

Exposure Draft:
National Consumer
Credit Regime

Submission by
Credit Ombudsman Service Limited

May 2009



SUBMISSION

EXECUTIVE SUMMARY

National Consumer Credit Protection Bill

- A. A licensee should not be liable under R190 of the NCCP Bill if a consumer insists that the licensee submit a credit application despite the licensee's preliminary assessment that the credit contract would be unsuitable for the consumer.
- B. A licensee should not be liable under R192(1) if an alternative credit arrangement is not available to a consumer.
- C. R260(3) should be deleted entirely. The deletion of R260(3) will ensure that it is not used as a defence by a predatory lender to avoid undertaking further enquiry and verification. Its deletion will still allow a credit provider to either rely on the information received from the credit assistant or make further enquiries and verification.
- D. Smaller, less complex organisations do not have the type of resources larger organisations possess. The licensing requirements particularised in LIC170(1)(b), (h), (j), (k) and (l) are potentially costly, difficult and onerous for small operators to comply with.

These operators will be discouraged from applying for an Australian Credit Licence, relying instead on the prospect of a licensee authorising them to be their credit representative. In order to encourage a competitive market, the NCCP Bill should expressly provide for the 'scalability' of licence conditions for small operators.

- E. In all instances under the NCCP Bill where a consumer is referred to the licensee's EDR scheme, the consumer should be directed to the licensee's internal dispute resolution scheme at first instance.
- F. As presently drafted, ASIC will only know if a registered person, licensee or credit representative ceases to be a member of an EDR scheme if it is notified of this. An EDR scheme should be required to advise ASIC where this has occurred.
- G. An EDR scheme should also be required to notify ASIC (a) if an award or order has been made by the Ombudsman against a registered person, licensee or credit representative, but the award has not been complied with; and (b) of cases of serious misconduct by a member.
- H. Licensees and credit representatives should be required to comply with any decision properly made by an EDR scheme under its terms of reference, a failure of which should constitute a breach of its licence conditions entitling ASIC to suspend or cancel a person's registration or licence.

- I. We strongly support the Bill's requirement for a credit representative (and an individual authorised by a body corporate credit representative), to join an ASIC-approved EDR scheme.

Recent developments in relation to Timbercorp and Great Southern Plantations, both of which have now gone into administration, lend compelling support for our position. Both companies used authorised representatives extensively to sell managed investments. Consequently, investors in these products wishing to recover their losses will have no recourse but to seek to recover their losses through costly legal proceedings against these authorised representatives. More accessible and cost effective redress might have been available had the authorised representatives been required, under Chapter 7 Corporations Act, to join an ASIC-approved EDR scheme.

National Credit Code

- J. It is inappropriate for the written notice provided by the credit provider, under sections 66(2A)(b)(ii) and 86(1A)(b) of the NCC, to set out the consumer's rights under the relevant EDR scheme. This is because there is a potential conflict of interest in the credit provider interpreting the rights of the consumer under the scheme. While COSL would be happy to provide its members with a template for this purpose, it would be adequate for the notice to simply advise the consumer of the name of the EDR scheme to which they belong and the contact details of that scheme.
- K. As presently drafted, a loan intended to refinance an existing loan which was used to purchase a residential investment property will not be regulated by the NCC. In relation to the definition of residential property, the NCC does not indicate whether the residential dwelling needs to be built within a certain time of the purchase of the land to be regulated.
- L. The term "reasonably incurred" appearing in section 99 of the National Credit Code should expressly refer to both the amount *and* the incurring of it, in light of other provisions which expressly require the amount of expenses recoverable by a credit provider to be reasonable.
- M. A licensee or credit representative should be prohibited from lodging a caveat against any landed property of the consumer to secure the payment of its fees.
- N. The National Credit Code should require a credit provider to (a) consider in good faith the debtor's financial circumstances, their hardship application and request for a stay of enforcement proceedings; (b) if legal proceeding have not commenced, desist from commencing legal proceedings to recover the debt while the credit provider is considering the debtor's financial circumstances and hardship application; (c) desist from listing a default while it is considering the application; and (d) if the credit provider declines the application, provide the debtor with reasons for declining the application.

1. Our organisation

The Credit Ombudsman Service Limited ('COSL') is an external dispute resolution (EDR) scheme approved by the Australian Securities and Investments Commission (ASIC).

COSL is a not-for-profit company operating exclusively in the non-bank sector. Its membership comprises mainly mortgage brokers, but also includes non-bank lenders, micro lenders, promoters of non-bank residential lending programmes, aggregators and mortgage managers.

As a condition of ASIC's approval, COSL is required to meet the stringent conditions prescribed by ASIC's Regulatory Guide 139, including being impartial, accessible, independent and absolutely free of charge to consumers. Like all ASIC RG139 approved schemes, COSL is controlled by a Board with equal representation from industry and consumer organisations and an independent chair. Determinations made by the Credit Ombudsman bind members but not consumers.

The key objects of COSL are to:

- (a) act as the primary complaints resolution body for the credit industry;
- (b) provide an alternative to legal proceedings for the resolution of complaints between consumers and financial service providers who are members of COSL; and
- (c) ensure the timely, efficient and effective settlement of complaints against its members, having regard to relevant legal requirements, recognised industry codes of practice, good practice in the credit industry and fairness in all circumstances.

Importantly, COSL is able to award compensation in an amount of up to \$250,000 for loss. It is also able to make orders compelling a member to do or refrain from doing specified acts.

The overwhelming majority of mortgage brokers in Australia are either members of COSL or loan writers for whom COSL members have assumed responsibility. Importantly, about 38% of all home loans written in Australia are written by members of COSL or their loan writers.

COSL is the largest EDR scheme in Australia with about 8,500 members, and covers a further 11,300 (non-member) loan writers. COSL's strategic aim is to expand its coverage in the credit industry and so provide more consumers with further access to an EDR process.

About 99% of enquiries and complaints received by COSL are settled by non-adjudicative means, that is, by conciliation, although the Credit Ombudsman does exercise his power to make Determinations, the terms of which are then published on COSL's website.¹

COSL's services are funded by a combination of membership fees and complaint fees paid by its members.

2. This submission

Given the nature and composition of its membership, COSL is in a unique position to comment on the Exposure Bills² and, in particular, the regulation of credit providers, credit services providers and credit representatives in the context of external dispute resolution.

NATIONAL CONSUMER CREDIT PROTECTION BILL ("NCCP Bill")

3. R190 – Entering into an unsuitable credit contract

A licensee should not be liable to a civil penalty if a consumer insists that the licensee submit a credit application despite the licensee's preliminary assessment that the credit contract would be unsuitable for the consumer.

4. R192(1) – Remaining in an unsuitable credit contract

A licensee should not be liable to a civil penalty if an alternative credit arrangement is not available to a consumer.

5. R260(3) – Reliance on information provided by credit assistant

The responsible lending provisions of the NCCP Bill ('NCCP Bill') are commendable and represent a significant improvement to the existing law on unjustness and responsible lending generally.

However, we have significant concerns about R260(3). This provision states that a credit provider is not required to make enquiries about, or take any steps to verify, the information that was used by a credit assistant for the purpose of making a preliminary assessment.

The effect of R260(3) is to shift significant responsible lending obligations from the credit provider to the credit assistant. This is not consistent with the policy objective of having different levels of credit assessment for credit providers and for credit assistants. In fact,

¹ www.cosl.com.au

² National Consumer Credit Protection Bill 2009 and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009

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the effect of R260(3) is that significant obligations of the credit provider under the NCCP Bill are downgraded to a level equivalent to the obligations owed by a credit assistant.

We appreciate that R260(3) is intended to avoid the credit provider having to obtain information already obtained by the credit assistant. We also appreciate that it is qualified by the requirement in R290 that the credit provider must have reasonably believed the information provided by the credit assistant, or would have reasonably believed the information had it undertook enquiries or verification.

However, our experience suggests that some credit providers will contend, quite legitimately, that they were not on notice that the loan application was fraudulently completed by the broker or that the declaration as to capacity to repay was falsely made by the consumer (normally because they are desperate to refinance a loan in default or face losing their home).

These credit providers will therefore assert that they were reasonably entitled to rely on the information in the loan application or borrower's declaration. Under existing law, their assertion cannot generally be challenged. This is because a credit provider has no obligation to obtain proof of the stated income of the borrower, either directly from the borrower or from a third party.³ Furthermore, section 70(2)(l) of the UCCC does not impose a positive obligation on the credit provider to make reasonable enquiries as to the borrower's capacity to repay.

Consequently, our concern is that R260(3) is likely to encourage certain credit providers to dispense with the need to undertake their own enquires or verification on the basis that they reasonably believe the information provided by the credit assistant.

We consider that the objective of the responsible lending provisions in the NCCP Bill will be severely undermined by the very real likelihood that R260(3) will be exploited by predatory lenders as a defence to not undertaking further enquiry and verification, relying instead on the information provided by the credit assistant.

We should point out that information relied by a credit provider is not confined to documentary evidence (pay slips, bank statements), but also covers other information that may be provided to the credit assistant by the consumer (whether true or false) or information that a rogue credit assistant may fabricate in order to ensure that the loan application will be approved. Our experience indicates that this is a reasonably common occurrence.

It is difficult under the present law (both under the UCCC and case law) to make a finding that a loan is unjust. This is because the Courts have insisted that "something more" is required even if the credit provider knew or was on notice that the borrower did not in fact have the capacity to repay the loan, that the security was the family home, and that the borrower was unable to protect their own interests because they were in a position of special disadvantage or disability.⁴ But for R260(3), the NCCP Bill offered the prospect of overcoming this significant limitation.

³ *Accom Finance Pty Limited v Mars Pty Limited*, *Accom Pty Limited v Kowalczyk* (2007) NSWSC 726

⁴ *Perpetual Trustee Company Limited v Albert and Rose Khoshaba* [2006] NSWCA 41 per Basten JA at [128]; other cases where "something more" was required: *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook* [2006] NSWSC 1104 at [93]; *Mortgages v Satchithanatham*; *Cash King v Satchithanatham* [2006]

We consider that if R260(3) is retained, the responsible lending obligations of the NCCP Bill will add little, if anything, to the existing law on unjustness. This would be an unintended consequence and undermine the Government's objective to stamp out predatory lending practices.

We therefore ask that R260(3) be deleted in its entirety. By doing so, it is still open to a credit provider to either rely on the information received from the credit assistant or make further enquiries and verification. The significant difference is that R260(3) will not be used as a defence to avoid undertaking further enquiry and verification.

6. Licensing criteria for small operators – LIC170

We note that much of LIC170 replicates the requirements of the Corporations Act in terms of applying for an Australian Financial Services licence.

It is trite to say that smaller, less complex organisations do not have the type of resources larger organisations possess. The licensing requirements particularised in LIC170(1)(b), (h), (j), (k) and (l) are potentially costly, difficult and onerous for small operators to comply with.

These operators will be discouraged from applying for an Australian Credit Licence, relying instead on the prospect of a licensee authorising them to be their credit representative. If they wish to nonetheless continue to operate in the industry, they would, in the alternative, need to be appointed a credit representative by a licensee (LIC250).

In view of the fact that:

- (a) a licensee is responsible for the conduct of its credit representative, whether or not the credit representative's conduct is within the authority of the licensee (LIC290); and
- (b) there are significant cost implications for a licensee wishing to appoint a credit representative,

we consider that there is every possibility that a large number of small brokers will be forced out of the industry. This has obvious implications for their capacity to earn a living.

Furthermore, there will be a substantial lessening competition if only large brokers and aggregators are able to obtain an Australian Credit Licence and small brokers are effectively excluded.

In order to encourage a competitive market, the NCCP Bill should expressly provide for the 'scalability' of licence conditions for small operators, in particular those relating to:

- arrangements for managing conflicts of interests (LIC170(1)(b));
- internal dispute resolution procedures complying with ASIC requirements (LIC170(1)(h)) – see 7 below;

NSWSC 1303 per Bell J; No Fuss Finance Pty Ltd v Miller [2006] NSWSC 630- Supreme Court of New South Wales, Equity Division, per Justice Barrett; Elkofairi v Permanent Trustee Co Ltd [2002] NSWCA 413 (18 December 2002) per Beazley JA at [54] and [55]

- compensation arrangements (LIC170(j); and
- adequate financial, technological and human resources and formal risk management systems (LIC170(1)(l)).

7. Internal dispute resolution (IDR) procedure

As a general conduct obligation, section LIC170(h)(i) requires a licensee to have an IDR procedure that complies with standards and requirements made or approved by ASIC in accordance with the regulations.

We support the need for licensees to have an effective IDR procedure.

However, we consider that it would be difficult to set standards and requirements that are equally relevant and appropriate for larger organisations as they are for small operators (such as one- or two- person businesses)⁵.

For example, the top down approach advocated by AS ISO 10002 calls for 'top management' to show and promote commitment to complaint-handling within the organisation and to provide resources, support and training to complaints-handling personnel. However, that approach does not readily lend itself to the structure and operations of a one or two person business. We consider that such IDR requirements are not particularly relevant to, or easily implemented by, small operators.⁶

Smaller and sole operators obviously do not have the same resources for handling complaints as larger organisation which generally have the capacity to employ dedicated and well-resourced complaint-handling staff. There are also other pressures on smaller or sole operators which may from time to time hinder their ability to handle complaints within prescribed timelines.

Consideration should therefore be given to providing separate guidance for smaller operators and tailoring this to reflect the realities of their operations.

We suggest that licensees who are single or small operators be required only to:

- (a) record the complaint as having been received;
- (b) acknowledge receipt of the complaint in writing⁷ as soon as reasonably practicable;
- (c) within a reasonable period, provide a substantive response in writing to the consumer which:
 - (i) clearly states the position of the licensee in relation to issues raised in the complaint;
 - (ii) addresses all the issues raised in the complaint; and
 - (iii) states whether the licensee is prepared to settle the complaint and, if so, on what terms; and

⁵ 95% of COSL's membership comprises one to five person businesses

⁶ although we note that AFS licensees, including individual and small financial planners, are already required to have IDR procedures that comply with ASIC's RG 139 and 165

⁷ including electronic communication

- (d) if the licensee rejects any aspect of the complaint:
- (i) provide reasons in writing for this; and
 - (ii) advise the consumer that the licensee is a member of an EDR scheme and provide the details of that scheme.

8. Referral to EDR

We suggest that in all instances under the NCCP Bill where a consumer is referred to the licensee's EDR scheme,⁸ the consumer is directed to the licensee's internal dispute resolution scheme at first instance. In this regard, we note that ASIC's Regulatory Guide 139 recognises that, on the basis of procedural fairness, a licensee should be afforded an opportunity to try to resolve a dispute before it is referred to an EDR scheme.

9. Reporting persons ceasing to be EDR members

LIC210 provides that ASIC may suspend or cancel a person's registration or licence if they are in breach of a condition of their registration or licence, one such condition being EDR membership. ASIC may also issue a banning order against a person if it suspends or cancels the person's licence (LIC315).

As presently drafted, ASIC will only know if a registered person or licensee ceases to be a member of an EDR scheme if they notify ASIC of this (and there does not appear to be an express requirement in the NCCP Bill to do this).

We consider that a far better approach would be to require or authorise an EDR scheme to advise ASIC that a registered person, licensee or credit representative has ceased to be a member of the scheme. We note that clause 19 of the draft Finance Brokers Bill⁹ contained a similar provision.

For instance, a person may cease to be a member of an EDR scheme for a number of reasons:

- they may have not renewed their membership;
- they may have been expelled or suspended from the scheme pursuant to the terms of reference of the scheme;
- their membership may have been cancelled because of the non-payment of membership fees or a monetary award made by the Ombudsman in favour of a consumer;
- they may have failed to comply with a Determination or Order issued by the Ombudsman; or
- they may have resigned from the scheme for whatever reason.

⁸ 66(2A) – Notice of refusal of hardship application; 79A – Notice of a defaulted direct debit payment; 80 – Additional information in a default notice; and 86(1A) – Notice that postponement application not granted.

⁹ released by the Ministerial Council on Consumer Affairs in November 2007

In all these instances, only the EDR scheme will be in a position to notify ASIC that the registered person or licensee (or credit representative) has ceased to be a member of the scheme.

This will give further efficacy to LIC210(1)(a) which provides that ASIC may suspend or cancel a person's registration or licence if they are in breach of a condition of their registration or licence, such as not being a member of an EDR scheme.

10. Credit representatives ceasing to be EDR members

Furthermore, it does not appear to be a requirement of the NCCP Bill for a registered person or a licensee to notify ASIC that their credit representative is no longer a member of an EDR scheme. We do not consider that LIC275(4)(b)(i) imposes such a requirement as it relates only to changes in the details of the EDR scheme. Nor is there a requirement for a credit representative to notify ASIC that they have ceased being a member of an EDR scheme.

Consequently, we also recommend that the NCCP Bill imposes an obligation on an EDR scheme to advise ASIC when a credit representative ceases to be a member of the scheme.

11. EDR member not complying with award or engaging in serious misconduct

An EDR scheme should also be required to notify ASIC:

- if an award or order has been made by the Ombudsman against a registered person, licensee or credit representative, but the award has not been complied with; and
- of cases of serious misconduct by a member (see ASIC's RG139.62(a)).

In doing so, the EDR scheme should be afforded immunity from legal proceedings (such as defamation) by the registered person, licensee or credit representative. Changes to defamation laws introduced on 1 January 2006, whereby corporations can no longer bring actions for defamation, are of little comfort to COSL as a large portion of its members are not incorporated.

Under its terms of reference, COSL is nonetheless able to provide ASIC with such information as it may require (including notification that a member has ceased to be a member or has not complied with a decision or award). However, it would be preferable for an EDR scheme to have the protection of statutory immunity rather than have to rely on the (untested) contractual effect of its terms of reference.

12. Condition of licence to comply with EDR decision

We strongly recommend that licensees and credit representatives should be required to comply with any decision of an EDR scheme properly made under its terms of reference, a failure of which should constitute a breach of its licence conditions entitling ASIC to suspend or cancel a person's registration or licence. We note that clause 14(d) of the draft Finance Brokers Bill prescribed such a requirement.

This will provide a compelling incentive for licensees and credit representatives to comply with decisions of EDR schemes because a breach of a licence condition entitles ASIC to suspend or cancel a person's registration or licence. ASIC is also be able to make a banning order under section LIC315.

Without such a legislative requirement, an EDR scheme's ability to enforce awards or orders will be limited to taking the registered person, licensee or credit representative to court or attempting to claim on their professional indemnity insurance policy. This is not a satisfactory outcome as it involves the EDR scheme incurring significant costs and the consumer facing uncertainty and delays.

13. Requiring credit representatives to join an EDR scheme

We strongly support LIC250(4)(c) which requires a credit representative to join an ASIC-approved EDR scheme. We also note that section LIC257(6)(c) similarly requires an individual authorised by a body corporate credit representative (with the consent of the registered person or licensee) to join an EDR scheme.

The NCCP Bill itself provides compelling reasons for this requirement:

(a) Implications of credit representative acting for two or more licensees (LIC260(1))

Despite LIC295(2) allocating responsibility between two or more licensees for the conduct of a credit representative, there will be instances where it will not be clear under whose authority, if anyone's, a credit representative has acted.

Indeed, clause 2.55 of the Commentary to the Exposure Bills notes that there are "complex factual matters that cannot be readily established" in relation to whether a credit representative was authorised by, or conducted credit activities on behalf of, a registered person. The Commentary suggests that this "will be squarely within the knowledge of the credit representative" who "will be in the best position to both know and demonstrate that their conduct has been authorised by their principal".

Certainly, almost identical provisions under the Corporations Act 2001 (which allocate to multiple AFS licensees responsibility for the conduct of an authorised representative), have not been entirely successful.

The experience of the Financial Industry Complaints Service ('FICS' - which is now part of the Financial Ombudsman Service), is instructive of the difficulties faced by an EDR scheme where an authorised representative (under Chapter 7 of the Corporations Act) is not required to join an ASIC-approved EDR scheme. FICS has been bogged down in disputes over whether the person whose conduct is in question was an authorised representative of the AFS licensee at the relevant time.

The following are examples of Determinations issued by FICS which illustrate this problem:

- (i) In one typical case, the FICS member denied liability and asserted that any responsibility for the representative's acts should be with another licensee.¹⁰
- (ii) Similarly, in another case the FICS member argued that the complaint was directed to the wrong FICS member and that it should be addressed against the FICS member allegedly responsible for representative's conduct.¹¹
- (iii) In another case, the FICS member was potentially responsible for the advice given by an authorised representative who was not himself a member of FICS. It was argued that the authorised representative should not be denied his right to be heard or represented except through the FICS member. It was also argued by the authorised representative that under the *audi partern* rule, a man cannot incur the loss of liberty or property for an offence by a proceeding until he has had a fair opportunity to answer the case against him.¹²
- (iv) In still another case, the FICS member denied liability to the consumer on the grounds that when its authorised representative undertook to invest the consumer's money in a share trading portfolio, the representative did so in his own capacity and not as an agent of the FICS member.¹³

It follows that EDR coverage of credit representatives would substantially reduce the number of likely disputes about, and obviate the need for a consumer to enquire into, whether the conduct of a credit representative was authorised by a particular registered person or licensee. The credit representative would be liable for its own conduct and the consumer would not need to concern itself as to the scope of the credit representative's authority.

(b) Definition of "within the authority"

A representative (which is defined to include a credit representative) bears the onus of proof when asserting, by way of defence, that they were engaged in credit activities on behalf of either the registered or the exempt person, and that their conduct was authorised by or conducted on behalf of that person.¹⁴

¹⁰ <http://www.fics.asn.au/archive/Determination/200712/Determination3406441533.pdf> para [8]

¹¹ <http://www.fics.asn.au/docs/Determination/Determination3327585871.pdf> 4th para page 2

¹² <http://www.fics.asn.au/docs/Determination/Determination3327585934.pdf> 2nd para page 1 and paragraph numbered 7 on page 2

¹³ <http://www.fics.asn.au/archive/Determination/200709/Determination3399357359.pdf>, para [4]

¹⁴ paragraph 2.55 of the Commentary to the Exposure Bills

It is difficult to see how a credit representative would be able to discharge the onus of proof if they are denied the right to be heard or represented except through the EDR scheme of which their principal is a member. We consider that the only way a credit representative could fairly and legitimately raise such a defence is if they were a member of an EDR scheme in their own right.

(c) Credit representative not relieved from liability to consumer

We also note that the following provisions of the NCCP Bill, when read together, lend further support to the necessity of credit representatives being required to join an EDR scheme:

- (i) the client has the same remedies against a registered person or licensee as it has against a credit representative: LIC310(1);
- (ii) the credit representative and registered person or licensee are jointly and severally liable to the client in relation to those remedies: LIC310(2); and
- (iii) a credit representative is not thereby relieved from any liability that they may have to the client or the registered person or licensee: LIC130(4).

There are other compelling reasons for requiring a credit representative to join an ASIC-approved EDR scheme:

(d) Where the licensee no longer trades or is in administration

The recent Queensland Court of Appeal decision in *Delmenico v Brannelly & Anor*¹⁵ illustrates the consequences of a licensee going into external administration. As the licensee was not party to the proceedings (it was in administration), the client of the licensee was left to pursue the corporate authorised representative and individual adviser (a director of the corporate representative) who were alleged to have caused the client financial loss.

The cost of such legal proceedings is far too prohibitive for the average consumer. Requiring credit representatives to be members of an EDR scheme therefore provides such consumers with an effective and free alternative to costly legal proceedings.

It might be noted that some 95% of COSL members comprise one to five operators only, many of whom operate as companies which, anecdotal evidence suggests, have a nominal share capital. Our records indicate that many COSL company memberships are cancelled or not renewed because the company no longer trades for one reason or another.¹⁶

¹⁵ *Delmenico v Brannelly & Anor* [2008] QCA 74

¹⁶ In the 12-month period January 2008 to December 2008 alone, 130 COSL members resigned or did not renew their membership because they had ceased trading or had their membership cancelled because they went into liquidation or administration.

If credit representatives acting for these companies are not required to be members of an EDR scheme, consumers dealing with them would be forced to pursue their claims against them in Court in the event that their principals cease trading or are in administration.

(e) Credit representatives are the first point of contact for consumers

The draft Finance Brokers Bill 2007¹⁷ required a representative of a licensee to join an approved EDR scheme, despite the draft Bill also requiring the licensee to be responsible for the acts of the representative.¹⁸

The requirement was in recognition of the results of a survey commissioned by ASIC which found that 22% of brokers sent their representatives to consumers' homes and 14% sent their representatives to a consumers' workplace.¹⁹

When one considers that the worst cases of inappropriate and predatory lending practices referred to COSL almost invariably involve representatives of brokers who miss-sell loans to persons unable to afford them, it is a matter of serious concern that these representatives are not required to be members of an EDR scheme, particularly since they are generally the first point of contact for consumers. The same can be said about representatives of brokers who promote mortgage minimisation and budget monitoring services in inappropriate circumstances.²⁰

(f) ASIC will be regarded as endorsing credit representatives

In the case of *Hayes v ASIC*²¹, the Deputy President of the Administrative Appeals Tribunal, Mr Rodney Purvis Q.C, agreed with the submission made on behalf of ASIC that:

“When a person is licensed as an authorised representative, ASIC effectively endorses that person to the public as reliable and a person in whom consumers can place trust and confidence. ASIC views this public aspect of the role as a serious matter relevant to the confidence of the market and consumers generally.”

It would be reasonable to assume that, under the NCCP Bill, ASIC would also be seen as endorsing credit representatives as reliable and trustworthy. It appears to us that ASIC would be in a far better position to do so if credit representatives were required to join an approved EDR scheme.

¹⁷ released by the Ministerial Council on Consumer Affairs in November 2007

¹⁸ clauses 23(a), 23(b) and 23(c) of the draft Finance Brokers Bill 2007

¹⁹ ‘A Report on the Finance and Mortgage Broker Industry (March 2003)’ prepared by the Consumer Credit Legal Centre (NSW) Inc.

²⁰ for an explanation of these terms, see para 2.16 of the National Finance Broking Regulation, Regulatory Impact Statement Discussion Paper at:

http://www.consumer.gov.au/html/nat_finance_broking/downloads/national_finance_broking.pdf

²¹ *Hayes and Australian Securities and Investments Commission* [2006] AATA 1506 at [73]

(g) Consumer redress available despite credit representatives not having PII

The fact that the NCCP Bill does not require a credit representative to have its own professional indemnity insurance (PII) cover does not mean that there is no utility or benefit in requiring them to join an EDR scheme.

The fact is that COSL has not to date made a claim on the PII policy of any of its members. This is because the average compensation received by or awarded to a consumer²² is less than \$4,000.²³ This amount is below the amount of the 'excess' that is payable by a COSL member broker under the standard PII policy arranged by Security & General. Where the compensation agreed to or awarded is for a greater amount, it appears that scheme members still prefer to pay the amount from their own pockets rather than claim on their PII policy and risk higher premiums being imposed on renewal or not having their policy renewed at all.

(h) Credit representative ceases to act for licensee

COSL has encountered numerous cases where a representative (eg. a loan writer or contractor) against whom a complaint is made no longer acts for its principal. This may occur where, for example, the principal has revoked the representative's authority to act on its behalf; the representative becomes a representative of another person; or the representative leaves the industry.

In these circumstances, the principal is generally unable to deal effectively with the complaint against its former representative because it cannot compel the representative to provide their version of events or documents pertinent to the complaint. The representative will usually be in possession of their own internal working papers and file notes which are often crucial to the consideration of a dispute by an EDR scheme, but which are unlikely to have been made available to the principal.

Even if there is an agreement between the principal and the credit representative under which the latter is obliged to provide such documents to the principal, it would be impractical, time-consuming and costly for the principal to enforce this obligation through legal proceedings. This would not be an ideal outcome for consumers either.

The NCCP Bill's requirement that a credit representative join an approved EDR scheme will allow the scheme to seek these documents directly from the credit representative. If the credit representative refuses to provide the scheme with the requested documents, an inference may be drawn that the documents would not have corroborated the credit representative's version of events.²⁴

²² for the 12-month period ending 30 April 2009

²³ compensation in relation to credit-related disputes is almost always substantially less than that of investment-related disputes

²⁴ *Katsilis v Broken Hill Pty Co Ltd* [1977] 18 ALR 181, per Barwick CJ; *Allen v Tobias* [1958] HCA 13; (1957-1958) 98 CLR 367 at 375

It does not appear that an EDR scheme would be able to draw a similar inference where the principal is unable to produce the credit representative's documents. This is because the principal would not have been the provider of the actual services the subject of the complaint.²⁵

Consequently, simply making the principal responsible for the conduct of its former credit representative would not generally assist a consumer in obtaining redress where the consumer is unable to make out its case without the credit representative's co-operation.

It follows that in these circumstances, a consumer's ability to seek effective redress can only be assured if the credit representative is a member of an approved EDR scheme in its own right.

(i) Cost/benefit considerations

We consider that the NCCP Bill's requirement that credit representatives join an EDR scheme will provide enhanced consumer protection and effective access to redress that may not be otherwise available.

This consumer benefit, in our view, easily outweighs the likely cost of EDR membership for credit representatives. While we are still working on our financial modelling for membership fees, we anticipate that credit representatives will pay between \$100 and \$200 per year for membership.²⁶

Being a member of COSL will also entitle each credit representative to one free complaint voucher per membership year.²⁷ Consequently, if a credit representative is the subject of a complaint received by COSL, the complaint fees that would otherwise be payable for that complaint²⁸ would be waived. Obviously, the credit representative would still be liable for any award that may be issued by the Ombudsman.

NATIONAL CREDIT CODE

14. Hardship threshold

We welcome the Commonwealth Government's decision to:

- increase to \$500,000 the monetary threshold under which debtors with loans not exceeding that amount may seek assistance from credit providers if they are experiencing financial hardship;

²⁵ the principal is not vicariously responsible for the acts of the representative because the representative is an independent contractor, not an employee or agent of the broker principal

²⁶ a one-off nominal application fee may also be payable towards the cost of establishing and maintaining their membership records

²⁷ subject to the condition that all other fees have been paid by their due date – see www.cosl.com.au

²⁸ on average, this was \$315 per closed complaint for the period 1 March 2008 to 28 Feb 2009

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- allow a debtor to request the Court to postpone enforcement proceedings where the maximum amount of credit is not more than \$500,000; and
- require the credit provider to respond to the debtor within 21 days of the debtor's application for a payment variation on grounds of financial hardship.

The new threshold will enable a significantly greater number of people to benefit from the consumer protection provisions of the Exposure Bill where they can show that their financial hardship is only temporary and that a payment variation will enable them to meet their loan commitments.

However, we note that the National Credit Code merely entitles a debtor to apply for a hardship variation. It makes no mention of the debtor's ability to seek a stay of enforcement proceedings at the time of applying for a hardship variation under section 66.

As currently drafted, the National Credit Code does not oblige a credit provider to:

- consider in good faith a debtor's application for a stay of enforcement proceedings;
- consider an application for a payment variation in good faith (for example, to assess the application without taking into account matters extraneous to section 66 such as the debtor's previous payment history²⁹ or previous hardship applications); and
- advise the debtor of its reasons for declining the application.

It is also noted that under section 68(2), a Court is limited to changing the credit contract in a manner set out in section 66. Unfortunately, section 66 continues to limit the types of variations that a debtor may seek from the credit provider on grounds of financial hardship.

There is no policy or practical reason for excluding, for example, a change in the interest rate applying to the loan as a type of payment variation that a debtor might seek from their credit provider. There are other types of variations that may also yield practical and beneficial outcomes for both parties in the particular circumstances.

In view of the above, we strongly recommend that the National Credit Code also require a credit provider to:

- (a) genuinely consider in good faith the debtor's financial circumstances and hardship application;
- (b) if legal proceeding have already commenced, consider in good faith an application by the debtor for a stay of enforcement proceedings;
- (c) if legal proceeding have not commenced, desist from commencing legal proceedings to recover the debt while the credit provider is considering the debtor's financial circumstances and hardship application;
- (d) desist from listing a default while it is considering the application;
- (e) consider other types of temporary payment arrangements, including reducing interest rates, allowing interest-free payments, postponing loan repayments, increasing credit limits and deferring or waiving arrears and fees and charges; and

²⁹ Capital Finance Australia Ltd v Fairservice [2006] VCAT 624

- (f) if the credit provider declines the application, provide the debtor with reasons for declining the application.

The Code of Practice of the Mortgage and Finance Association of Australia ('MFAA') requires precisely this of its members. While we encourage other peak industry bodies to revisit their respective codes of practice and at least match the MFAA's hardship provisions, it is an appropriate regulatory response for these additional requirements to be incorporated into the National Credit Code because not all licensees and credit representatives will be members of an industry association or subscribers to an appropriate code of conduct.

We consider that our proposed amendments will:

- reflect the seriousness and expediency with which a hardship application should be considered by a credit provider;
- accommodate the legitimate expectations of the debtor applicant;
- ensure that default interest and fees and enforcement costs are kept to a minimum; and
- ensure that the applicant's rights are not adversely impacted and that he or she is not denied alternative courses of action that may have otherwise been available to the applicant.

On a separate issue, it is inappropriate for the written notice provided by the credit provider under sections 66(2A)(b)(ii) and 86(1A)(b) to set out the consumer's rights under the relevant EDR scheme. While COSL would be happy to provide its members with a template for this purpose, it would be adequate for the notice to simply advise the consumer of the name of the EDR scheme to which they belong and the contact details of that scheme.

15. Residential investment property

As presently drafted, a loan intended to refinance an existing loan which was used to purchase a residential investment property will not be regulated by the National Credit Code.

In relation to the definition of residential property, the National Credit Code does not indicate whether the residential dwelling needs to be built within a certain time of the purchase of the land to be regulated.

16. Enforcement expenses

Enforcement expenses are expressly excluded from the National Credit Code's definition of "credit fees and charges".³⁰

Section 99 of the National Credit Code provides that "a credit provider must not recover or seek to recover enforcement expenses from a debtor, guarantor or mortgagor in excess of those *reasonably* incurred by the credit provider" (my emphasis).

There is a view that the term "reasonably" as appearing in the equivalent section 99 of the UCCC should refer to both the amount *and* the incurring of it, in light of other provisions of the UCCC which expressly require the amount of expenses recoverable by a credit provider to be reasonable.³¹ It has been argued that section 99 should be construed similarly to those sections.³²

However, the fact that section 99 is worded differently to those other sections may strengthen the view that section 99, unlike the others, only requires that the expenses be reasonably incurred.

It is worth noting that the costs of enforcement can quickly increase into tens of thousands of dollars.³³ Indeed, *Ristic v Greater Building Society Ltd*³⁴ gives a good indication of how costs in mortgage cases can quickly accrue. In 1998, Mr Ristic had a \$20,000 loan. In 2001, the balance of the loan account had reached \$92,937. Of this, the solicitor's costs and costs of the enforcement proceedings totalled \$72,294.

Consequently, we recommend that it be made clear that the term "reasonably" in section 99 of the National Credit Code refers to both the amount *and* the incurring of the enforcement expenses.

17. Caveats

We strongly recommend that a licensee or credit representative be prohibited from lodging a caveat against any landed property of the consumer to secure the payment of its fees or commissions. This is a reasonably common but offensive practice.

³⁰ Section 186A, reflecting Schedule 1, Clause 1 Consumer Credit Code

³¹ For example, s 55(1) UCCC provides that a guarantee is void to the extent it secures an amount that exceeds the sum of the amount of the liabilities of a debtor under the credit contract and "reasonable expenses of enforcing the guarantee". See also s 78(8)(d) (the credit provider can only deduct its "reasonable enforcement expenses" from the sale proceeds of mortgaged goods) and s 45(1) (a mortgage is void to the extent it secures an amount that exceeds the amount of the liabilities of the debtor under the credit contract and the "reasonable enforcement expenses" of enforcing the mortgage).

³² D McGill and L Willmont Annotated Consumer Credit Code (LBC Information Services, Pyrmont NSW, 1999) at 648

³³ Lovric and Millbank 'Darling, please sign this form: a report on the practice of third party guarantees in New South Wales' (NSW Law Reform Commission and the University of Sydney, Research Report 11, 2003) at para 8.30-8.32.

³⁴ [2002] NSWCA 266