mortgage products, but also credit cards, personal loans, motor vehicle loans, and leasing arrangements for motor vehicles and other equipment. Setting up separate regulatory regimes for different types of credit product would mean that these lenders have to comply with two possibly different regimes and answer to state regulators for some products and the Federal regulator for others. This would defeat many of the stated goals of the Federal takeover of credit as stated in the Green Paper. Further it could create difficulties with enforcement and policy development when problems involve linked products from both jurisdictions. Regulators will inevitably waste time and resources making complex (and otherwise unnecessary) decisions about which products or complaints fall within their jurisdiction and which do not.

d. Brokers often advise on a range of products including mortgages and other credit products

Finance and mortgage brokers often advise on and provide access to a range of credit products. Specialist mortgage brokers largely deal in mortgage products but also advise on, and provide access to, mortgage packages such a home loans with linked credit cards and/or offset accounts. Other finance brokers offer access to the full range of credit products available in the market from mortgages, through personal loans, motor vehicle loans, short-term finance (such as bridging loans and caveat loans), business and investment finance, and vehicle or equipment leasing. Again, regulating only part of these activities at the Federal level would lead to a complex regulatory regime, with the same parties having to possibly comply with different requirements and regulators for different products. This would in turn also potentially lead to adverse steering as consumers would be often be directed towards those products which attracted the least compliance burden and/or were regulated by the regulator with the least resources or inclination for enforcement activity.

e. Mortgages and other credit products interact in complex ways

While the much higher value of the mortgage market does mean that it has a greater potential to impact on the broader economy, other forms of credit affect a significantly wider proportion of the community[2] and also interact with mortgage credit, and in particular with consumers' ability to afford their mortgage repayments, in ways which are more insidious than is immediately obvious from the raw statistics.

Many clients who contact the Credit and Debt Hotline have a range of debts contributing to their financial stress, including often mortgage credit, one or more credit cards/store cards, motor vehicle loans and small amount loans from non-mainstream suburban lenders. In CCLC's experience, what is described as "mortgage stress" is often the cumulative impact of multiple debts (whether acquired before of after the mortgage). Many clients also have a complicated debt history, sometimes involving multiple refinances of their home loan in which other non-secured debt has been rolled into their mortgage, greatly impacting on the amount owed and the affordability of repayments. The latter is particularly problematic when, having failed to address the underlying causes of debt accumulation, consumers incur further unsecured debt after the refinance(s).

f. Consumer protection principles in relation to credit are not product specific

While the differences between credit products are many, even within categories such as mortgage or credit cards, the underlying principles that ensure adequate consumer protection are largely the same regardless of product variation. Consumers of credit products require:

- Clear and sufficient information pre-contractual to compare product features and cost;
- Adequate assessment of ability to repay and product suitability by lenders/advisers;
- Protection from misleading, deceptive or unconscionable conduct/representations;
- Clear and sufficient ongoing information to monitor the account on an ongoing basis, including repayments, withdrawals/expenditure, outstanding balance, payout figure, and the application for interest and other fees and charges;
- Protection from unfair or excessively punitive terms (including unfair or excessive fees, charges and interest);
- Access to reasonable flexibility to accommodate financial hardship;
- Clear parameters defining fair and lawful enforcement/debt collection activity;
- Access to justice through access to an external dispute resolution scheme; and
- Certainty that all credit providers are regulated.

We submit that these protections can be best delivered by a single regulatory regime. Further, product innovation is maximised, and market distortion minimised, when regulation is applied through universally applicable principles, rather than on a product-by-product basis.

[2] Figures on the numbers of accounts are given in the CHOICE submission to this Green Paper

2. Should credit simply be absorbed by FSR?

We are strongly opposed to simply rolling credit into the existing FSR regime. Credit regulation has been developed over many years to respond to particular problems in the marketplace. The current regime has its limitations, which are dealt with below to some extent, but there is no need to disregard decades of experience. The FSR regime is heavily weighted towards disclosure. There have been legitimate questions raised over the effectiveness of disclosure under the UCCC, but the average UCCC regulated credit contract is usually concise compared to some Product Disclosure Statements issued under the Corporations Act. More importantly, disclosure is a very limited tool in providing effective consumer protection. Current credit legislation contains some very specific and largely industry accepted protections and controls to protect the vulnerable, prevent exploitation and to ensure fair practices in a market that crosses all demographics. Perhaps best expressed by ASIC in their submission to the Productivity Commission's review of the Consumer Protection Framework:

> "*We note that unlike most other financial products credit products create indebtedness. There may well be good policy reasons for seeking to impose, with a broad framework of product diversity and consumer choice, some regulatory constraints on how, and on what terms, debtors become indebted as well as on how contractual obligations are enforced. Note also that many of the specific requirements of the UCCC (and preceding credit and money-lending legislation) were developed in response to specific market practices seen as overarching and exploitative. In our view, this legacy of actual experience should not be lightly dismissed simply on the basis of abstract conceptions of consumer choice or autonomy.*"[3]

In the light of the US Sub-prime crisis and the wave of consequences being experienced internationally as a result, this warning should resonate even more strongly.

That said, the UCCC regulates products, not players, and as also noted in the ASIC submission, this has become a weakness in a fast developing market and a hindrance to early regulatory intervention where this may be warranted. For this reason, CCLC submits that an adaptation of the FSR regime should be applied to credit as outlined in Section 4 below. Specifically, all entities in the credit market from advice and sales, through account management, to debt collection should be required to be licensed, subject to appropriate conduct provisions and to mandatory membership of an EDR scheme.

[3] Submission by the Australian Securities and Investments Commission to the Productivity Commission Review of Australia's Consumer Protection Framework, Paragraph 3.69, Page 43.f

3. Responsible lending should be central to any effective regulatory regime for credit

The ACT Fair trading Act imposes a very specific process on lenders to assess a borrower's ability to meet their contractual commitments under a credit contract, including the extension of an existing credit contract. CCLC sympathises with the intention behind this legislation. We have amassed hundreds of examples over the years of clients who have been offered credit limits on their credit cards far in excess of their ability to pay (sometimes far in excess of their annual income). Historically this has also been a chronic problem with some fringe lenders specialising in small amount loans, which often rely on "blackmail" securities, direct debits and high default fees, rather than a critical assessment of ability to pay, and some car dealers ("approval guaranteed"). More recently this problem has spread to the home loan market, with "lo-doc" and "no-doc" loans providing ample opportunities for lenders to rely on the value of the security rather than the borrower's ability to meet their repayments as they fall due. While the most heinous examples of this have occurred in the non-bank lending sector[4], many other worrying trends have emerged, even among mainstream lenders including:

- High loan to valuation ratios (up to 100% or more);
- Increased use of "low doc" and "no doc" loans (including for PAYG earners and social security recipients);
- Increased use of brokers/intermediaries, some of whom participate in a number of activities of concern, from "up-selling" consumers into loans larger than they want or need to encouraging or perpetrating fraud;
- Decline in the quality of property valuations;
- Acceptance of a wider range of income types from more insecure sources;
- Deterioration in quality control and verification processes within lenders.

Many of these factors have been noted by parties other than consumer representative organisations including APRA[5] and in submissions to the House of Representatives Standing Committee on Economics, Finance and Public Administration Inquiry into Home Lending Practices and Processes used to deal with people in Financial Difficulty.

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[4] For examples refer to Appendix A in relation to predatory lending using false business purposes declarations.

[5] Research released by APRA in June 2007[5] found evidence of deteriorating lending standards among ADIs including: only five of forty-seven lenders compared to about half of those surveyed in 1998 used the 30% of income for repayments rule, others preferring net income surplus models, some of which estimated the amount required for day-to-day expenses at below the poverty level; 5% of loans were for more than 95% of the value of the security property, compared to 1% in 2002-03; about half the lenders surveyed offered riskier "low-doc" loans which allow borrower to self-certify their income, representing 10% of all home loans by value. These findings prompted warnings to lenders from the APRA Chairman, John Laker. Reported by Washington,S, "Banks throw out loans rule book", Sydney Morning Herald, 23 June 2007, http://www.smh.com.au/news/business/banks-throw-out-loans-rulebook/2007/06/22/1182019375951.html

There is no perfect formula for ensuring responsible lending and borrowers will always be subject to unforeseen events that affect their ability to pay. Sustainable, affordable lending stimulates economic activity. Systemic unsustainable lending ties up income in loan repayments, suppresses economic activity and eventually leads to bad debts, which can have a ripple effect through the economy.

We suggest that it is unnecessary for the legislature to prescribe the precise process by which proper credit assessment should be done, only that it stipulate that it must be done and impose serious consequences for the credit provider, and useful remedies for the debtor, when it is not.

One of the limitations of the current approach is that the courts have not been prepared to forgive any part of the principle debt where the borrower has received a benefit. While this line of authority has a sound base in the principles of unjust enrichment, the result is that the remedy for borrowers is usually inadequate to prevent the loss of their home and/or bankruptcy.[6] Further, these authorities have failed to have a significant deterrent effect, with lenders confident that court challenges will be rare and will not involve the loss of the principle amount lent when they do occur. CCLC advocates that a stand-alone provision requiring lenders to assess the capacity of borrowers to repay their loans is warranted, with penalties for non-compliance and remedies for borrowers, including the possibility of a reduction in the principle debt in some circumstances.

CCLC therefore proposes a multi-pronged approach to the problem of unsustainable lending and predatory market behaviour including:

- Creating a stand-alone obligation in the UCCC or its successor to have regard to the borrower's ability to repay a debt without substantial hardship with penalties in the case of a breach of the provision. Best practice guidelines, policy statements (or whatever regulatory/administrative instrument is appropriate) for different types of product could possibly be developed to inform compliance with this section as considered necessary.
- Giving clear power to the courts and tribunals and EDR Schemes to relieve a debtor of not only fees, charges and interest, but also part of the principle debt in appropriate cases;
- Instituting a comprehensive licensing regime for creditors, with the power to exclude players from the market for systemic breaches of the relevant legislative provisions.

However it is achieved, responsible lending should be central to any effective regulatory regime for the benefit of not only borrowers, but also the broader community.

[6] The BFSO has circumnavigated this problem in unsecured lending, mainly in relation to credit cards, by convincing the banks of the efficacy of accepting a reduced debt with a repayment arrangement over bankruptcy.

4. What should happen immediately?

Full assumption of responsibility for credit by the Commonwealth Government will and should take considerable time to complete, especially if the aim is to improve rather than detract from the current regulatory arrangements. CCLC submits that there are good reasons to retain dual responsibility[7] for an interim period while this extensive task is executed. One advantage of this approach is that the expertise and resources of the States governments could be retained during the changeover period. Another is that the aspects of the current regime that are working well should not be easily dispensed with; considerable resources have been invested by industry, government, and consumer groups in systems, education and compliance under the current law. In this interim period the following should take priority:

a. All credit providers should be required to be licensed and to be members of an ASIC approved EDR scheme as a matter of urgency;

b. The Finance Broker Regulation that has been developed by the intergovernmental working party should be finalised and enacted as soon as possible with ASIC as the licensing authority;

c. The UCCC should be retained, and the most recent amendments under consideration by, or approved by MCCA, should continue to be enacted via the Queensland Parliament; and

d. The Commonwealth should support the State Governments to respond to the immediate challenges presented by historically high numbers of housing repossessions.

To elaborate:

a. All credit providers should be required to be licensed and to be members of an ASIC approved EDR scheme as a matter of urgency;

While CCLC does not support the inclusion of credit in the existing regime for financial services without exception or amendment, it is imperative that credit providers be required to be licensed as soon as feasibly possible.

External Dispute Resolution is essential to an effective consumer protection regime. This was recognised in the Commonwealth's Financial Services Reform package, it has been recently recognised by the Productivity Commission Review of the Consumer Protection Framework, and it is apparent to CCLC in our daily role as consumer

[7] As noted in the Green Paper, there is in effect a dual regime already, as many credit providers are licensed by ASIC as a result of their involvement in the provision of other financial services. Further ASIC has responsibility for taking, and has taken, action in relation to misleading and deceptive conduct, unconscionable conduct and debtor harassment in relation to credit. Finally ASIC is responsible for approving and monitoring the EDR schemes to which many credit providers, and some debt collectors, already belong (including many entities which are not regulated by FSR).

advisers and advocates. The Ministerial Council for Consumer Affairs has an in-principle commitment to introduce compulsory EDR, but has not acted to date.

Authorised Deposit Taking Institutions are required to be members of an appropriate EDR scheme but other credit providers are not. Despite this, many other credit providers have joined EDR on a voluntary basis, especially as this is required to qualify for membership of the Mortgage Finance Association of Australia, one of the major industry associations for non-bank lenders. However, many lenders do not belong to an EDR scheme, leaving significant gaps in access to dispute resolution. Further, non-compulsory membership does not guarantee consumer protection. For example, CCLC obtained a determination from the Credit Ombudsman Scheme Ltd ("COSL") for a finance broker to compensate our client for breaches of a number of laws and obligations. With no legal obligation to remain in the scheme, the broker simply refused to pay. Similarly, shortly after many non-bank lenders announced financial difficulties as a result of the global credit crunch, RAMS home loans withdrew its membership of COSL. CCLC now regularly receives calls from borrowers who have loans with RHG (the company which continues to manage the original RAMS loans) who have no access to EDR. The Federal Government could have an immediate impact on access to justice in relation to credit by licensing credit providers and requiring compulsory membership of an EDR scheme.

CCLC submits that licensing should be required for all credit providers, without exception. Exceptions result in loopholes and regulatory failures[8]. Further, the failure of credit regulation to date to afford protection to small business borrowers and individuals borrowing for investment purposes is out of step with the remainder of financial services regulation. The general regulation of financial services under the *Corporations Act* 2001 (Cth) already includes small business and investors, as does the limited credit jurisdiction under the *ASIC Act* 2001 (Cth). Important industry codes, such as the Code of Banking Practice[9], cover small business and investors. The national finance broking regime as currently proposed will also cover small business and investment broking, at least in so far as they are required to be licensed, to have minimum standards and conduct, and to be members of an EDR scheme.[10]

There has been widespread recognition that small businesses and individual investors can be as vulnerable as individual consumers making household domestic purchases. The economic damage done by unacceptable market conduct in this market sector is just as destructive as in the personal domestic domain. Further, there has been increasing recognition that as risks and financial responsibilities have been shifted from government to households, there is a greater need for protection of ordinary individuals seeking forms of self-employment, or investing for a self-reliant future. CCLC receives regular calls from small business contractors who have no access to dispute resolution over motor vehicle loans secured by vehicles that are necessary for the ongoing operation of their business. We also receive calls from borrowers with loans for investment properties, and from those who have borrowed to invest and lost everything. There is

[8] See section 5c below.
[9] Code of Banking Practice cl. 1.1.
[10] See discussion in National Finance Broking Regulation – Regulatory Impact Statement Discussion Paper, 2005, p. 60.

no access to justice for these borrowers, unless their lender happens to be in external dispute resolution.

The Federal Government could also take the opportunity to impose similar standards on credit providers as are likely to be required for brokers, mortgage managers and mortgage originators under the Finance Broker Regulation discussed in the subsequent section to ensure competitive neutrality and uniform obligations to consumers. In particular credit providers should have an obligation to ensure that any credit product is appropriate in so far as it matches the borrower's needs, circumstances and capacity to pay. This would be the first step in establishing a strong responsible lending culture, giving the regulator the power to engage with lenders over assessment processes and to intervene in serious, systemic failures.

Ideally debt collectors would also be licensed and subject to compulsory EDR scheme membership, to ensure that credit providers cannot contract out of their licensing obligations by selling their debts, and to ensure that consumers have access to dispute resolution at every stage of the credit process from sales to collections. This may take longer to achieve, however, because of the licensing regimes currently imposed by some States.[11]

Most importantly, a comprehensive licensing regime is required in order to give courts/regulators the power to exclude some players from the market. There are a small number of market participants who appear over and over again in consumer complaints. Some of these are the subject of adverse Tribunal orders or EDR decisions, requiring compensation or other monetary penalty to be paid to consumers. However, currently there is no efficient mechanism by which these people/entities can be excluded from the market, or subject to particular behavioural conditions to minimise further harm.

b. The Finance Broker Regulation that has been developed by the intergovernmental working party should be finalised and enacted as soon as possible as Federal legislation if possible (or uniform State legislation if necessary) with ASIC as the licensing authority;

Considerable time and effort has been invested in the National Finance Broker Bill 2007 by all parties involved. While some of the provisions were controversial, the vast majority were not. Subsequent consultation suggests that the more controversial provisions, and practical operational issues, could be resolved to the satisfaction of most industry and consumer representatives.[12] Further, the competitive neutrality issues that concerned some industry stakeholders (raising the obligations of brokers and mortgage managers above those of traditional credit providers) could be addressed if the step in Section 4a above were implemented simultaneously.

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[11] See for example the Commercial and Private Inquiry Agents Act (NSW), which is currently under review. CCLC has suggested to the Review that debt collectors should be required to be members of EDR. We have also suggested that the regulators should liaise with the Federal Government in relation to the implications of the Green Paper and any future impact on debt collection regulation.

[12] A meeting in Melbourne on the 24th June 2008, which involved both the Mortgage Finance Association of Australia, the Finance Broker Association of Australia, CCLC, ASIC and various state and Federal government representatives, demonstrated a high level of agreement among stakeholders, or at least the possibility of a reasonable compromise on many parts of the legislation.

The urgent need for comprehensive broker legislation has been recognised by many stakeholders, most recently COAG in its decision to hand mortgage credit regulation to the Commonwealth, and although the process for developing such legislation by the States has been slower than hoped, it is now nearing completion and should be permitted to proceed with the support of the Federal Government. The multi-governmental working party now has extensive knowledge of the subject matter, and the views of various stakeholders, and should be permitted to continue its work. Any change to these arrangements is likely to result in delay. This would be an unacceptable outcome. This legislation is required now more than ever, as the significant numbers of families facing mortgage stress[13] are prime candidates for predatory lending[14] and require urgent protection.

The one practical difficulty posed by state regulation of finance brokers on a uniform basis is that of a multi-jurisdictional licensing regime. As a result, appointing ASIC as the licensing authority is the logical optimum solution. ASIC has considerable experience, not only as the licensing authority for other financial services products, but also in relation to taking enforcement action in relation to mortgage broking activities.[15]

CCLC has had the opportunity of reading the submission by COSL to the Green Paper. CCLC endorses the comments by COSL on the importance of having the capacity to track individual brokers through the licensing system and to require brokers to join an EDR scheme in their own right. CCLC has dealt with a number of consumer complaints about the same individuals, although those individuals have worked for a range of employers and company entities within a short space of time. It is important that these individuals can be effectively monitored, compelled to participate in dispute resolution processes, and if necessary, be excluded from the market.

The Joint Consumer Submission in response the National Finance Broking Bill forms Appendix B to this submission.

c. *The UCCC should be retained, and the most recent amendments under consideration by, or approved by MCCA, should continue to be enacted via the Queensland Parliament; and*

The Consumer Credit Code ("UCCC") has been in place for over 12 years. Credit providers have invested heavily in developing compliance systems in accordance with the provisions of the UCCC and government and consumer organisations have also invested a considerable amount of time in developing expertise and consumer education materials based on the UCCC. A body of law has also developed around the interpretation of the Code, largely in the State Tribunals (where they exist) and the Supreme Courts.

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13 JPMorgan/Fujitsu Consulting report, details as published in "Mortgage stress may affect 1 million households" in The Australian on 4 July 2008

14 Report by the Australian Securities and Investment Commission titled "Protecting wealth in the family home: An examination of refinancing in response to mortgage stress", released in March 2008

15 Cash King, Sample & Partners, Commonwealth Bank loans to remote aboriginal communities; as detailed in ASIC media releases published on http://www.asic.gov.au/

The UCCC has had a problematic history, largely due to widespread avoidance. Many of these loopholes, specifically the use of promissory notes and bills of exchange to escape coverage, have only very recently been closed and those changes should be given an opportunity to take effect.

There are other processes in train to amend the UCCC to address avoidance and/or inadequacies that have been identified over years of experience including:

- The fringe lending amendments[16];
- Amendments to section 80 notices[17](the need for this change dates back to the Post Implementation Review)
- Amendments to capture vendor finance contracts for the sale of land and companies who claim to charge no interest and yet inflate the place of their goods in lieu of a credit charge to avoid the UCCC.[18]

The fringe lending amendments contain vital provisions that are urgently required to protect the most vulnerable members of our society. CCLC, Legal Aid NSW and other consumer organisations have worked very closely with industry groups[19] to propose an amendment to the UCCC in relation to business purpose declarations. An explanation of the way in which business purposes declarations have been used to systemically avoid the Code and facilitate predatory lending is provided in Appendix A. The proposal put forward by the joint industry/consumer coalition in relation to predatory lending has been considered by the Ministerial Council on Consumer Affairs and it is our understanding that Parliamentary Counsel was (subject to the developments discussed in the Green Paper) to draft an amendment along the lines of our proposal for limited further consultation. We submit that this process should also continue, given the universal buy-in by diverse stakeholders with extensive experience in this field.

The unfair fees aspects of the bill caused the most angst on the part of mainstream lenders. It is our understanding that these provisions have undergone further revisions as a result of further consultation conducted earlier in 2008[20], and we support the enactment of those revised amendments. Protection against unfair fees is an important aspect of consumer regulation in relation to credit, where competition often fails the most vulnerable borrowers. The assumption in the Green Paper that the market is an effective regulator of fees and charges flies in the face of year of experience in consumer credit regulation and this is reflected in the fact that some provisions of the UCCC already ready regulate fees[21] and have done so since the UCCC commenced in 1996[22].

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[16] Consumer Credit Code Amendment Bill 2007, Consumer Credit Amendment Regulation 2007
[17] Circulated by e-mail by the Uniform Consumer Credit Code Management Committee in 2008
[18] Justice Legislation Amendment Bill 2008
[19] This process arose from a forum in August 2007 instigated by the Predatory Lending Project in NSW. A coalition of industry and consumer groups was formed to pursue regulatory reform to address predatory lending. The Joint Press Release can be viewed on the Australian Banker's Association Website at http://www.bankers.asn.au/default.aspx?ArticleID=1112"http://www.bankers.asn.au/default.aspx?ArticleID=1112
[20] A Roundtable to discuss these amendments was held in early 2008 with a large number of relevant stakeholders and further final submissions were invited.
[21] Consumer Credit Code s72
[22] CCLC supports the comments in relation to fees made in both the CHOICE and the Consumer Action Law Centre submissions to the Green Paper. We also support the extension of Unfair Terms

At the very least, the remainder of the Bill, including the business purpose declaration amendment discussed above, and the prevention of blackmail securities[23], must be enacted without further delay.

There is also other work being undertaken in relation to comparison rates, disclosure and responsible lending in relation to credit cards, which should be either carried to completion by the States with the support of the Commonwealth or assumed by the Commonwealth without delay. The resources spent on these issues should not be wasted.

d. The Commonwealth should support the State Governments to respond to the immediate challenges presented by historically high numbers of housing repossessions.

The Reserve Bank estimated in March this year that 40,000 mortgagors were one month behind in repayments, with 15,000 more than 3 months overdue[24]. Arrears in western Sydney were 2.5 times greater than those in other parts of NSW[25].

Repossession proceedings in NSW have doubled since the 1990s[26]. In 2007, there were a total of 3948 writs of possessions issued in NSW[27]. This equates to 75 homes being repossessed each week. Currently sheriffs in Bankstown are reporting an average of 15 houses being repossessed each week, which is triple the numbers from three years ago[28]. NSW Supreme Court Statistics also show that 5,368 applications for possession were issued in 2006 compared to about 3287 in 1991 at the height of the last recession.[29] The figures for 2007 have not been released. Further interest rate rises have occurred since these statistics were collated initiated by both the Reserve Bank and by mortgage providers raising rates independently to respond to increase in the cost of funds as a result of the fallout from the subprime crisis in the US.

The growth in the number of calls to CCLC's Legal Advice Line (see Graph in Section 1a above) reveals a similar story. The consequences for consumers whose homes are

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Legislation to credit as is contemplated in Victoria and submit that comprehensive unfair terms legislation should be enacted at the federal level.

[23] This is where small amount lenders, often referred to as pay day lenders, take security over essential household items, in order to secure repayment even in the event of bankruptcy. The goods rarely have any market value, although they often have considerable emotional value or are essential to the borrower's maintenance of even a very basic standard of living. Consumer advice services have seen loans where security has been taken over baby's cots and prams, for example.

[24] *When pain persists, they arrive*, by Jonathan Dart and Jessica Irvine, Sydney Morning Herald, March 28, 2008

[25] *When pain persists, they arrive*, by Jonathan Dart and Jessica Irvine, Sydney Morning Herald, March 28, 2008

[26] *When pain persists, they arrive*, by Jonathan Dart and Jessica Irvine, Sydney Morning Herald, March 28, 2008

[27] *When pain persists, they arrive*, by Jonathan Dart and Jessica Irvine, Sydney Morning Herald, March 28, 2008

[28] *When pain persists, they arrive,* by Jonathan Dart and Jessica Irvine, Sydney Morning Herald, March 28, 2008

[29] *Mortgage Defaults Stabilise* Supreme Court media announcement 12 February 2007, http://www.lawlink.nsw.gov.au/practice_notes. These statistics do not distinguish possession applications arising from home loans from those arising from investment or commercial loans. No statistics have yet been released by the Court for 2007.

repossessed are also escalating. Both the cost of renting alternative housing and waiting lists for government housing are increasing[30]. Some charities are finding mortgage repayments more affordable than short-term housing[31].

While home repossessions will be inevitably be more frequent than usual in the current economic client, it is clearly in the public interest that unnecessary repossessions are prevented.

In CCLC's opinion the 30 days to rectify a default in relation to a mortgage prior to the commencement of enforcement action is insufficient to allow hardship processes to work effectively. While ideally borrowers should take action earlier than a default notice to put a repayment arrangement in place, the fact is that most do not, and may not even know about their right to request a hardship variation until such time as they seek advice upon the receipt of a default notice. Currently section 80 of the Code provides that the debtor has 30 days from the service of the section 80 notice to rectify the default. In the case of debtors suffering mortgage stress this is insufficient time for the debtor to apply for hardship, receive a response, and if necessary complain to an EDR scheme and/or file in a Court/Tribunal for hardship.

Many lenders now send a default notice under section 80 after the first default. It is only reasonable that the lender should have 30 days to respond to the request for hardship. However, by the time that 30 days ends the loan has been accelerated and the credit provider can commence court proceeding for possession of the family home.

CCLC submits that the time to comply with a default notice should be extended to 90 days for home mortgages and to 60 days for personal credit. Alternatively, an option could be adopted whereby if the debtor applies for hardship at any time up until judgment is entered, they are given an additional 60 days to negotiate hardship with the lender, and if necessary, apply to an EDR scheme.[32] The threshold for hardship applications under the UCCC should also be increased to $500,000 as many callers to CCLC with Sydney home loans have loans above the current threshold. As some lenders are also not in EDR, these borrowers have no forum in which to raise their claims for hardship except the Supreme Court. An increase in both the time to comply with a default notice issued under the UCCC and an increase in the hardship threshold, in concert with compulsory EDR as suggested above, would ensure that no person or family lost their home without access to an independent decision-maker to determine whether, with some flexibility, their loan could be brought back on track.

[30] *Mortgage pain for 750,000 owners*, by Maxine Firth, Sydney Morning Herald, February 3, 2008
[31] *Heaviest mortgage pain being felt in outer west,* by Sunanda Creagh, Sydney Morning Herald, March 3, 2008
[32] A similar scheme has been implemented in the US in response to the subprime crisis, as detailed in "Banks fear overreaction to mortgage crisis", Buffalo News article dated 3 June 2008 at http://www.buffalonews.com/145/story/359896.html

5. What should happen in the medium to long term?

In the longer term the UCCC should be reviewed to address its remaining deficiencies, and enacted as Commonwealth legislation. Specifically the current legislation does not cover all available products, such as business lending, investment products and shared appreciation mortgages. Reverse mortgage amendments are planned but not yet enacted. The UCCC does not currently contain a straightforward requirement to assess a borrower's capacity to pay. Any review of the Code should ensure that it is sufficiently specific to be meaningful and enforceable, and sufficiently flexible to be relevant to market innovation.

a. Comprehensive Product coverage

There is no reason why the majority of the protections contained in the UCCC should not also be available to business and investment borrowers. While the effectiveness of the disclosure provisions has been justifiably questioned, a quick perusal of the information required to be disclosed reveals little that is not of vital consequence to any potential borrower seeking to make an informed decision. The provisions relating to access to information, and notices in the event of default are similarly uncontroversial. Even the unjust contract provisions are almost identical to those already available in relation to business and investment contracts in NSW under the *Contracts Review Act* 1980. Further, the Financial Ombudsman Service (previously the Banking and Financial Services Ombudsman) already determines disputes in relation to maladministration in relation to small business and investment loans, and the Credit Ombudsman Service Limited reviews complaints in relation to investment loans.

There may be an argument to exclude business borrowing from the hardship variation provisions of the Code[33] and there are perhaps other sections that could be specifically modified or made unavailable to business borrowers[34]. We note that ASIC supported the possible extension of the credit law to small business in its submission to the Productivity Commission Review of the Consumer Protection Framework.[35] While credit providers are likely to resist the extension of the Code to further categories of borrowers, there are long-term advantages to having a single set of rules and required documentation, albeit modified for a wider range of products.

Credit and investment products can no longer be easily delineated. Relatively recent product developments, specifically reverse mortgages and shared equity loans, have thrown this limitation of the UCCC into sharp relief.[36] The credit side of the equation is contemplated by the UCCC but not the investment or diminishing wealth aspects. The particular risks associated with these products are not addressed at all in the UCCC

[33] UCCC, sections 66 & 68.
[34] See comments in the responsible lending section below.
[35] Submission by the Australian Securities and Investments Commission to the Productivity Commission Review of Australia's Consumer Protection Framework, Page 35, paragraphs 3.32 & 3.33
[36] Where a borrower takes out a traditional mortgage for part of the value of their property and then takes out a shared equity loan for another portion. The latter portion is "interest-free" while the debtor is not in default, in return for which the creditor takes a proportion of any increase in the value of the property at the time the debt is paid out (usually upon the sale of the property or refinance).

regime. The much-awaited broker regime will attempt to address some of the issues pertaining to advice given in relation to reverse mortgages, and an information statement is being developed under the UCCC. Nonetheless, this is being approached in a piece-meal, product-by-product fashion, rather than addressing the conceptual shift in the nature of the products and market being regulated.[37]

b. Responsible lending

A stand-alone obligation in the UCCC or its successor to have regard to the borrower's ability to repay a debt without substantial hardship with penalties in the case of a breach of the provision is essential. Best practice guidelines, policy statements (or whatever regulatory/administrative instrument is appropriate) for different types of product could possibly be developed to inform compliance with this section as considered necessary.

If the UCCC is extended as suggested in section 5a above, a responsible lending obligation may need to vary in its application to different types of product. For example, a reverse mortgage does not require repayments as such (although it does entail a range of other risks) and some business or investment activities (such as property development) actively contemplate the sale of the asset as part of the business plan.

If an overall obligation to provide only "appropriate finance" is adopted as part of the licensing regime, more specific obligations in the UCCC or equivalent legislation may be unnecessary, but experience suggests that such a fundamental cultural shift will not be so easily achieved. This could be evaluated as part of the review of the UCCC in the light of the effectiveness of any licensing obligations that have been imposed in the interim period.

Further, remedies for individual debtors are likely to be best delivered through legislation rather than the licensing regime. The courts (and tribunals, if they are available) need to be specifically given the power to relieve a debtor of not only fees, charges and interest, but also part of the principle debt in appropriate, narrowly defined cases.

c. Anti-avoidance

The UCCC has a long history of problems with avoidance:

- Pay day lending emerged as a result of the UCCC initially not applying to loans of less than 60 days;
- When the Code was amended to cover short term lending, charges were expressed as fees to avoid the interest rate caps in States where they existed;
- Entities have split their functions in order to charge part of their fees as brokerage, or required cheque cashing fees as a separate transaction, and thereby avoid the minimum charges provisions and thereby escape regulation;
- False business or investment purposes declarations have been taken, sometimes in order to facilitate predatory and exploitative asset-based lending;

[37] Further comments on this topic are contained in the Joint Consumer Submission to the National Finance Broking Bills at Appendix B.

- The price of goods are inflated and associated loans are characterised as "interest-free";
- Until very recently, promissory notes and bills of exchange were used for small personal consumer loans to avoid the operation of the UCCC.

While state regulators have been criticised for their sluggish response to these problems, it has to be conceded that keeping up with a very creative industry has been no small task. CCLC submits that casting the net of the regime as broadly as possible would address many of these problems. Even if various products or players are exempt from some aspects of the regime, it easier for regulators to take action if they don't first have a battle to establish jurisdiction over the activity or entity at all.

In addition to the extension of the regime, CCLC submits there should be a general clause preventing the use of schemes or arrangements which have the effect of avoiding the intent of the law. This would make it much easier for regulators to intervene as problematic practices emerge. If the coverage is not extended, then anti-avoidance provisions are needed even more so.

d. Interest rate caps

NSW and the ACT have interest rate caps that include fees and charges in their calculation. Qld has recently passed similar (but not identical) provisions. Victoria has a dual cap, which distinguishes secured and unsecured lending, and does not include fees and charges in its calculation. The NSW cap has been in existence since 1996, but was amended in 2006 to include fees and charges to prevent lenders from avoiding the cap by expressing the cost of credit as fees instead of interest.

The interest rate caps rarely impact upon mainstream industry participants. Small amount lending (including "payday" lenders) is a unique market servicing significant numbers of vulnerable consumers. The single most important protection for those consumers, who are unable to benefit from competition in the mainstream sector, is a limit on the cost of credit.

Some industry advocates argue that consumers are entitled to choose relatively high cost credit, as long as they can afford to repay it. The problem, they say, is not the cost of credit, but the need to lend responsibly. While this is reasonable in theory, the experience of financial counsellors and community legal services is that many customers of small amount lending outlets have few real choices. They do not "choose" expensive loans in any real sense, but accept the only "solution" available to them. Sometimes driven by extreme need or compulsion, the reality of repayment is psychologically postponed and cost is therefore a remote consideration. The "solution" is often illusory, quickly becoming part of the problem, as income is further diminished by repayments.

Lenders charge higher amounts for small loans because of the higher fixed costs relative to the loan amount, and because of the higher risk profile of the target market. From a business perspective these are legitimate considerations. From a social justice perspective, however, this translates into the most expensive loans for those who can least afford them.

Payday lenders argue that for very short-term loans, the 48% cap stops them collecting their reasonable costs. This argument is based on the assumption that low-income consumers need access to short-term loans. In our experience, this is simply not true. Low income consumers need access to small amount loans payable over many months so that they can manage their repayments.

It may be true that business people need access to very short-term loans but the cap would not apply to this, at least under the current law.

While businesses have claimed to be unable to operate under the cap, many businesses continue to operate in NSW and CCLC has reviewed a number of on behalf of borrowers to find that they are compliant. However, NSW residents still obtain loans from interstate providers.

Further information about small amount lending, its impact on borrowers, and the 48% cap in NSW is provided in Appendix C. CCLC submits that the 48% cap, inclusive of fees and charges, should be enacted nationally for consumer lending. To prevent further avoidance activity, the test as to whether the cap applies must turn on the actual use of the funds.

6. Other Issues

a. Access to Low Cost Tribunals

NSW consumers are currently able to bring credit matters before the Consumer, Tenancy and Trader Tribunal. CCLC has had the benefit of reading the submission by CHOICE[38] in relation to low cost, accessibly tribunals and endorses the comments therein, particularly in relation to "keeping EDR honest", ensuring that there are genuine viable alternatives for consumers (court is rarely a "real" option), for trying complex issues of fact, and developing a body of relevant law for application by the EDR schemes. CCLC would like to add two further points:

1. EDR schemes do not currently make determinations in relation to applications for contract variations for consumers in financial hardship as defined by s66 of the UCCC[39]. The Financial Ombudsman Scheme ("**FOS**", formerly the Banking and Financial Services Ombudsman), does not consider s66 of the UCCC within its terms of reference. The FOS will consider whether the member (usually a bank) has conducted a reasonable process under s25.2 of the Code of Banking Practice[40], including whether the consumer has been informed of their rights under the UCCC where they apply, but will not make a determination about an appropriate repayment arrangement. The Credit Ombudsman Scheme Ltd ("**COSL**") will review whether the credit provider has responded appropriately to a request for a hardship variation under the UCCC, but again will not stand in the shoes of the credit provider in making a decision about what is an appropriate repayment arrangement.

   The CTTT on the other hand has the power under s68 of the Code to grant a hardship variation provided the conditions of the section are met. That is that the Tribunal can require the credit provider to accept a particular proposal, albeit having heard the credit provider and taken its interests into account. The Supreme Court also has this power, and recently applied it[41], but in reality, unless the matter is already before the Supreme Court because the credit provider has applied for possession in a home mortgage matter for example, most consumers will not have the means (financial hardship is a prerequisite after all), nor be prepared to risk the potential adverse costs order if they are unsuccessful, to make such an application to the Supreme Court.

   CCLC currently assists borrowers to apply for hardship in the CTTT in appropriate cases. We submit that a low cost option such as the Tribunal must continue to be available, or that it is essential that the EDR schemes are able to offer similar rights and remedies in relation to hardship as are currently available at the CTTT. Currently, the

[38] CHOICE Submission to Green Paper: Financial Services and Credit Reform - Improving, Simplifying and Standardising Financial Services and Credit Regulation
[39] Consumer Credit Code s66 "A debtor who is unable reasonably, because of illness, unemployment or other reasonable cause, to meet the debtor's obligations under a credit contract and who reasonably expects to be able to discharge the debtor's obligations if the terms of the contract were changed in a manner set out on subsection (2) may apply to the credit provider for such a change." The section then sets out a series of possible contact variations. Access to the section is limited by loan size at the outset of the loan by a floating threshold, currently $278,457.
[40] Code of Banking Practice Clause 25.2
[41] *Permanent Custodians Limited v Carolyn Joy Upston* [2007] NSWSC 223 (16 March 2007)

EDR schemes can make a decision to set aside a contract of guarantee worth hundreds of thousands or dollars, and yet technically they cannot make a repayment arrangement for someone in financial hardship. Further, while the difference in outcomes for consumers (between EDR and the Tribunal) is not enormous in practice at present, we submit that this could change if the credit providers were aware that consumers did not have the alternative of taking their matter to an accessible Tribunal.

2. In NSW, the CTTT has exclusive jurisdiction in relation to civil penalty applications under the UCCC. These apply in circumstances where the credit provider has breached key provisions of the Code (primarily in relation to disclosure, but not limited to disclosure). The penalty usually consists of the interest payable under the contract, or part thereof, plus actual loss suffered by the borrower(s) if any can be shown. While the civil penalty provisions of the UCCC have been infrequently used (compared to those under the Credit Acts which predated the UCCC), these provisions have proven a very effective deterrent. CCLC has rarely seen a breach of the UCCC key disclosure provisions in recent years by a mainstream lender. Further, fear of falling foul of the civil penalty provisions was the main concern cited by industry associations in discussions about how to effectively regulate consumer loans that were dressed up as business or investment loans to intentionally avoid the Code. CCLC also finds the prospect of possible civil penalties very useful in negotiations with predatory fringe lenders in circumstances where they have unsuccessfully sought to avoid the jurisdiction of the UCCC. The proceeds of civil penalty applications have also been used over the past two and a half decades to provide funds for the various consumer credit funds which exist in some States. These have been used to fund a variety of consumer projects including education, research and advocacy.

   If the CTTT were no longer available for these applications, an alternative jurisdiction would need to be established. While the ongoing efficacy of civil penalties could be reviewed in the light of their infrequent application as part of a wider review of the UCCC, CCLC would urge considerable caution before dispensing with something that has been a very effective deterrent, arguably dramatically reducing the potential role for enforcement agencies.

b. Access to a compensation fund

CCLC has read the CHOICE submission in relation to compensation for loss and endorses those comments. We further submit that the National Broker Regulations as currently drafted will also generate rare occasions where consumers will be without redress. The Bill has been carefully conceived to ensure that the onus is on credit providers, rather than consumers, to deal with only licensed intermediaries. It has also been drafted in recognition of the fact that the improper conduct of an intermediary will often result in an unfair or inappropriate loan, a problem that the credit provider has both the power to resolve, and arguably the responsibility to resolve if they have conducted business with an unlicensed operator. However, there will still be occasions when the credit provider has done all that can be reasonably expected to ensure that a particular entity is licensed, and it is not licensed any longer. In these circumstances the lender may be able to escape liability, the broker may have disappeared or be insolvent, and the borrower will be without redress.

c. Adequate resources for ASIC

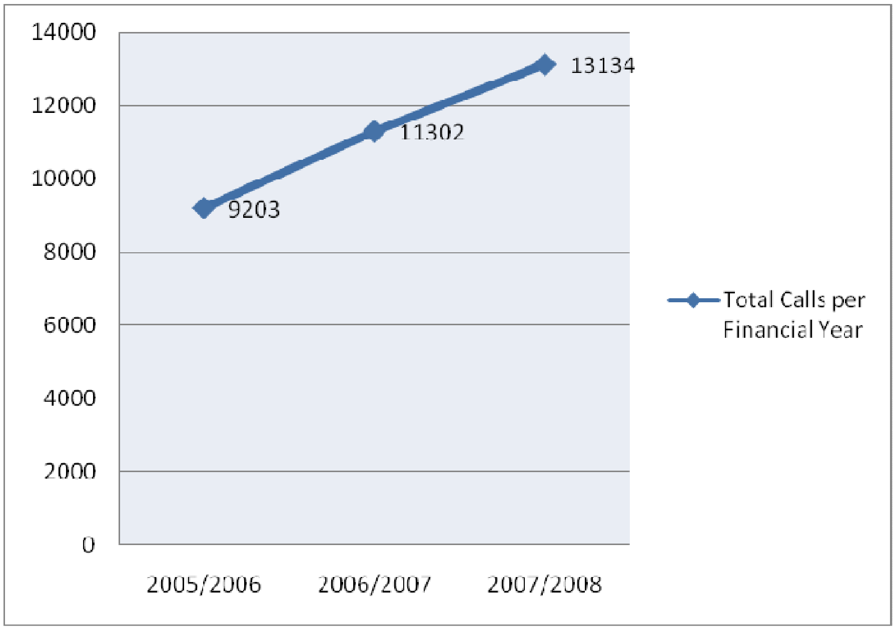
As stated above, CCLC supports a staged handover in which the States retain an important role for at least an interim period. In fact, CCLC would prefer the states to retain a residual enforcement role for issues that are truly local, or which contain multiple facets including credit and other consumer issues, and to also retain some of the other roles listed below.

If, however, ASIC is to be the sole, or primary, regulator, we are concerned that it be appropriately resourced to carry out this role effectively. While enforcement activity by the States in the credit jurisdiction has been less than optimal, the State governments have conducted some enforcement activity and performed a wide variety of other roles relevant to the credit jurisdiction. The NSW office of Fair Trading for example, produces extensive multi-lingual consumer resources, both paper and web-based, in relation to credit, and more recently has been involved in community radio and DVD production. It has a team of officers involved in community liaison and education, on credit and other consumer issues, and runs campaigns, surveys and other public activities. It also administers the credit counselling program for the funding of financial counselling and consumer credit legal services, and has recently announced funding for a state-wide No-Interest Loans ("NILS") program. The policy section has been extremely active in recent national law reform initiatives, and has extensive industry knowledge and contacts. Further, while court based enforcement activity is visible and can be easily counted, other activities like compliance visits and surveys, which are equally important in ensuring broad based compliance, are also undertaken and need to be incorporated into any resource analysis. We note with concern that ASIC was recently given the functions of the Financial Literacy Foundation without any significant increase in resources to perform these functions. It would be a matter of great concern if ASIC was required to simply assume all the current functions of the States without sufficient additional resources.

d. Funding for financial counselling and legal centres

State governments invest considerable resources in the funding of financial counselling and legal services to deal with issues arising from, among other things, consumer credit. The Consumer Credit Legal Centre, which also operates the Credit and Debt Hotline, receives between 70-80% of its overall recurrent funding from the Credit Counselling Program administered by the NSW Office of Fair Trading. This funding has been increased twice in the past two years in an attempt to keep step with growing demand.

Total Calls to CCLC's Credit and Debt Hotline and Legal Advice Line 2005-2008



CCLC is aware of at least three other generalist community legal centres in NSW that receive some funding from the Credit Counselling Program to conduct credit and debt casework and education services. Most NSW funded financial counselling positions come from this same fund, which was recently increased by $1million in recognition of high levels of financial stress in the community. We are concerned that the states will understandably cease funding such services if they no longer have responsibility for the regulation of credit.

We note that the Productivity Commission recommended increased resources for financial counselling and legal services for consumers. Lenders also support increased resources for financial counselling. We also note that the Commonwealth Government has just doubled its financial counselling program. This is a very positive development, but would be pointless if it simply replaces a withdrawal of support by the States. Consumers are facing real and urgent financial difficulties and need real increases in advice and advocacy services, not just a reshuffle of funding sources.

Appendix A

The Abuse of Business and Investment Purpose Declarations

The provisions of section 11, particularly s11(2) in relation to business and investment purpose declarations, have constituted a well-known loophole to compliance with the Code, depriving vulnerable borrowers from the protection the Code affords and rendering the law optional for those intent on avoiding it. What has been created by s11(2) is a two-tier system, perhaps best described by two different employees of a finance broker giving evidence in the NSW CTTT about the same transaction:

> *Employee 1:The Applicants* [the borrowers] *would have been unable to obtain a personal loan as they were* ***unable to provide proof of income****. The only appropriate means to obtain finance would be a mortgage* (emphasis added).
> *Employee 2: It would have been impossible for the Applicants to obtain a personal loan, if they* [the broker] ***cannot do a loan conforming with the provisions of the Code then it may be appropriate to obtain a different type of loan****. A limited credit history must have been provided by the Applicants as the Respondent* [the broker] *only arranges private mortgages in such circumstances* (emphasis added).

In this way, those borrowers most in need of protection because they are desperate for funds and are unable to qualify for a mainstream loan, are left vulnerable to asset lending, inappropriate short-term loans and the imposition of unconscionable fees and charges. Finance broker legislation in both NSW and Victoria is also dependent on attracting the jurisdiction of the Code to apply and therefore also circumnavigated in the same manner.

Recent CCLC Cases

CCLC recently won a case in the CTTT where the consumers had signed not only a business purpose declaration, but a "business loan application form" detailing a business name and false loan purpose. The consumers in question wanted the money for kitchen renovations. They did have an ABN and bred dogs, for which they were paid $300 or $400 per dog. However, they only sold a handful of dogs in any given year, and were reliant almost exclusively on social security payments. The broker was fully informed of their true intentions in relation to the loan and coached them in relation to the application by asking "if you had a proper business, what would it be?", to which they replied "mobile dog wash" because they had seen this on the TV.

The loan was for $10,000 with an interest rate of 10% per month, reverting to 15% in the event of default. The case was primarily successful because of a technical problem with the timing of the signing of the business purposes declaration.

We have now spoken to three other couples, unknown to each other, who have dealt with the same broker and credit provider, although one did not proceed with the loan. In each case the same question was asked: "If you had a business, what would it be?" As a result a nurse's assistant became the operator of a private nursing business, and a geologist's assistant a weed control specialist (in a drought). In each of these cases the callers were seeking loans for wholly personal purposes such as debt consolidation and home mortgage arrears. In each case the interest rates were between 8% and 10% *per month (*that's 96 – 120% per annum), and up to 15% per month (180 per annum) if in default.

CCLC is currently acting for three older couples, who did not qualify for standard reverse mortgages products sold by banks, and were therefore sold an alternative product by a finance broker[42]. In all three cases the couples were put into five-year loans, with the entire debt due and payable at the end of the term. Each couple was reassured that no repayments would be necessary and that they would not lose their houses because another loan would be organised at the end of the term.

They were not informed, however, that the lack of repayments was made possible by a draw-down of the interest as a lump sum at settlement, and that further interest would be charged on the interest and principle for the entire period of the loan. The result of these arrangements is that these couples have paid a much higher effective interest rate than that disclosed on the contract, thereby diminishing their equity to the point that a further loan is unlikely to be granted.[43] As a result, all three are facing a homeless retirement. Each couple was required to sign a business/ investment purpose declaration.

Mr and Mrs X contacted CCLC because they defaulted on their mortgage and the lender was seeking possession of their house. At the time of entering the mortgage, they were both unemployed with 4 children and another on the way. Their sole source of income was Centrelink benefits.

Mr and Mrs X wanted the loan because they needed to refinance their existing home loan which was in serious arrears, pay off some other personal debts, pay for renewal of registration for their car and to cover the cost of renovating their house to convert the garage into a fourth bedroom to accommodate their expected fifth child. They approached a mortgage broker who arranged for the loan amount to be split into two separate loans with two separate lenders. The first loan accounted for about 60% of the total loan amount and had an interest rate of 8.95% p.a. with a default rate of an additional 3% p.a., while the second loan had an interest rate of 23.6% p.a. with a default interest rate of 31%.

From the outset, Mr and Mrs X had informed the broker of their level of income and that they were unemployed. In spite of this, neither the broker nor the lender took steps to ascertain whether or not Mr and Mrs X could meet the repayments. In fact, the broker told our clients that he knew they would not be able to afford the loan, so he would structure the loan to include an amount equal to six months of interest payments so that they would not have to make any payments for that period. He assured them that after the 6 months, he would change the loan over to a "normal loan" for no extra charge. He also assured our clients that they would receive $26,000 at settlement. Over the weeks that followed, the broker informed our clients of several changes made to the loan arrangement, which ultimately resulted in our clients not having an interest free period as promised, leaving them with repayments that they could not afford. The amount they received at settlement also turned out to be significantly less than promised.

It appears that the broker completed the loan documents dishonestly as the documentation was witnessed by a person that Mr and Mrs X had never met. Statements as to their income and employment status were also filled out by someone other than our clients. The broker told our clients to complete a business purpose declaration form, stating that the loan was for investment purposes. Our clients signed as instructed without any comprehension that the document would deprive them of significant protections under the law. Despite a favourable determination for our clients in COSL against the broker, and a settlement with the lender, our clients have since lost their

[42] The same broker acted in all three cases, although the borrowers are otherwise unknown to each other.

[43] It is possible that the loan-to-valuation ratios on these properties was such that another loan was never a realistic proposition, even if the interest had capitalized in the manner of a standard reverse mortgage. Either way the representations of the broker were completely unfounded.

home and have little hope of receiving any of the proceeds of the sale after repayment of even a reduced debt.

Business and investment purposes declarations are invariably used to facilitate predatory lending. Predatory loans are characterised by:

1. Excessively high set up costs which are financed by the loan
2. One or more intermediaries such as finance brokers
3. High ongoing interest rate and default interest rate
4. Swift enforcement action
5. False categorisation as a business or investment loan to avoid the Consumer Credit Code
6. No access to alternative dispute resolution
7. Reliance on an asset rather than income to meet loan repayments
8. Indifference to poor credit history or history of default.

One of the defining characteristics of a predatory loan is that either:

1. The borrowers could have obtained a loan on better terms; or
2. The borrowers are such a poor credit risk because of their financial situation that default on the loan is almost inevitable.

Profit is made by brokers and lenders on excessively high up- front fees and default charges recovered from the sale of the property.

The Predatory Lending Project set up by CCLC, NSW Legal Aid and the Public Interest Law Clearing House receives new referrals of these types of loans every week. This loophole must be closed if the UCCC is to be in anyway effective for those who need it the most.

Appendix B

Consumer Credit
Legal Centre NSW

National Finance Broking Le[illegible]

consumer
action
law centre

Joint Consumer Submission

March 2008

By email: policy@oft.commerce.nsw.gov.au

Senior Project Manager (Credit)
Policy and Strategy Division
NSW Office of Fair Trading
P.O. Box 972
PARRAMATTA NSW 2124

Dear Sirs/Mesdames,

National finance broking legislation
Joint consumer group submission

This response has been prepared by the Consumer Action Law Centre ["Consumer Action"] and Consumer Credit Legal Centre (NSW) ["CCLC"] on behalf of the following organisations:

- Australian Financial Counselling and Credit Reform Association
- CARE Financial Counselling Service/Consumer Law Centre (ACT)
- Centre for Credit and Consumer Law
- CHOICE
- Consumer Action Law Centre
- Consumer Credit Legal Centre (NSW)
- Consumer Credit Legal Service (WA)
- Financial Counsellor's Association of NSW
- Public Interest Law Clearing House (NSW)

In preparing this submission we have had access to the submission prepared on behalf of the Mortgage Finance Association of Australia (the "MFAA submission") and we make reference to that submission where relevant.

The above organisations are strongly supportive of the draft National Finance Broking Legislation (the **draft legislation**) and believe it should be legislated as a matter of urgency. We believe that the draft legislation would, if implemented, greatly assist Australian consumers of credit. The aspects of the legislation that, in our view, particularly valuable for consumers include:

- the requirement for brokers to independently satisfy themselves that the borrower can repay the loan without hardship;
- the requirement that brokers be licensed;
- the requirement that brokers act efficiently, honestly and fairly and in the best interests of consumers;

- the requirement for finance brokers to be members of an external dispute resolution (**EDR**) scheme;
- the provision of a public register of brokers and brokers' representatives;
- the requirement that brokers hold mandatory professional indemnity insurance; and
- the requirement that brokers disclose the commissions they receive

We note that the draft legislation, in some respects, imposes higher conduct standards on borrowers compared with lenders. For example, preventing brokers from refinancing consumers with more expensive credit, and requiring brokers to independently verify a consumer's capacity to repay a loan, both may impose better and stricter standards on brokers than on lenders. However, two key points must be noted:

1. The involvement of brokers in a transaction can limit a consumers' access to remedies they would otherwise have against the lender. For example, the chances of having a credit contract re-opened are reduced if the claim arises due to misleading or unfair conduct by the broker; and

2. It is accepted that there are problems with the current credit regulation that need to be addressed, including the lack of an effective obligation to assess ability to pay.

Currently, the opportunity is to reform the law relating to finance brokers, and if positive incremental advances can be made, then they should be made. We must avoid the situation where lenders and brokers can argue that they should have the same obligations as each other – this would lead to a "lowest common denominator" approach to regulation and would ignore the fact that they fulfil very different roles.

We note the strong objections by some industry representatives to some of the detailed provisions of the legislation. We also question whether this level of detail is best placed in legislation rather than in a more flexible regulatory instrument. Therefore, in the interests of ensuring the speedy progress of this urgently needed legislation, we suggest that the principles of the provisions dealing with assessment of capacity to pay and appropriate finance be preserved in the legislation, and that some of the more detailed requirements be moved to a mandatory code of conduct, the content of which could be negotiated during and after the passage of the overarching legislation. This would enable the important regulatory framework, including licensing, access to external dispute resolution, general duties to the consumer, and disciplinary processes to be established as a matter of urgency pending the resolution of some of the more contentious details.

We suggest that principles to the following effect remain in the legislation (some of these are copied or adapted from principles put forward by the MFAA, others are additional):

- "a broker must act fairly and responsibly towards the consumer";

- "a broker must not supply the lender with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete";

- "a broker must take into account the borrowers' capacity to repay any credit contract without undue hardship";

- “a broker must only recommend or arrange credit or other financial products that are consistent with the borrowers’ credit requirements and appropriate to the borrower’s apparent needs and circumstances”;
- “a broker must not improperly or unfairly fail to provide details of credit products that meet the borrower’s credit requirements and would be appropriate to the borrower’s apparent needs and circumstances”;
- “a broker must not favour his or her own interests above those of the borrower”;
- “a broker should record the reasons for any credit proposal recommended or arranged. Where a credit proposal is intended to replace existing credit arrangements, the broker’s reasons should include the comparative cost of any new arrangement as compared to the previous arrangements, any substantive change to the terms of the credit including the amount and timing of repayments, the cost of exiting the current credit arrangements, and any other factor relevant to the needs of the consumer”;
- “The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes”;

We anticipate that further detail in relation to best practice in this regard would be included in mandatory Code of Conduct referred to above.

More detailed commentary is included below on the need for these specific principles to be enshrined in the legislation. Comment is also provided on the current drafting of some provisions in the event the legislation is to proceed in close to its current form.

Matters not currently covered by the draft legislation

Fees and Commissions

Consumer groups have unsuccessfully argued for a cap on fees and commissions in the past. We are not repeating that submission in this instance, although we continue to believe there is a case for such a limitation.

In this submission we are advocating a prohibition or cap on the amount of fees that can be directly financed from a loan at settlement. Whereas the majority of brokers obtain their income from commission paid by lenders, some brokers (some of whom are classified as “introducers” by lenders rather than brokers) obtain their income from significant fees charged directly to the consumer and paid upon settlement of the loan out of the funds advanced (this may or may not be in addition to a commission paid by the lender). In the worst cases of predatory lending experienced by our clients, these fees are substantial, exploitative, and could not be paid by the borrowers unless they were financed as part of the loan.

As demonstrated by the following table showing the amounts paid to brokers by actual clients of consumer assistance agencies compared to their loan amount[44], the amounts charged by some brokers bear no relationship to the amounts borrowed and are arguably more an indication of the relevant borrowers' personal disadvantage or desperation (and arguably the risk perceived by the broker in undertaking a "dodgy" transaction).

Brokerage by Loan Size		
Loan amount	Brokerage	Percentage of loan
$122,000	$19,615	16%
$255,000	$19,855	7.7%
$255,000	$8,920	3.4%
$502,000	$16,000	3.1%
$110,000	$2,995	2.7%
$223,750	$5,500	2.4%
$300,000	$4,030	1.3%
$170,000	$1,105	0.65%
$256,000	$300	0.12%

In our experience those clients who pay the highest fees are those with the least capacity to meet their repayments on an ongoing basis and the addition of these fees to the outstanding balance of their loan exacerbates this problem. Often the fees are successfully hidden until settlement of the loan by obtaining the borrower's signature on incomplete documentation. In short, this practice is simply equity stripping – the brokers takes his or her fee at settlement and the lender later recovers the entire amount plus interest and default charges from sale of the security property when the borrower inevitably defaults.

We submit that a prohibition on financing such fees into the loan amount, or a cap on the amount of brokerage that can financed from the loan, would effectively reduce the incidence of predatory loans. Even if the funds to pay such fees are obtained from other sources of credit, it would be much more difficult to obscure the amount of the fees if the borrower needs to apply for a second loan, or use a credit card, to pay those fees.

Industry participants[45] at the Predatory Lending Forum[46] held in Sydney on 29 August 2007 unanimously supported placing a limit[47] on the amount of broker fees which could be financed as part of a loan.

There is a precedent for this strategy in the United States. North Carolina has specific provisions applicable to high cost lending including a complete prohibition of financing fees or insurance premiums into a mortgage loan covered by the legislation. We are not seeking selective application of this rule as is the case with the targeted predatory lending laws in

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[44] Details derived from an unpublished survey conducted by CCLC in May 2005 of legal aid, community legal centre and financial counselling clients who had refinanced their home loan in the previous five years in response to financial difficulty and then found themselves in financial difficulty again. More details are available in the CCLC submission to the Productivity Commission review of the Consumer Protection Framework, Submission 95 available at http://www.pc.gov.au/inquiry/consumer/submissions

[45] Industry participants included ABACUS, the Australian Bankers Association and the Mortgage Finance Association of Australia.

[46] The Forum was an initiative of the Predatory Lending Project, an alliance of Legal Aid, CCLC and other specialist consumer/credit legal centres, the Public Interest Law Clearing House and member law firms formed to address predatory lending in the home mortgage market.

[47] Time did not permit a full discussion about what that limit should be.

North Carolina. At the same time, we are not seeking to prohibit or limit the financing of all fees, only brokerage fees. In effect, because of the predominance of brokers who are remunerated solely by lender commissions, the provision is self-targeting. We aware that some brokers charge fees to the consumer, do not collect lender commissions to maintain their independence, and do not charge exorbitant or exploitative amounts. Those fees could be collected directly from the consumer rather than financed into the loan. Alternatively, there could be a monetary limit (appropriately indexed) on the amount that could be financed.

Comments on the specific provisions of the draft legislation

Definition of Credit

We are greatly concerned that the definition of credit does not include consumer leases, vehicle leases, equipment leases or any other variation on financing arrangements which do not technically include the deferment of debt. This creates an anomalous situation where many transactions conducted by brokers will not be covered by the Act. Not only is this undesirable itself, but it opens up the possibility of product steering to avoid coverage of the Act and the development of practices to exploit the loophole thus created. The definition must be amended to include leases and any other arrangement that would be commonly included in the financing options made available by brokers and other relevant intermediaries.

Definition of Broking

Consumer groups welcome the broad definition of finance broking and particularly the inclusion of advice about credit arrangements (such as mortgage reduction schemes) even where another broker negotiates the credit. We also support the inclusion of car dealers and retail outlets where credit is made available to consumers for the purpose of purchasing goods, although we anticipate some fine tuning of the provisions may be necessary to ensure that responsibility for compliance with the legislation in those circumstances vests in the most appropriate entity. Credit available at point of purchase is not only a common source of consumer credit complaints, but the landscape is increasingly complex with a range of credit and leasing products sometimes made available.

Granting and revoking licenses

We strongly support a nationally uniform and coordinated approach to licensing. The draft legislation appears to allow each jurisdiction to tailor licensing application processes. Noting that a licence in one jurisdiction will qualify brokers to trade in all jurisdictions, we are concerned that jurisdictions with 'softer touch' licensing practices will invite forum shopping.

It is our view that the appropriate regulatory authority should have the right to refuse a license application if the applicant has breached consumer protection legislation. This could be achieved by adding a subsection (d) to subsection 11(2) reading: 'if he or she has been found by a court to have breached a consumer protection provision of the *Trade Practices Act* or any equivalent State or Territory consumer protection act.'

In particular, there may be licensees who have been found by a court to have engaged in misleading and deceptive or unconscionable conduct and to whom it would not be appropriate to grant a license. Breaches of consumer protection laws obviously harm many consumers, and many individuals who breach such laws have a predatory attitude and do not have a suitable character to be finance brokers.

A national system would also deal better with the problem of cancellation of licences. As a broker need only hold a licence in one jurisdiction to trade nationally, there needs to be a coordinated approach to a regulator identifying malpractice and revoking licences. If New South Wales, for example, identified a ground for cancellation of a broker's licence, it would be incongruent for them not to be able to cancel it merely because the licence was obtained in Victoria.

Length of license

In section 10(3) of the draft legislation, the length of broker licenses is not defined. The summary explaining this subsection advises that the length of the broker license will depend on the local jurisdiction. We see no reason for the length for which a license is granted to be non-uniform and depend on jurisdiction. It seems incongruous that in a national market, the length of licenses issued depends on the location in which they were issued. The length of licenses should be consistent.

Liability of credit providers for unlicensed brokers

We strongly support the liability of credit providers for the actions of unlicensed brokers. The regulatory system should not be dependent on consumers knowing that they must deal with registered or licensed brokers. Educating consumers of this fact would be an expensive exercise for government, consumer groups and those members of industry who take part. It will also never be 100% effective and there will always be desperate people who agree to deal with operators outside the regulatory regime regardless of their knowledge. To be effective the onus must be on credit providers to deal with licensed/registered brokers only and the consequences of doing otherwise must be an automatic implied agency relationship between the broker and the credit provider for the purposes of dealing with complaints by the consumer. This is the **<u>only</u>** way that illicit operators can be effectively excluded from the market.

Business purposes loans

a) Misrepresentation of consumer loans as business purposes loans

The use of business purposes declarations to avoid the UCCC is matter of serious concern to consumer assistance agencies. We acknowledge that work is currently being undertaken by government and other stakeholders to address this issue via amendment of the UCCC. It is vital that this legislation addresses this conduct. It is also important that this legislation is consistent and complementary with any amendment to the UCCC. Further, brokers and other intermediaries covered by the draft legislation should not be able to avoid compliance with the draft legislation itself by classifying loans as business or investment purposes, as is currently the case with the broker legislation in both NSW and Victoria.

We note that the inclusion of section 33(2) in the draft legislation is intended to address this issue. We have a number of concerns with this approach:

- The placement of the section in Part 3 Division 1 means that the section will not come into play until Schedule 1 Section 2 has been overcome. While the onus is on the broker in Schedule 1 Section 2 to show that the service has been provided for a bona fide business transaction, the two stage process of having to first counter any suggestion that the finance was provided for a bona fide business purpose in the Schedule before section 33 (2) can be considered seems to add unnecessary layers of complicated legal argument and potential for divergent and unintended interpretations. If there is a gateway provision regarding business purpose transactions then it should be placed in the schedule.
- The current drafting of section 33(2) places too much weight on the requirement to make inquiry of third parties in establishing a business purpose. Firstly there may be practical problems in finding an appropriate third party to verify some genuine business transactions. Secondly, the experience of the clients of consumer assistance agencies and the case law both suggest that the practice of using "tame" third parties, particularly accountants, to verify the financial position of applicant borrowers, some of whom they have never met let alone inspected their financial records, is fairly well-entrenched. This method could be easily adapted for verifying non-existent business purposes. It may be difficult to prove a "business relationship" in all such cases. Thirdly, and most importantly, the focus on third party inquiries reduces the section to a "tick-a-box" requirement that detracts from the real issue – that being that the broker should ensure that business transactions are bona fide, something which could be established from a range of evidence including but not limited to documentation (such as business financial records or a business plan), third party inquiries, the existence of an ABN and/or business name etc.

It is important to note that the issue to be addressed by this part of the legislation is not, as could be implied, that brokers cannot rely on the instructions of their clients. On the contrary, our experience is that many consumers fully disclose their financial position, including arrears on an existing loan or loans to the broker, and it is the broker that suggests that the loan be falsely categorised as being required for a business. The need for verification is largely directed at making it more difficult for brokers to encourage consumers to sign false business purposes declarations, or to simply dictate paragraphs for consumers to sign setting up false business or investment purposes.

We submit that section 33(2) should be moved to the Schedule and that the specific requirement in relation to third parties should be deleted and replaced as follows:

> "unless the finance broker is satisfied, upon making reasonable inquiries, that the credit is sought wholly or predominantly for other purposes."

The meaning of "reasonable inquiries" is something we think could be appropriately explored in a mandatory code of conduct.

We also submit that there should be very specific provisions carrying a penalty for breach, applicable to all types of finance (not excluded as a result of the Schedule), to the effect that:

- "The broker must not supply the lender or any other person with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete." (almost identical to a principle suggested by the MFAA submission)

- "The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes."

While the latter section is somewhat repetitive of the former, it serves two additional purposes:

1. To assist where actual subjective knowledge of the broker is difficult to establish;
2. To serve as a very clear message to industry participants that the use of false business purposes declarations is an unacceptable practice. This is necessary because it is apparent from current industry practice that procuring a false business purpose declaration does not carry the same import as presenting, for example, false income information. The experience of our clients (and staff) is that some sales representatives present a business or investment purposes declaration as simply a method of accessing a broader range of finance products, or a tax concession (regardless of the real purpose of the loan).

b) Bona fide business transactions

We support the inclusion of broking for small business customers within the purview of the Act. There has been widespread recognition that small businesses customers of credit and other financial services can be as vulnerable as individual consumers making household domestic purchases. The economic damage done by unacceptable market conduct in this market sector is potentially as destructive as in the personal domestic domain. In recognition of this, the general regulation of financial services under the *Corporations Act* 2001 (Cth) includes small business and investors, as does the limited credit jurisdiction under the *ASIC Act* 2001 (Cth). Important industry codes, such as the Code of Banking Practice[48], cover small business and investors.

We note that the MFAA submission argues that there is no evidence of problems in the small business finance broking market. CCLC asserts the contrary. In the months immediately following the release of the March 2003 report, "*A report to ASIC on the finance and mortgage broker industry*", CCLC received many calls from business and individual investors recounting very similar stories to those contained in the case studies attached to the report. As many of the structural problems such as conflict of interest, and a lack of adequate regulation or required standards, apply to all forms of finance broking, these

[48] Code of Banking Practice cl. 1.1.

complaints were not entirely surprising. As CCLC is funded to assist individuals rather than businesses, we could not provide any advice or assistance in those cases. We recognise that some small business broking is very different in nature and impact to large personal purchases such as residential housing, and that speed is often of the essence. However, it is vital that such customers are at the very least given adequate information about the nature and cost of products and services provided and access to external dispute resolution in the event of a dispute.

We submit that most of section 32 should also apply to small business transactions. Further, most of the principles outlined in the opening section of this submission should also apply to small business broking. The following principles as a minimum must apply to all transaction including those conducted for small business:

- "a broker must act fairly and responsibly towards the consumer";
- "a broker must not supply the lender with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete."
- "a broker must not favour his or her own interests above those of the borrower"
- "The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes."

We also note that the current wording of the Schedule 1, subsections 2(1) & (2) is that the exemption applies where "a finance broker provides the service to a consumers for the purpose of a bona fide business transaction...". We are concerned that these subsections could be interpreted as the broker's subjective intention, divorced from the borrower's intention or any objective information (as has been the case with some decisions involving Section 6(1)(b) of the UCCC). As stated above, we think that section 33(2) (amended as suggested) should be moved to Schedule 1, or the determination as to whether this Act applies should be clearly stated to turn on the actual use of the funds, rather than either party's intention.

Borrowers' capacity to repay

As stated above, we strongly support the requirements for finance brokers to investigate the borrower's capacity to repay the loan without hardship. However, as also stated above, we submit that this broad principle only should be incorporated into the legislation, with the detail and extent of the broker's duties to be set out in a mandatory Code of Conduct.

We note the MFAA submission's argument that it is the lender in any credit transaction who should assess capacity to pay and that the duty of the broker should be confined to supplying the lender (or any other relevant person) information which is to the best of their knowledge neither misleading, deceptive or inaccurate. We also note that lending criteria vary from lender to lender and product to product, making it difficult to set any single standard of capacity to pay.

We have seen evidence of the following practices engaged in by brokers which frustrate the lenders ability to properly assess capacity to pay, most of which would be addressed by the MFAA suggested solution:

- Encouraging borrowers to extrapolate their income from a very short, atypical period or otherwise exaggerate their income;
- Encouraging borrowers to fabricate their income, including arranging for accountants to provide false verification for general capacity to pay, for a particular income level or a non-existent business which apparently generates income;
- Taking blank, signed forms from borrowers and completing them afterwards with incorrect income details;
- Altering loan application forms, including income details, after borrowers have completed and signed the forms with genuine income details.

We therefore support the principles put forward by the MFAA to the effect that:

- "a broker must act fairly and responsibly towards the consumer";
- "a broker must not supply the lender with any information which the broker knows is misleading, deceptive, or inaccurate."

We would alter the second principle slightly to read that "a broker must not supply information that *he or she knows, or ought to know*, is misleading, deceptive, inaccurate or incomplete." This is necessary to get around the difficulties presented by proving a broker's subjective knowledge when it is patently obvious from the information available that the broker should have had the requisite knowledge.

However, we are also aware of lenders who give little attention to capacity to pay on some products, particularly low-doc and no-doc products. For example, the lending criteria of one lender states that for one particular product if the borrower has an ABN, and the LVR is no greater than 75%, no proof of income is required. While it would be clearly preferable that lenders also had a duty to properly assess capacity to pay, the current law is at best ambiguous. However, as stated in our opening comments, the involvement of brokers in a transaction can limit a consumers' access to remedies they would otherwise have against the lender. For example, the chances of having a credit contract re-opened as unjust are reduced if the claim arises due to misleading or unfair conduct by the broker and the broker is not found to be the agent of the credit provider. Of course we would enthusiastically support any move to increase lenders' obligations in this regard, but this is an opportunity to ensure that brokers do not steer consumers towards these products inappropriately, and in full knowledge that repayment will be exceedingly difficult, if not impossible. Further, in our experience to date, the inappropriate distribution of low-doc and no-doc products is conducted exclusively through brokers, making the broker's role in the transaction an appropriate point for intervention.

Other examples of affordability issues that brokers fail to take into account in recommending products to consumers include, for example:

- Balloon payments at the conclusion of loans;

- Short-term, interest-only mortgages where the entire amount outstanding becomes payable within a 12 months to five years;
- Home loans that have a period (which may or may not be equal to the term of the loan) of no repayments and capitalised interest, or "pre-paid interest", that are not reverse mortgages and therefore require the sale of the home at the end of the term;
- The need to meet repayments on other credit accounts that are not refinanced by the loan.

While it is not the role of the broker to set lending criteria and precise formulas for determining serviceability, brokers should not be able to recommend or arrange products that the borrower clearly cannot afford. We therefore propose an additional principle to possibly replace the current section 33(3 - 6) to the effect that:

> "a broker must take into account the borrowers' capacity to repay any credit contract without undue hardship".

More detail about what is required to meet this standard could then be included in the mandatory Code of Conduct.

In the event that the above provisions remain in the legislation in close to their current form, then we make the following comments:

- The prohibition on having reference to assets in assessing ability to pay (as opposed to assessing whether the security is adequate) could be more narrowly construed. Generally speaking, we support the principle that loans should be repaid from income, including projected rental income for investment properties. However, a complete ban on taking into account asset values does appear to be needlessly inflexible, particularly if the general principle of appropriate finance is adopted. We suggest that the section, if it remains, should require that , capacity to pay should not be reliant on the sale of the borrower's home;
- The requirement to take into account future events is very broad. Brokers, like lenders, should not be required to have a crystal ball, or extensive actuarial training. It would also be inappropriate to project pay rises in assessing capacity to pay. However, there are certain very predictable events that should be taken into account in assessing the affordability of a loan, such as balloon payments, the requirement to pay out short-term mortgages at the end of the term, the unavailability of Centrelink payments for dependent children once they reach a certain age and imminent retirement to name a few. The section could perhaps be reworded as a requirement to take into account reasonably foreseeable changes in the borrower's circumstances which may impact on capacity to pay.

Credit recommendations and comparisons

Section 36 addresses matters to be complied with if a broker puts forward two or more credit proposals. We are concerned that this section will work to the detriment of consumers by discouraging brokers from making multiple options available to the consumer and from recommending one over another because of the more onerous obligations imposed in these circumstances. In the worst examples of broker misconduct that the authors of this submission are aware of, the broker presents one option only. This provision will have little effect in those scenarios and is therefore more likely to deprive more mainstream consumers from being presented with a range of options.

Section 37 deals with reverse mortgages. The extra protection given to consumers entering into reverse mortgage contracts is appropriate. Reverse mortgages are often hard to understand, can cause consumers to discount long-term needs, and are generally sold to older consumers (some of whom are especially vulnerable). However, we are concerned at the narrowness of the definition of 'reverse mortgage' in the draft legislation. We perceive that there is a risk that equity release loan agreements may, after the enactment of the draft legislation, be structured to escape the definition in the draft legislation. Further, other credit products requiring particularly complex advice (such as shared appreciation mortgages) are not covered by the provision.

The availability of reverse mortgages, along with general marketing encouraging people to "release" their equity, appears to have created fertile ground for misrepresentation, misunderstanding and unjust conduct. In a number of instances, loan agreements have been misrepresented to elderly consumers as reverse mortgages, or as equivalent to reverse mortgages in effect, when in fact they are neither. For instance, in March 2007 Consumer Action's legal advice line dealt with a case involving a 62 year old man with Alzheimer's disease who was given a secured personal loan that was misrepresented as a reverse mortgage by a well-known non-bank lender. CCLC is also acting for three couples in their 60s who were sold five year loans with capitalised interest instead of a reverse mortgage. All three couples face the necessity of selling their home in order to repay the loan at the end of the five-year term with significantly reduced equity. All three couples had intended to live in their homes until death or serious incapacity forced them to move. CCLC has also seen examples of elderly consumers being sold equity release products such as a line of credit secured by their home in lieu of a reverse mortgage. One such couple is now faced with selling their home despite the elder member of the couple having reached 70, having used most of the equity they drew down to make repayments on the loan. While it could be argued that such products do not meet the borrower's credit requirements, this may be difficult to prove if the broker has drafted the consumer's credit requirements to fit the product intended to be sold.

Section 38 places particular obligations on brokers where a transaction involves the refinancing of existing credit commitments. Again we support the imposition of specific obligations in these circumstances. We also support the specific duties contained in the section. However, we feel that the section does not adequately address some of the common disadvantages of refinance arrangements including:

- The increased risk associated with transferring unsecured debt to secured debt, particularly where that security is the family home;
- The increased risk of incurring further unsecured debt when the original problematic debt has been "dealt with" without addressing any underlying imbalance in income and expenditure;

- Encouraging borrowers to borrow more than necessary "just in case" and risking unnecessary higher indebtedness.

There are also other issues pertinent to credit "advice" that are not addressed in the legislation, including but not limited to the implications of interest-only loans and secured lines of credit, and the appropriateness (and questionable effectiveness) of some mortgage reduction packages.

We submit that the detailed provisions in the draft legislation be replaced with a variation on the principles proposed by the MFAA submission in relation to the comparison of credit proposals. The following should be applicable to all transactions regardless of whether the broker puts forward multiple credit options and/or the borrower is refinancing and/or the product proposed or arranged is a shared equity or equity release product. We submit that these provisions could replace the current sections 35(3), 36, 37 & 38:

- "a broker must only recommend or arrange credit or other financial products that are consistent with the borrowers' credit requirements and appropriate to the borrower's apparent needs and circumstances";
- "a broker must not improperly or unfairly fail to provide details of credit products that would be appropriate to the borrower's apparent needs and circumstances";
- "a broker must not favour his or her own interests above those of the borrower"
- "a broker should record the reasons for any credit proposal recommended or arranged. Where a credit proposal is intended to replace existing credit arrangements, the broker's reasons should include the comparative cost of any new arrangement as compared to the previous arrangements, any substantive change to the terms of the credit including the amount and timing of repayments, the cost of exiting the current credit arrangements, and any other factor relevant to the needs of the consumer."

Again we anticipate that further detail in relation to best practice should be included in the mandatory Code of Conduct. Specific guidelines in relation to reverse mortgages, shared equity products, secured lines of credit, and other equity release products should be included in the Code of Conduct.

Alternatively, if the provisions are retained, the Section 37(1)(b) commencing "if, after making inquiries of the borrower….." should be reworded to ensure that there is a positive obligation on the broker to make such inquiries. The current wording of the section could possibly be construed otherwise. Consideration should be given to extending the coverage of this section to include a broader range of products, particularly any product where the debt may increase over time despite the borrower complying with the terms and conditions, or where the amount owed has a relationship to the current property value. Loans where the amount owed does not necessarily decrease despite repayments (interest-only/line of credit loans) also require specific advice. This issue should be covered in either the legislation or the Code of Conduct (if that course of action is adopted).

Penalties

The penalties for serious contraventions of the draft legislation should be set somewhat higher. For instance, unlicensed broking should carry a harsher maximum fine than $22,000. Such a low fine runs the risk of creating the situation where the benefit an individual gains from breaching the law (e.g. broking without a license) outweighs the fine s/he must pay if caught. It is equally important for there to be adequate funding for enforcement action by regulators.

Definition of professional misconduct

The definition of professional misconduct should be expanded to include breaches of provisions in consumer protection acts. Clearly, a broker who engages in misleading and deceptive and/or unconscionable conduct under the *Trade Practices Act* while providing a broking service has committed misconduct. Breaches of consumer protection acts in the course of providing a broking service should constitute professional misconduct.

Administration of compensation fund

The proposed compensation fund should not be controlled by the regulator, and its governing body should be entirely separate from the regulator. To separate the compensation fund from the regulator would be consistent with good governance principles. The board of the compensation fund should be independent and representative – it should have an equal mix of consumer and business representatives.[49]

Type of EDR schemes that should be approved

Only EDR schemes approved by the Australian Securities and Investment Commission (**ASIC**) should be approved for the purposes of the draft legislation. ASIC-approved EDR schemes meet minimum consumer protection requirements. The simplest way to ensure that brokers belong to EDR schemes that are capable of, and willing to, fairly and effectively resolve consumer/trader disputes is to approve only ASIC-approved schemes. ASIC has a strong consumer protection record and years of experience in monitoring and approving EDR schemes. The requirements it imposes on EDR schemes it approves are appropriate.

Stay of proceedings brought by a lender

We strongly support the range of consumer remedies provided for in Part 4 of the draft legislation. In particular, we support the ability for a proceeding begun by a lender against a borrower for repossession of a home to be stayed where proceedings have begun under this legislation against a broker (either in a court or through an external dispute resolution process). Consumer groups have long lobbied for recognition that remedies against a broker are often inadequate when the real issue at stake is often an unsuitable loan. For this reason we have lobbied in the past for brokers to be deemed the agent of the lender. While we have been unsuccessful on that count, we believe that this provision is an important measure to avoid serious injustice.

[49] Section 57 of the *Motor Car Traders Act (Vic) 1986* requires the Claims Committee of the Motor Car Traders Guarantee Fund to consist of at least one business representative, one consumer representative and one lawyer.

We are aware of considerable industry opposition to the section 54 provision for a stay. We believe that opposition is unfounded. The provision is couched very narrowly, and there is ample provision for the court to have regard to the lender's interests in granting the stay. The stay is only available where: the borrower's residential home is at risk; where the action against the broker could, if successful, prevent the need to foreclose on the home; and the interests of either party will not be irretrievably affected if such an order is made. We submit that the circumstances in which all three of the above pre-conditions apply will not be frequent. Further, to allow the lender to take action to take possession and sell a person's home in such circumstances is manifestly unfair and potentially results in unnecessary personal and social costs.

We submit that the section should not only be retained but amended slightly as follows to ensure that appropriate borrowers are not needlessly excluded from its application:

1. The term "irretrievably affected" is very broad. Arguably, a very minor but enduring deterioration in the lender's position would warrant the rejection of a stay application. Section 54 should require the lender to demonstrate that they will be *substantially and irretrievably* affected in order to defeat the application for a stay.
2. Section 54(4)(b) arguably makes some capacity and willingness to make repayments on the part of the borrower essential to obtaining a stay. There is no need to make the requirement to make repayments on the part of the borrower pivotal in itself. While most home loans are large enough that some ongoing repayments would be necessary to prevent irretrievable deterioration of the position of the lender *and* the borrower, this will not be the case with smaller loans. CCLC has been involved in cases involving smaller loans, secured by registered or equitable mortgage over the borrower's home, where the recovery of the broker's fees, set up costs and other damages such as default interest and legal fees, would be sufficient to set off the entire loan. The ability to make repayments pending the outcome of the broker proceedings should be but one issue to be canvassed in determining whether the interests of the parties will be substantially and irretrievably affected.

The MFAA submission also argues that the provision is unnecessary, needlessly duplicating the Supreme Courts' broad discretion to grant stays in possession proceedings. A perusal of the case law in relation to mortgages under the Contracts Review Act in NSW and the recent UCCC matter of *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook*[50] reveals that whereas most of these cases involved brokers, their role receives little, if any attention, by the Court. While this is a natural consequence of proceedings in which the dispute for adjudication is between the borrower and the lender, we submit that there is arguably little awareness among Supreme Court judges of the key role played by brokers in today's mortgage market. Further, the provisions of the draft legislation are both new and novel, in so far as they clearly recognise the blurring of roles between brokers and lender as a result of lenders effectively outsourcing some, or all, of their direct customer interface. As a result, a specific provision which gives the Court a clear mandate to grant a stay in the circumstances outlined, and importantly guides the exercise of that discretion, enables borrowers to have access to a stay in appropriate circumstances,

[50] [2006] NSWSC 1104.

while ensuring that all parties are protected from the consequences of applications which are ill-conceived in terms of their long-term impact.

The MFAA submission also raises the prospects of increased PII premiums or other barriers to getting PII cover as a result of this stay. In the light of the narrow construction of the circumstances in which the stay is available, and the requirement for the court to have regard to any irretrievable affect on the lender's interest, we think that claims for damages as a result of this provision and a consequential impact on PII premiums or availability is unlikely.

We also believe consideration should be given to a broker being able to be joined to a proceeding brought by a lender for repayment of a debt, where there is no threat of repossession of a home. Brokers are not exclusively involved in home or securitised lending, and if a consumer has an action against a broker in relation to such a loan, then it is fair and efficient for that to be dealt with in the context of any action by a lender for repayment of a debt.

Mortgage repossessions take a serious toll on individuals, families, and communities. They also increase the demands on government and community services. Unnecessary repossessions should be avoided if at all possible. While we do not believe the stay provision will be widely used, its absence would mean that some consumers with unjust loans would face pyrrhic victories whereby having won their case against the broker they still lose their home.

Limitation periods

In section 52 of the draft legislation consumer remedies are subject to a 3 year limitation period. This limitation period is unreasonably short. In some situations, consumers will not be aware that they have suffered loss until well after the finance broking service was provided. A 3 year limitation period will mean that deserving consumers are denied a remedy. A 6 year limitation would be more appropriate – far fewer consumers would be unaware of their loss after 6 years compared with 3 years. Ultimately, limitation periods are a balance between individual justice and general commercial certainty, and in our view a 6 year limitation period would constitute the best balance.

Implementation of legislation

We note that the draft legislation states that the 'current arrangement is for similar, but not necessarily identical, bills to be introduced in other jurisdictions'. Our concerns about this would likely be shared by other stakeholders. From our perspective, the non-uniformity could cause a reduction in coordination between the various regulators to the detriment of consumers.

While we would certainly support non-uniform legislation that is substantially similar to the draft legislation, it is worth considering the feasibility of taking a uniform approach such as that existing for the Uniform Consumer Credit Code (**the UCCC**).

Appendix C

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SMALL AMOUNT LENDING IN NSW

About small amount lending

Small amount lenders typically offer short-term loans (ranging from a couple of days to about 18 months) for small amounts (usually $100-$5,000) and charge significant fees for arranging this type of loan. Pay-day lending, where very small loans are given until the borrower's next pay day (usually only a couple of weeks) is a sub-set of small amount lending, although this type of lending is less common in NSW since it was brought within the jurisdiction of the Consumer Credit Code.

The interest rate cap in NSW – vital consumer protection

The 48% cap on consumer lending in NSW, inclusive of interest, fees and charges, is:

- Important because competition does not protect vulnerable consumers from expensive loans
- Necessary because disadvantaged and/or desperate consumers often fail to understand or heed disclosure of loan terms and cost
- Necessary to include the total cost of credit within the existing interest rate cap
- Clearer than any other measure such as forbidding costs that are "unconscionable" or "excessive"
- Comparatively easy to enforce

NSW has legally capped interest on consumer loans at 48% for many years. Lenders were previously able to avoid the law by disguising the real cost of the loan as fees and charges rather than as interest. In March 2006, the law was changed to include fees and charges in the calculation of the interest rate cap to prevent this practice. Case Study 1 occurred prior to the change in the law and the costs involved would no longer be legal in NSW. However, CCLC continues to see consumers with interstate loans with exorbitant interest rates, including a current client who borrowed $100 from a Queensland lender and was sued for $800 within two months of taking out the loan.

The interest rate cap rarely affects mainstream lending where rates are generally kept much lower as a result of competition. Most borrowers who are able to access the mainstream market would never consider paying 48% interest. The impact of the cap is therefore on small suburban outlets and mobile lenders offering much lower amounts than are generally available through the banks and other lenders. While CCLC accepts that there is considerable demand for these products that is not being met by the mainstream credit market, and that there are fixed costs associated with lending that increase the relative cost of providing smaller loans, we submit that the risks for the more vulnerable consumers who often use these loans are great. Many consumers who borrow from such lenders later seek assistance from legal and financial counselling services because they cannot repay the amounts borrowed. Some have

Case Study 1 – Ms A needed to borrow $2,500 urgently and responded to an advertisement in the local paper that said "Easy Loans No Credit Checks". Ms A told the lender she was in receipt of Centrelink benefits as her only source of income. The loan she was given was $3,550, and included a fee of $1,050. A caveat was also taken over her home and lodged the next day. The loan was for 1 month and a default rate of interest of 10% per month applied if she did not pay the entire amount back within that time. Ms A was unable to pay on time and was threatened with bankruptcy shortly afterwards.

Case Study 2 – Ms B has an intellectual disability and mental health problems. Her sole source of income was Centrelink disability benefits. Ms B borrowed $200 from a lender for a period of 7 days. The total credit fees and charges were about $80 and a significant proportion of these fees were made up of a "cheque cashing fee", and a membership fee, which were purportedly not credit charges for the purposes of the Consumer Credit Code. The lender did not explain any of the charges or the terms of the contract. Ms B did not understand that she had to repay the entire loan and charges in just 7 days.

multiple problems including mental illness and other disabilities. Often these consumers are unable to fully understand the terms and cost of their loan, or are so focused on the need for money that they give little consideration to how it will be repaid.

Why an interest-rate cap?

An effective interest-rate cap is a simple and cost-effective method of controlling the cost of credit for consumers for whom competition has failed. A cap sends an immediate and clear message to all credit providers that there is a line in the sand, an easily calculable delineation between legal and illegal lending. There is no need to challenge every fee or charge in a court or tribunal to determine its legality and regulators can more easily enforce the law. Experience has demonstrated that less clearly defined tests such as "unconscionable" or "excessive" can be useful in individual negotiations but do not drive systemic change. Laws should exist for all consumers, not just those who are able to access individual legal assistance. The ACT also has a comprehensive interest rate cap. Queensland and South Australia are currently considering following the NSW lead and introducing an interest-rate cap inclusive of fees and charges. A number of US states are also considering interest-rate caps to regulate payday lending.

Recent changes to the law to prevent the use of Bills of Exchange and Promissory Notes to avoid the Consumer Credit Code

The changes to the NSW law that brought fees and charges into the calculation of the 48% cap occurred over 2 years ago. This debate has been re-ignited by a recent change in the law to prevent Bills of Exchange and Promissory Notes from being used to avoid the Consumer Credit Code. Many lenders in NSW openly admit that they have been taking advantage of these loopholes. These very important changes have been introduced to address widespread avoidance of the main piece of legislation regulating consumer lending in Australia. Such avoidance cannot be tolerated if consumer protection laws are to be effective. The debate about the 48% cap is a separate issue and should not be confused with the need to ensure effective coverage by the relevant law.

Will consumers continue to have access to credit?

> **Case Study 3** – Mr C needed to borrow money for food and rent. He approached a small amount lender for money. The lender approved the loan and organised for a direct debit on Mr C's account. When Mr C was paid his regular social security payment, the lender debited the whole amount of money owing leaving him with no money for food. Mr C then had to approach a charity for a food hamper.

Access to credit is an important issue for consumers and CCLC is aware of lenders who offer small amount loans in NSW and comply with the 48% cap. While it may be difficult to offer very short-term loans (a few weeks) at 48%, in our experience consumers generally want lower repayments over a longer term. Many very short-term loans are simply rolled over again and again attracting more fees and charges each time.

It is also important to remember that there is no point in enabling access to a service that simply exacerbates underlying disadvantage. It is often argued that consumers use small amount lending to pay for necessary goods and services. Unfortunately, when a person has insufficient income or other resources to pay for essentials, borrowing to meet those expenses results in even less income to cover essential goods and services in the future, as income is further diminished by the need to repay previous loans. This problem is increased manifold, if the amount to be repaid is considerably greater than the amount borrowed because of high fees and charges or interest. In our experience, some businesses have adapted to the interest-rate cap and continue to offer small amount loans in NSW. Encouraging responsible lending practices, combined with an all-inclusive interest-rate cap, strikes a balance between facilitating access to credit for those who can afford to repay it, and protecting the most vulnerable members of our community.

The above case studies are based on the experiences of real people. Some small details have been deleted or changed to protect the privacy of the borrowers.

About CCLC – Consumer Credit Legal Centre (NSW) Inc ("CCLC") is a community-based consumer advice, advocacy and education service specialising in personal credit, debt and banking law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We provide legal advice, financial counselling, information and strategies, and referral to face-to-face financial counselling services, and limited direct financial counselling. Last financial year we took over 11,000 calls for advice or assistance.

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 website resources, education resources and workshops, and media comment.