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Manager
Consumer Credit Unit
Corporations and Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email: consumercredit@treasury.gov.au

Dear Sir/Madam

Submission on 'The National Consumer Credit Reform Package'

1. I specialise in comparative consumer law, serving for example on the Editorial Boards of the *Yearbook of Consumer Law* and the *Australian Product Liability Reporter*.¹
2. I strongly agree we need re-regulation of Australia's consumer credit markets, as proposed in 'The National Consumer Credit Reform Package'.² Below I consider some improvements that could be made regarding an External Dispute Resolution scheme. But I begin by supporting a key improvement proposed in the National Consumer Credit Protection Bill: imposing responsible lending rules (focused on 'suitability' and repayment capacity).
3. Such rules have parallels with more longstanding fair trading legislation requirements on suppliers to provide goods that are both 'fit for purpose' and of general 'merchantable quality' (eg not unsafe). In today's increasingly service-based economy, the law should promote economic as well as physical security.³ Restoring consumer confidence is particularly important during this recession in Australia and the world's major economies, and underpins a parallel comprehensive revamp underway for other consumer law nation-wide.⁴
4. Imposing such 'know-your-customer' rules in consumer credit will bring Australia in line with other areas of law too, and with several other jurisdictions. They have long been found in legislation protecting those

¹ www.law.usyd.edu.au/about/staff/LukeNottage

² <http://www.treasury.gov.au/consumercredit/content/legislation.asp>

³ See also Bar-Gill, Oren and Warren, Elizabeth, "Making Credit Safer" NYU Law and Economics Research Paper No. 08-27; University of Pennsylvania Law Review, Vol. 157, 2008; Harvard Law School Program on Risk Regulation Research Paper No. 08-3 at <http://ssrn.com/abstract=1137981>

⁴ See <http://www.eastasiaforum.org/2009/03/25/australias-lethargic-law-reform-how-not-to-revive-consumer-spending/>

investing in securities. The rationale given is often the complexity of such products. Yet loan transactions are also complex for most individual consumers. So countries like Japan have now enacted such rules to restore confidence in both unsecured lending and sales credit markets.⁵ More generally, suitability rules are now widely found in OECD member countries, through administrative/criminal law and/or private law.⁶

5. Such developments recognize pervasive and persistent market failures, especially information asymmetries and behavioural biases (such ‘over-optimism’ bias) favouring suppliers.⁷
6. Problems are exacerbated in Australia after the Global Financial Crisis. Competition has been drastically reduced in favour of its four big banks, which (ironically) have enjoyed large profits.⁸
7. There is also more awareness world-wide about the strong interrelationships among different financial markets nowadays, and between them and the real economy.
 - a. In the US, burgeoning unsecured consumer debt (particularly through credit cards) was a major factor behind the growth in subprime mortgages, marketed as a means of lower-cost refinancing. This fueled the boom in securitisation and other financial markets, followed by the inevitable bust.
 - b. Australia was lucky – rather than deliberate – to have missed out on much growth in securitisation, although several non-bank institutions (now mostly bankrupt or bought out) did take advantage of the then booming markets in the US to secure low-cost funds for on-lending here. Relatedly, Australia also had less (clearly) sub-prime mortgage lending. But mortgage loans did balloon anyway, and (ironically) they are still being encouraged through ongoing “first home owner” grants and other measures from both federal and state governments.⁹ And behind this lies similar long-term growth in credit card debt, and growing evidence of sharp practices in unsecured consumer credit markets more generally.¹⁰
8. The proposed Bill’s requirements for responsible lending are therefore well overdue. If they had been implemented earlier, as many have called for over the years, we might have averted such a serious financial crisis.
9. Comparing more closely Japan’s legislation enacted already in 2006,¹¹ however, the following might be considered for our Bill:
 - a. A rule (or at least a presumption) that the consumer has “incapacity to repay” when the proposed loan payments would exceed more than one-third (or some other clear percentage) of his or her net income;

⁵ See Kozuka, Souichirou and Nottage, Luke R., “Re-Regulating Unsecured Consumer Credit in Japan: Over-Indebted Borrowers, the Supreme Court, and New Legislation” (September 2007) Sydney Law School Research Paper No. 07/62 at SSRN: <http://ssrn.com/abstract=1019392>

⁶ OECD Project DTSI/CP(2006)8: see “The Report on OECD Member Countries’ Approaches to Consumer Contracts” (6 July 2007, at <http://www.oecd.org/dataoecd/11/28/38991787.pdf>)

⁷ See Kozuka, Souichirou and Nottage, Luke R., “The Myth of the Careful Consumer: Law, Culture, Economics and Politics in the Rise and Fall of Unsecured Lending in Japan” (with Souichirou Kozuka) in Johanna Niemi-Kiesilainen, Iain Ramsay & William Whitford (eds) *Consumer Credit, Debt and Bankruptcy: National and International Dimensions* (Hart, Oxford, forthcoming 2009); available soon via www.ssrn.com or on request.

⁸ See <http://business.smh.com.au/business/smash-and-grab-days-may-be-over-for-the-big-banks-20090515-b61n.html>

⁹ See again <http://www.eastasiaforum.org/2009/03/25/australias-lethargic-law-reform-how-not-to-revive-consumer-spending/>, and also now <http://www.smh.com.au/national/rudd-advisers-criticise-home-buyers-grant-20090515-b62w.html>

¹⁰ See eg the ACCC’s efforts regarding debt collection practices: <http://www.accc.gov.au/content/index.phtml/itemId/622458>. In New Zealand, see also <http://www.eastasiaforum.org/2008/10/09/financial-crisis-and-loansharks-in-japan-and-nz/>

¹¹ See again See Kozuka, Souichirou and Nottage, Luke R., “Re-Regulating Unsecured Consumer Credit in Japan: Over-Indebted Borrowers, the Supreme Court, and New Legislation” (September 2007) Sydney Law School Research Paper No. 07/62 at SSRN: <http://ssrn.com/abstract=1019392>.

- b. An interest rate cap (even if set at a high level), applied consistently across Australia (in contrast to the variable rates nowadays).
10. We might also go a step further and require Australian credit suppliers to notify ASIC – as well as borrowers themselves – if they have actual or constructive knowledge that their products are associated with abnormally high levels of borrower stress (such as suicides or declared insolvency rates, compared to industry averages). The analogy here with similar duties on suppliers of consumer *goods* to notify regulators of serious product-related accidents. That duty is imposed now in the US, the EU, Japan (since 2006), China (since 2007) and probably soon Canada (currently before Parliament). A variant was also recommended by our Productivity Commission in 2008. Our Consumer Law Roundtable and Choice are pressing for its inclusion in the proposed new nation-wide Consumer Law.¹² I propose here to extend a similar notion, for similar policy reasons, to the National Consumer Credit Protection Bill.
 11. Lastly, I welcome the proposed Bill's requirement (also long called-for) that mortgage brokers be properly regulated and that all Australian Credit Licencees be required to be members of an External Dispute Resolution scheme (in the shadow of standards set by ASIC).
 12. However, experience from other industry “ombudsman” schemes (eg telecommunications) shows that to reduce disputing and poor customer relations, it is not enough for such schemes to be provided for “free” to consumers. For the schemes to work, even though they do not (yet) involve court-like processes, it is often necessary for consumers to seek legal or professional help. But the schemes typically do not allow a wronged consumer to claim any expenses for such necessary assistance, in contrast to most courts. Suppliers know this, so they have incentives to not settle claims quickly or for amounts not reflective of the actual costs involved for consumers. A solution, which should be added to the Bill, is a requirement for the proposed scheme for Credit Licencees to include a “consumer advocate” service available to deserving consumer complainants, whose costs (borne otherwise by the scheme) could be claimed back from the service provider who is found to be at fault (either through a settlement reached, or a subsequent binding determination).
 13. A second improvement for our legislation would be to clarify whether the scheme is based on administrative law, arbitration law, or contract law. The question has already led to litigation for other schemes. The answer has not yet emerged, but it has various implications (eg the standards of “natural justice” expected, whether consumers or just industry members can complain about those, and whether there can be appeals to the courts for substantive errors of law).¹³

Please let me know when this and other Submissions are made available online. I am happy to be consulted further on this matter.

I also extend an invitation to the Minister or Treasury officials to attend the fourth annual Consumer Law Roundtable, bringing together consumer law academics, policy-makers and peak NGOs for discussion of pressing issues such as this credit law reform. It will be held at Sydney Law School on 4 December, with funding from the ARC's Asia-Pacific Futures Research Network to invite leading two consumer law experts from Japan and New Zealand respectively.

Yours truly

Luke Nottage

¹² See <http://www.treasury.gov.au/contentitem.asp?ContentID=1501&NavID=>

¹³ See further Nottage, Luke R., “Consumer ADR and the Proposed 'Consumer Law' in Australia: Room for Improvement” (March 29, 2009). Sydney Law School Research Paper No. 09/10 at SSRN: <http://ssrn.com/abstract=1370106>

