



**Endorsed by**  
Consumer Law Centre ACT  
Hobart Community Legal Service Inc

## **CONSUMER SUBMISSION – NATIONAL CONSUMER CREDIT PROTECTION BILL 2009**

### **1 - INTRODUCTION**

Consumer Action Law Centre ("**Consumer Action**") welcomes the exposure draft of the proposed *National Consumer Credit Protection Bill 2009* (the "Bill"), and associated Regulations. We believe the Bill introduces some significant benefits for consumers.

In particular, Consumer Action commends:

- a) the requirement that most parties involved in the credit process be licensed,
- b) the compulsory requirement for credit providers to join external dispute resolution schemes,
- c) the retention of interest rate caps in those states that currently have them, and;
- d) the creation of new responsible lending obligations.

Despite these positive developments, Consumer Action believes that the Bill could be further enhanced to meet its stated objectives.

Our key concerns are not with the overall intention of the legislation. However, we are concerned that some of the obligations, lack of obligations, and exemptions contained in the Bill could lead to a situation where more responsible lenders and intermediaries are likely to comply, but where less ethical industry participants continue to engage in poor conduct. This would merely perpetuate the current situation, whereby the most serious detriment experienced by consumers is often a result of a deliberate attempt to avoid provisions of current laws.

The loans that cause the most problems often involve a large number of parties in the transaction. For example, the following is a recent case that presented to Consumer Action:

#### **Case Study:**

Consumer Action recently represented a woman who was in her late 70's. Before her husband died, aged 97, he had been manipulated by their son, who convinced his father to give him \$200,000 for his benefit. The debt was secured by a mortgage on the family home, and the payments exceeded the father's pension.

At the date of the loan, the husband was 93. The son had made initial contact with a broker. It appears that the broker was aware of the circumstances. Other parties (including the lender) may not have been fully aware of the circumstances, but the age of the borrowers alone should have led to further enquiries by the lender.

The broker submitted the loan application to a solicitor lender. The law firm acted in the role of the lender, representing a lending business which was apparently owned by the law firm. The Lender referred the son, and husband, to an accountant (to verify that the borrower could afford the loan) and to a solicitor (to verify that he understood the loan).

The son failed to pay the loan, and the lender took legal action to sell the couple's home for an amount exceeding \$300,000.

This is not an uncommon case for services such as ours.

While this loan would be "unsuitable" under the new regime, it may not necessarily be completely "caught" by the proposed protections in the Bill.

The solicitor lender may be exempt from licensing (particularly if, as in many cases, the lender isn't actually owned by the firm), the accountant will be exempt, and the lender would be able to argue that it accepted information that was presented by the broker (via the solicitor lender) – which may seem reasonable on the face of it, particularly with the support of an accountant and another solicitor. While the broker has clearly recommended a loan that is unsuitable, it is not appropriate that the consumer's only remedy is to pursue the broker.

Unless the Government is prepared to warn consumers of the potential risks of dealing with an intermediary, the new laws must place a consumer in a similar legal position whether the consumer approaches a lender directly, or whether there are a number of other entities in the chain.

As outlined below, we have concerns that different roles such as general credit advice, referral, and arranging a loan could be split between a number of entities, creating difficulties for consumers seeking redress in those situations, and providing the regulator with fewer powers than if the entire transaction had been undertaken by just a lender.

We strongly recommend that the legislation is "stress tested" against "real life" examples, to ensure that consumers and regulators have similar remedies and powers in relation to unjust (or illegal) credit conduct, whether there is one business or many involved in the transaction.

Please find below our comments in relation to a number of areas.

## **2. RESPONSIBLE LENDING**

### **2.1 Need for a requirement for a credit assistant to disclose all relevant information to the lender.**

The proposed Bill does not create a clear obligation on credit assistants to disclose all relevant information to lenders. This weakens the responsible lending provisions of the Bill, effectively “breaking the chain” of information that a lender should be required to know, in order to make a responsible lending decision.

Where a borrower approaches a broker, it is the broker – rather than the lender – who has direct contact with the borrower. A broker may be aware of information that the lender would take into account when assessing the application or in deciding the level of verification of information required. For example, a lender may wish to make additional enquiries if it was made aware that the borrower could not read or did not speak English – however there doesn’t appear to be any obligation for the broker to disclose this information. A broker may deal almost entirely with a friend or relative of the borrower rather than with the borrower directly. This can sometimes indicate that the borrower is under the influence of another person, or that the borrower may not completely understand the arrangement. A responsible lender would make further enquiries if this is the case, and therefore would benefit from this information.

**Recommendation:**

There should be an obligation placed on credit assistants to provide lenders with all information of which the broker is aware, that would reasonably be expected to be taken into account by the lender when assessing an application, or in determining the level of verification of information required.

**2.2 Allowing lender to rely on information provided by broker.**

We have previously raised our concerns about R260 (3) (*“Reasonable enquiries etc. about the consumer - When not required to make inquiries and take steps to verify”*) and understand that other stakeholders have also raised concerns.

We believe that R260 may, in fact, put some borrowers in a worse situation than they are under current law, and limit the ability of Courts and EDR schemes in relation to responsible lending disputes. We believe that there will be some circumstances where a lender could successfully argue it was reasonable to believe particular information, in circumstances where a responsible lender would have questioned the information or taken steps to verify it. ,

The experience of our service is that the most serious consumer problems have resulted from lenders accepting information provided by a broker, without any verification.

**Recommendation:** R260 should be deleted.

### **2.3 Exempting Activities of Lawyers.**

The exemption for activities conducted by lawyers is too broad. (Transitional and Consequential Provisions) Regulations 5.2(3))

A number of law firms are involved in arranging loans, lending money on behalf of individual clients, or on behalf of a lending body, which may have a relationship with the lawyer or law firm. These loans are usually interest-only type loans, and are often high risk for consumer borrowers.

In a 2004 report<sup>1</sup>, Nicola Howell found that ‘solicitor lending’ could “*cause severe problems for consumer borrowers*”<sup>2</sup> and that this lending involved a range of arrangements. Most commonly, these arrangements include situations where:

- A solicitor facilitates or brokers a loan between an individual client (or a client’s company) and a borrower. (This is distinguished from the situation where the solicitor merely provides advice and/or draws up documentation for a loan that has already been agreed in principle between the parties.)
- A legal practice pools funds from a number of clients, holds those funds on trust, and establishes loans between the borrower and investor clients, with the clients recorded on the documents as the mortgagees and credit providers.
- A legal practice pools investor funds for lending, again holding those funds on trust, and the solicitor’s nominee company is the mortgagee and credit provider.
- A legal practice is very closely associated with a ‘responsible (sic)’ that operates a mortgage investment scheme, seeking and pooling investor funds and managing the loans that are provided by the scheme. (This situation occurs in a number of firms that had large mortgage practices and then transferred the mortgage management to a separate company when the *Managed Investments Act 1998 (Cth)* came into effect.)
- A lawyer or legal practice lends funds directly to individuals or businesses. As shown later, funds provided by or through law firms are typically interest only loans, for a fixed term (normally 1 – 5 years). The loans are usually secured by a first mortgage.”

**Recommendation:** The exemption for legal activities should not exempt the above credit activities.

### **2.4 Referral Only Exemption.**

The exemption for referral only [6.3(2)] is too broad. . (Transitional and Consequential Provisions) Regulations 5.3). We understand the intention behind exempting a person who simply advises another person that a licensee is able to provide a particular credit activity. However, “loan

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<sup>1</sup> 2004, Nicola Howell, “ Solicitor lending to consumers: a study of interest only loans and asset-based lending practices in Victoria “, Consumer Credit Legal Service

<sup>2</sup> *ibid*, p3

introducers” are often involved in irresponsible lending. Loan introducers may advertise – for example offering “easy credit” or the availability of credit to borrowers who have been rejected elsewhere.

**Recommendation:**

We propose that there should not be an exemption where the person has promoted or advertised the fact that the person can arrange or refer for credit. The exemption should also not apply if the person has given made any recommendation or given advice on the type of credit that the individual should obtain.

**2.5 Lack of regulation where a particular credit contract is not specified.**

We are concerned that the laws won’t cover situations where a person provides credit assistance without specifying a particular credit contract or lease (1.27 Commentary on Bill).

We believe that this could allow widespread avoidance, by allowing one “credit activity” to be divided between two businesses – one that is regulated and one that is not.

While the legislation only prohibits the provision of “unsuitable” credit, we expect that the licensing regime should act to prevent misleading conduct in relation to the provision of credit. While two products may not be unsuitable for a consumer, one may be much more suitable than the other. Misleading advice about the benefits of a less suitable (often more expensive) product is a current problem.

We are familiar with a number of examples where credit businesses have structured as two businesses, (as opposed to one), in order to avoid current laws.

In order to avoid the 48% interest rate cap in New South Wales and Queensland, some payday lenders document loans by way of a brokerage agreement with a broker and a loan with the lender. The broker and lender may operate from the same address, and the borrower may be unaware that he or she is dealing with two “separate” entities. The cost of the loan is divided between interest on the loan and a separate broker fee, thereby keeping “within” the 48% interest rate cap.

An example seen by Consumer Credit Legal Service some years ago in Victoria, concerned a business that charged \$3,000 for misleading “mortgage reduction” plans, which involved completing loan application documents. The Legal Service identified some breaches of the Victorian finance broker legislation in the way the fee was disclosed. However, the business structure was quickly changed to create two entities. One business provided the “mortgage reduction” plans for a fee, and then referred to a broker business to arrange the loan.

It appears that such a structure could be established to defeat the intention of the laws in relation to other forms of credit advice. An unregulated business could give advice about the benefits of consolidating debts (another area where the stated benefits are often questionable) and then inform the consumer that a business in the same office (or next door) can arrange such loans. An employee at a department store could recommend that a computer would be best purchased by way of a lease, and then refer the consumer to a broker to arrange the lease with the lender. This could all be done, without the consumer even being aware that there is a broker between the store and the lease or loan provider.



**Recommendation:**

An activity can only be excluded from the definition of “credit activity” if the business simply advises that a particular business provides a particular type of credit, but does not advertise the availability of credit, advertise in any other way that encourages consumers to contact the business in relation to credit and does not provide any advice in relation to the credit products.

**2.6 Further clarity required in obligation to assess ability to pay.**

R165, R265, R290 include the use of the phrase “*at the time the contract is proposed to be entered or the credit limit is proposed to be increased*”. We assume that this has been adapted from the Code section 70(l), however the wording has changed in a subtle way and this, in our view, could alter the meaning significantly.

Section 70(l) says:

*“whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship.”*

In this context what is relevant is what the credit provider knew, or could have ascertained by reasonable enquiry of the debtor at the time. That is, it may refer to future events provided they were known, or ascertainable at the time.

In the Bill the placement of the phrase about timing has shifted so that it refers to whether the consumer could comply with the contract, or whether the contract met the consumer’s requirements and objectives at the time it was proposed to be entered or the limit increased. In short, instead of the relevant issue being what was known at the time, it is whether they could actually comply at the time, or whether it suited them at the time.

This could enable a licensee to argue that it wasn’t required to consider foreseeable future events.

**Recommendation:**

Subsection (1) of sections 165 and 265 should be amended to:

*“will be unsuitable for the consumer if, based on the information known to the licensee at the time of the assessment, or on information that would have been known had the licensee made inquiries or verification as required under [section 150 or 260 respectively].”*

The reference “*at the time the contract is proposed to be entered or the credit limit is proposed to be increased*” should then be removed from the subsequent subsections.

Subsection (2) of section R290 should be similarly amended.

### **3. Dispute Resolution**

#### **3.1 – The proposed \$20,000 cap for Credit List matters**

As stated in the Explanatory Memorandum to the Bill, consumer remedies and ‘private actions’ *“...are considered an important way of influencing and curbing market behaviour”*.

The most significant private actions which would do this are Credit List applications (s70), especially those dealing with over commitment. Typically, consumers often don’t consider whether they have an action in relation to an unjust contract until they are in default, or until proceedings for repossession have been issued. These actions must be able to be brought in a cost free jurisdiction, otherwise they will rarely, if ever, be brought. These claims are also typically above the “small claims” limit.

Once legal proceedings have been issued, consumers no longer have access to external dispute resolution (“EDR”), therefore a cost free jurisdiction that can hear matters exceeding the proposed \$20,000 cap, must be available.

Consumer Action notes that consideration should be given to providing EDR schemes with the power to determine s70 applications where a lender has already issued court proceedings for repossession and/or repayment. This would provide consumer with access to effective and robust dispute resolution process, at a critical juncture . It is generally acknowledged that EDR schemes provide low cost, accessible dispute resolution for many consumers, and Consumer Action would strongly support this approach. Despite this position, Consumer Action accepts that for some cases (for example those where sworn evidence is required), a Court hearing is necessary.

We are not, however, convinced by the stated rationale for the proposed application of a \$20,000 limit.

At 5.20 the Explanatory Memorandum states that 87% of all VCAT general civil applications are under \$10,000. Consumer Action believes that the most significant matters heard in the Credit List (S.70 applications) usually involve sums well in excess of \$20,000, and it is these matters in particular that are likely to raise irresponsible lending issues. We are uncertain whether the figure of 87% quoted in the Explanatory Memorandum relates to the Credit List only or to civil matters generally.

In relation to legal representation, our experience is that credit providers will have legal, or experienced para-legal representation. Some of these matters are very complex – even those for small amounts- and we assume that arguments relating to the unsuitability of products could be quite complex.

**Recommendation: There should be no monetary cap placed on the proposed consumer credit jurisdiction**

#### **3.2 – Admissibility of EDR decisions in Court**

Currently, EDR determinations are not admissible as evidence in Court.

EDR schemes provides low cost, accessible dispute resolution for many consumers.

However, the success of EDR has not entirely dispelled some consumer concerns that accompanied its introduction in Australia, generally precipitated by the fact that it is industry funded. To counterbalance this aspect of EDR, a number of the processes and rules have been developed as a

counter-weight to potential industry bias. For example, the consumer can accept or reject a determination made by an EDR scheme, whereas the industry member is obliged to accept the determination. In a similar vein, we believe it is an important principle, that a consumer who is dissatisfied with an EDR determination can have the matter heard without the EDR determination being admitted in evidence in Court. While it is rare for a consumer to reject a determination and issue legal proceedings, it is important to the integrity of EDR that this can be done, and that any doubts about impartiality of EDR can be dealt with in another forum, (whether those doubts are founded or not).

In further support of this position, it should be noted that EDR determinations are not based on all relevant evidence. Often, evidence that favours consumers (for example, evidence of misleading conduct, made by way of oral statements) cannot be evaluated by an EDR scheme - if that EDR scheme makes its determination solely based on relevant documents. It is potentially highly detrimental, therefore, that such a determination may be considered admissible in Court.

**Recommendation:**

Remove the clause allowing admissibility of EDR Scheme determinations in Court, and retain current status quo.

Delete:

*5.12 The application of section 131 of the Evidence Act 1995 produces the correct outcome in relation to the admissibility of communications undertaken during the course of EDR proceedings. That is, materials used in a negotiation are generally inadmissible in court unless, for example, the parties' consent, where communication between parties includes a statement it was not to be confidential, or proceedings are to enforce the agreement. It is expected that EDR Scheme determinations will be admissible in Court.*

## **5. ACCESS TO JUSTICE**

### **5.1 – Time Limit (section 73 National Consumer Credit Code)**

This section imposes the time limit for taking action in relation to unjust contracts.

For the most part this is reasonable, but it creates a specific problem in the case of equity stripping achieved by multiple refinances.

Equity stripping is often facilitated by short-term contracts that are interest only, sometimes with all or part of the interest pre-paid (capitalised). At the end of the term, (often 12 months), the borrower has no choice but to sell the property of refinance. Where multiple refinances occur prior to the equity being depleted, the two year time limit will often have expired by the time the consumer seeks legal advice (usually in relation to a statement of claim received in relation to the last loan in the chain). The same effect is brought about by multiple refinancing of longer term loans, where the borrower has not been properly assessed for capacity to repay purposes and resolves their difficulties by refinancing.

We have seen many examples of borrowers who have started with a mainstream loan and then refinanced 2-4 times every 1-2 years, with non-conforming lenders who have a higher appetite for risk (and higher prices, accordingly) until the equity in the property has been exhausted. While this problem may be addressed somewhat by the 6 year time limit for the responsible conduct provisions, there may be other aspects of unjustness covered by s70 but not included in Chapter 3 of the Bill.

**Recommendation:**

Consumer Action believes that section 73 of the National Consumer Credit Code should be amended to say two years after the relevant contract has been rescinded, discharged or otherwise comes to an end OR six years from when the relevant contract was entered into or changed, whichever is the later (in line with the time limit for compensation under the Bill).

#### **4. ENFORCEMENT AND COMPLIANCE**

##### **4.1 – Require EDR scheme to report key events involving licensee’s to the regulator**

EDR schemes can be powerless in some cases if no action can be taken for non-compliance. It is inefficient if EDR schemes are required to enforce their decisions contractually through the courts. This would also have the effect of undermining the relationship between the scheme and its members. A simple solution is to create an obligation on the EDR scheme to report key events to the regulator which may impact on the licensee’s ongoing eligibility for a license.

**Recommendation:**

There should be a specific provisions obliging EDR schemes to report key events (such as resignation of membership, and non-compliance with contractual obligations). Reportable events should also include non-payment of amounts due, and failure to comply with determinations, decisions, directions and/or requests for information.

##### **4.2 – Dealing with unlicensed entities**

The Bill makes it an offence to deal with unlicensed entities. It also allows the consumer to seek compensation for unlicensed activities from the unlicensed entity. It does not, however, (as planned in the National Broker Bill, at clause 22) make licensees liable for the conduct of unlicensed entities with which they do business.

The purpose of that section was twofold:

- To eliminate unlicensed conduct by providing a strong incentive on licensees to only deal with other licensees – unlike the prohibition on dealing with unlicensed entities contained in the Bill, this provision can be enforced by affected consumers in addition to ASIC;
- To provide a remedy for affected consumers. The right for consumers to claim from the unlicensed entity itself is of limited value because the entity will not be in EDR. This forces the borrower to use the Court system. Further, the entity may not be able to be contacted or may have left the jurisdiction. Finally, the credit provider may be in the process of enforcing the loan and the consumer will have no rights against the credit provider *per se*. This would allow the credit provider to benefit from an activity expressly prohibited by the legislation (i.e dealing with unlicensed entities).

We do not propose to penalise credit providers who have done all that is reasonably required to check that the relevant entity is appropriately licensed and are caught out by timing issues (eg the license was revoked after the register was checked and prior to settlement of the loan), but those who knowingly do deal with such entity, should be subject to penalty.

**Recommendation:**

Consumer Action recommends that a new section, (similar to s22 of the National Finance Broker Bill), should be introduced to make licensees responsible to the consumer for the activities of any unlicensed entity with whom they have dealt with in relation to the consumer’s loan, provided that the dealings were not the inadvertent result of timing issues, as described above.

**4.3 – Courts power to grant relief from liability from civil penalty provisions (REM190)**

REM 190 gives the court the power to grant relief from liability from civil penalty provisions of the Bill. This is very broad and largely unfettered discretion and appears to undermine the overall intention of the legislation to drive behavioural change in industry for certain types of conduct. Further, it has the potential to impact on the effectiveness and efficiency of enforcement action commenced by ASIC (where the defence is raised automatically and has the potential to prolong proceedings at best and even render them ultimately fruitless).

We suggest that there should be a more specific list of relevant matters for the court to take into account. Such matters should include whether the breach is isolated or part of a pattern of behaviour, whether the licensee has been found liable for a civil penalty under the Bill previously, and what steps have been taken to rectify the breach including whether adequate compensation has been paid to consumers.

It is not clear whether REM190 applies to civil penalty breaches under the National Credit Code. It does not, as in some other sections, specifically exclude the Code provisions, suggesting that they may be caught. If this is the case, this is completely inappropriate, as section 102 of the Code already sets out a comprehensive list of considerations for the Court to take into account in setting a civil penalty for a breach of the relevant provisions of the Code.

**Recommendation:**

Specifically exclude the civil penalty provisions of the National Consumer Credit Code from the operation of REM 190

Create more guidance for the Court on the circumstances in which it is appropriate, and inappropriate, to grant relief from the payment of a civil penalty.

May 22, 2009