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Green Paper on National Credit Reform

Corporations and Financial Services Division

The Treasury

Langton Crescent

PARKES ACT 2600

Green Paper on National Credit Reform

NLA Response

Introduction

National Legal Aid (NLA) represents the Directors of the eight State and Territory Legal Aid Commissions (Commissions) in Australia. The Commissions are independent statutory authorities established under respective State or Territory enabling legislation. They are funded by State or Territory and Commonwealth governments to provide legal assistance to disadvantaged people.

NLA aims to ensure that the protection or assertion of the legal rights and interests of people are not prejudiced by reason of their inability to:

- Obtain access to independent legal advice;
- Afford the appropriate cost of legal representation;
- Obtain access to the Federal and State and Territory legal systems; or
- Obtain adequate information about access to the law and the legal system.

NLA welcomes the opportunity to comment on the Green Paper for National Reform **("the Green Paper").**

NLA acknowledges the significance of the national consumer credit framework as marking a generational change that will significantly improve the effectiveness of consumer protection.

Having regard to the size of the Green Paper and the timeline available for comment, it is not possible to provide detailed comments on all aspects of the paper.

This submission focuses on issues that will directly impact on consumers. It identifies possible gaps in coverage that could be addressed including:

- The imposition of a national interest rate cap;
- Reforms to existing laws regulating credit cards; and
- Reform to unfair practices in consumer leases and short term lending as well as providing better protection to reduce the incidence of predatory lending and equity stripping, particularly for the most disadvantaged.

We also believe a number of enhancements could be made that will provide better protection for consumers in circumstances of financial hardship, particularly where Court proceedings are being contemplated by the lender.

NLA's comments are informed by Commission case work experience with consumers in dispute with credit providers and/or intermediaries in relation to the provision of credit across all the States and Territories.

Response

Chapter 1 – Credit for Small business

NLA supports the extension of basic protections and obligations under the Credit Act and National Credit Code to small business lending (**Option One**), which we would hope would include extending the default notice provisions to small business loans.

NLA believes that it is essential that all consumers have access to justice to an EDR Scheme. This gives consumers access to a free or low cost way to resolve disputes.

Licensing is also essential for small business lending to ensure:

- Compulsory membership of EDR;
- Recording and monitoring of lending practices;
- Reduced predatory lending to small business; and

- Less general avoidance of the credit laws by including as many lenders as possible into the protection regime.

NLA notes that with such reform there would need to be a concomitant development of the responsible lending provisions to apply to guarantors of business loans. The current gap in coverage for guarantors who guarantee a business loan is of considerable concern. Our casework experience is that there is a concerning number of instances where vulnerable elderly people are unconscionably induced into providing their residential home as security for a friend or relative's business loan. Enhanced lending obligations in such cases would be of considerable benefit to ensure such practices are better regulated.

Chapter 2 – Regulation of Credit Cards

The level of credit card debt in Australia based on current rates of debt growth[1] is concerning.

The social and economic costs of unfair lending and market practices are becoming increasingly apparent amongst consumers, who have relied on easy credit to spend above their means.[2] This is particularly the case for disadvantaged consumers who form our client base, and who often have fewer options to address debt.

Our case work experience reflects available research, which illustrates that the specific regulation of credit card products has not kept pace with the development of these products. This has led to inappropriate lending and unfair market practices, with significant implications for disadvantaged consumers.

In response to these concerns, we support each of the six options outlined for reform by the **Ministerial Council on Consumer Affairs (**MCCA) in 2008. [3]

In addition to the MCCA Options, further reform will be needed to tighten up the assessment of lending and further limitations will need to be placed on unsolicited credit card increases.

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[1] In February 2010, Australian owed $47.1 billion on their credit cards ($34 billion of which accrued interest

[2] See NLA response to Q 1 for further details.

[3] MCCA Regulatory Impact Statement, *Responsible Lending Practices in Relation to Consumer Credit Cards*, August 2008

In NLA's view, the appropriate legislative response will need to involve a combination of enhanced remedial measures with specific preventative measures.

The key regulatory responses which we suggest are urgently needed for implementation, are outlined below and ranked[4] in terms of importance to consumer concerns:

1. MCCA Option Three - prohibit the card issuer from providing more credit than the consumer can repay from their income without substantial hardship;

2. Require that the assessment of determining the consumer's ability to repay the loan should be based on a loan period for complete repayment of 2 year loan;

3. MCCA Option Four - provide relief for the consumer by making the debt unenforceable to the extent that it exceeds an amount granted in accordance with Option three - with significant civil penalties applying for breach of Option four;

4. Prohibit unsolicited credit card increases;

5. MCCA Option Two - require credit providers to allow consumers to nominate their credit limit;

6. MCCA Option Six - require card issuers to increase the minimum repayment percentage for new credit card contracts (only) and for offers of increased credit limits on current cards;

7. MCCA Option Five - require card issuers to warn consumers about the effect of paying only the minimum repayments; and

8. MCCA Option One - change the timing of provision of essential information.

[4] Most important regulatory response is ranked #1 with least effective (in terms of ability to effect systemic change) response ranked #8.

There is also a need for an equally robust public reporting regime against these requirements. Improved public reporting will mean better accountability to regulatory authorities and the Australian community at large.

1. To what extent is credit card debt causing financial hardship?

NLA agrees that credit card debt is the largest single cause of debt problems in the consumer credit market.[5]

In soon to be released Victorian based research involving bulk waiver of credit-related debt, the vast bulk of that debt – upwards of 80% - is related to credit card debt. Of the 102 clients surveyed, 60 of those consumers were defined as 'special circumstances' clients, meaning they suffered from one or more of the following – homelessness, mental or physical illness, gambling and/or alcohol addiction, domestic violence and carer responsibilities. The research suggests that most, if not all of the clients, were given inappropriate credit card limits (or limit increases) which were then rigorously enforced by debt collectors against judgment-proof debtors.

Recent research also suggests that whilst credit card debt is no doubt a problem for the most disadvantaged, credit card debt is increasingly becoming a middle class problem.[6] Research also suggests an increase in bankruptcies in this demographic group. [7]

A recent study by the NSW Consumer Credit Legal Centre of callers to their Credit & Debt Hotline over a 2 year period suggests that advice on credit card debt was by far the greatest concern for callers to the Hotline.[8] Of the 2553 callers to the Hotline,

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[5] This proposition has been consistently put forward by specialist consumer representative organizations for a number of years. See for instance the submissions presented CCLC and Legal Aid NSW to the Ministerial on Consumer Affair Consultation – RIS on the Responsible Lending Practices in relation to Consumer Credit Cards, 2008

[6] See for instance "The Next Meltdown: Credit Card Debt", Business Week, Online Edition, October 20, 2008, Professor Keen

[7] In a recent report on personal insolvency over the last two decades, Professor Ramsay reports that there "is strong evidence that bankruptcy is becoming more of a middle class phenomenon" cited in "Bankruptcy Rates Rise for the Middle Class", Chris Zappone, *BrisbaneTimes.com.au*, 24 March 2009

[8] Credit card debt enquires represented three times the level of enquiry of any other loan product, including home loan, personal loan and motor vehicle loan. CCLC Submission to the Ministerial on Consumer Affair Consultation – RIS on the Responsible Lending Practices in relation to Consumer Credit Cards, 2008, p.4

58% were low income earners. [9] However, a further 15% were middle-income earners.[10]

Credit card debt also impacts on mortgage stress. Commission experience is that the two, more often than not, go hand in hand. The widespread mortgage stress currently faced by so many consumers today may not have become as severe if limits had already been put in place to halt irresponsible credit card lending practices. Easy credit fuels the continuation of unhealthy and unsustainable credit card habits and fails to protect the most vulnerable members in our community from falling further into the cycle of poverty.

NLA is able to provide case studies from Commissions which illustrate the impact of credit card debt on mortgage stress.

2. What practices in relation to credit cards are perceived to be unfavourable?

There are a variety of harsh and unfair practices used by credit providers in relation to credit cards. These are well documented in reports, many of which are cited in the Green Paper. [11]

3. What is the impact of these practices on consumers?

The exploitative practices of credit card providers have led to significant credit card debt and widespread credit card stress. [12] As with mortgage stress, there is a concomitant social cost to consumers and the community at large of ever-present concerns of not being able to manage finances.

We also refer to our introductory remarks to this Chapter and our response to Questions 1 & 2 for further details.

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[9] <$26,000 pa op cit at p.6

[10] ibid

[11] See, for example Standing Committee on Economics, Final Report on Inquiry into the ASIC (Fair Bank and Credit Card Fees) Amendment Bill 2008; *Card Games*, Choice, October 2006 and *Which Credit Card for You*, Choice, January 2010; Australian Credit Cards Fail UK Standards', Choice, 25 January 2009

[12] A recent *Australian Debt Study* by Galaxy Research for Veda Advantage found that 82% of Australians are worried about their ability to repay their debt over the next 12 months, March 2010.

4. Do these practices reflect the costs to industry of providing these services?

No. The following are two recent examples:

a. Bank fees exposed by the Reserve Bank

In 2008, the banks charged $1.2b in penalty fees out of a total of $11.6 billion of fee income earned in the same year. Recent reporting states that industry has accepted that more than three-quarters of the penalty fees - $954 million - could be avoided by consumers. The big banks now face the largest class action in Australian corporate history for overcharging their millions of customers about $5 billion in penalty and late fees over the past six years.[13]

b. Interest rates movements not reflecting Reserve Bank official rates of borrowing

A recent report from the Sydney Morning Herald states:

> *"Credit card providers are raking in close to $90 million extra each month in interest payments by disregarding the movements of the Reserve Bank on official rates. Since the onset of the global financial crisis in late 2008, credit card rates have risen and fallen outside changes to official interest rates. So-called low-rate cards have attracted an average interest rate ranging from 11.43 per cent to 13.26 per cent, while rates on standard cards, which often include expensive rewards programs, have ranged from 18.43 per cent to 19.65 per cent. However, interest rates today would be about three percentage points lower if credit card companies had passed on in full every increase and decrease in official rates since October 2008."*[14]

Analysis by The Sun-Herald also found that no-frills cardholders, a growing number of whom are using credit to pay for household essentials because of mortgage stress, have been slugged with a bigger proportional increase in interest rates than those with more sophisticated cards. [15]

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[13] See 'The Bank Slayers' , *smh.com.au*, 12 May 2010
[14] 'Credit Cards Bonanza', Melissa Singer, *smh.com.au*, 25 July 2010
[15] 'Credit Cards Bonanza', Melissa Singer, *smh.com.au* , 25 July 2010

5. What key information is useful to be disclosed or should be made more prominent? When and how should this information be disclosed?

A summary of the key features of the credit card should be displayed prominently at the time of applying for credit and in monthly credit card statements. Key features would include:

- amount of credit
- annual percentage rates
- calculation of interest charged
- repayments
- credit card fees and charges (ie a summary of fees and charges)
- other key enhancements as foreshadowed in this paper (eg time to repay debt).

NLA also supports the idea of a separate, easy to read, 'health' warning at the time that a credit card statement is sent out, as canvassed in the Green Paper.

6. What impact would these disclosures have on consumers and the credit card market more generally?

Disclosure provisions are always relevant to ensuring consumers are appropriately informed about their financial products. We suggest though that, disclosure requirements, whilst useful, are less effective as a method of remedying widespread abusive market practices in the credit area. Many inherently unfair market practices are not disclosed until *after the fact*. It is our experience that once people, particularly the disadvantaged, are tied to credit card debt, they lose their ability to make better choices about their finances.

7. Are further measures appropriate or necessary to clarify the responsible lending obligations of lenders in regards to credit cards?

Yes. The implementation of MCCA Option three and four combined with tightened credit assessment processes will be central to ensuring the effectiveness of responsible lending obligations. Assessment of capacity to pay the minimum repayment alone should not be sufficient to comply with responsible lending legislation.

The assessment should be made based on capacity to repay the fully drawn credit limit within 2 years, assuming no further drawings are made and the customer pays the maximum they can realistically afford each payment cycle. It is important that credit card lending is conservative and repayable in a short time.

This approach would also be useful in financial literacy work with consumers, on how to manage credit card debt, because information about how credit card limits are assessed could be used in financial literacy publications.

We support Consumer Action Law Centre's recommendation to MCCA (Option Two) that credit providers allow consumers to nominate the limit sought. However, we suggest that safeguards should be put in place to ensure that such a nomination by a consumer is not used as a basis for absolving a credit provider from their responsible lending obligations.

8. What impact would imposing additional requirements on the assessment of a consumer's capacity to repay have on their access to credit?

Concerns about access to easy credit must be weighed up against broader social and economic concerns. The underlying concern is that credit providers have for some time not lent responsibly on credit cards. This concern has also been expressed more generally by economists both here and abroad.

There is in our view a compelling argument that the long term consequences of an inadequately regulated credit card market may prove detrimental not only to the most vulnerable borrowers, but also to the community as a whole.

The Bank for International Settlements describes the mechanism by which irresponsible lending can endanger financial stability as follows:

> *These financial innovations have heightened what seems to be an inherent tendency to 'procyclicality' in liberalised financial systems. That is, as credit expansion fuels cyclical economic growth, asset prices and optimism rise while perceptions of risk recede. This further supports credit expansion, not least through the provision of more collateral to allow more borrowing, leading to spending patterns that could eventually prove unsustainable. Initial rational*

exuberance might in this way become irrational, setting the stage for a possible subsequent collapse.[16]

In Professor Steve Keen's article 'Unsustainable debt: Australia's own sub prime crisis' dated 18 September 2007, he states:

The problem is confronting all of us – not just those who have got themselves into inappropriate debt, but all those who have assets, earn income, or live in homes. As the US sub prime experience has shown, the repercussions of market failure in this area reach far beyond the unfortunate overcommitted borrowers and the dodgy lenders.

9. Are current lending practices sufficient to ensure consumers have a capacity to repay debt within a reasonable amount of time?

No. See the detailed research and analysis of current lending practices undertaken by Consumer Credit Legal Centre in NSW.[17] For example, on a $3000 credit limit, with repayments set at $60/month (2%), it would take almost 6 years to repay the credit on an interest rate of 10.8%, 10 years to repay the debt on interest rates of 20.7% and an indeterminate time to pay the debt with interest running at 24.5% or more.[18] Of considerable concern is that many consumers are signed up with interest greater that 24%. [19]

The appropriate policy response is that the assessment of capacity to repay should be based on the fully drawn credit limit within 2 years.

10. Are the remedies within the Credit Act sufficient to address the problems caused by consumers being able to access too much credit?

No. The prevailing view held by Courts and EDR schemes[20] is expressed by Hunt J in *Esanda Finance Corporation Ltd v Murphy*:

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[16] "Bank for International Settlements 78th Annual Report, 1 April 2007 – 31 March 2008." Basel. 30 June 2008. Page 137.
[17] CCLC Submission to the Ministerial on Consumer Affair Consultation – RIS on the Responsible Lending Practices in relation to Consumer Credit Cards, 2008
[18] op cit at p.22
[19] op cit at p.23
[20] Financial Ombudsman Service and Credit Ombudsman Service Ltd

> *Where the debtor has received the benefit of the whole sum...it is difficult to imagine the circumstances in which the debtor should not be required to repay at least the principal sum which has been lent.*[21]

Whilst this rationale is understandable as it centres around the idea that a debtor should not be unjustly enriched by such a transaction - the inherent unfairness to this rule is that it is inconsistent with the overarching obligation of lenders to lend responsibly. Proper consideration needs to be given to the notion that a lender has fiduciary-like obligations to protect a borrower, particularly disadvantaged borrowers, from financial harm by not lending irresponsibly.

Responsible lending is an overarching concept that sits above relative notions of accounting for a benefit received.

The notion of benefit received is just one of a number of competing factors that should be taken into account, in that:

- Consumers often have, after the harm has been done, little if any financial ability to fully account to the lender for that 'benefit';

- Lenders will, in most instances of significant credit card stress, simply sell off that debt to debt collecting agencies *at a reduced rate*;

- The failure of the consumer to account for the debt will invariably mean that consumer is rigorously pursued for the whole of that debt, plus the costs of debt collection;

- Debt collection procedures are notoriously harsh on consumers and often amount to harassment;

- Relentless pursuit of that unsecured debt, commonly by debt collection agencies will often involve writs for possession of personal property, bankruptcy, garnishment of wages and even sale of residential home on larger debts (and in some States such as Queensland, any sized debt);

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[21] (1989 ASC 55-702) cited in Green Paper - National Credit Reform, Treasury July 2010

- Debt collectors are invariably not provided with the relevant documents which would establish if the basis for lending was unjust;

- By selling off the debt in such circumstances, lenders absolve themselves of responsibility for the plight of the consumer who would not be pursued for bad debt *but for* their irresponsible lending practices;

- The lender will already have unduly profited in the transaction over an extended number of years through high interest rates, fees and charges; and

- The science of properly assessing benefit on credit card debt is of itself unconvincing in that it is difficult if not impossible to ascertain what would have happened if not for the irresponsible lending.[22]

A lender should be required, *at the time of lending*, to consider the consequences of providing credit which *if provided* would result in substantial hardship. A lender who fails in such an obligation, should be forced to deal with the consequences of their actions; namely, they be prohibited from seeking to enforce a debt that should not have been provided in the first place. To aid enforcement of these obligations, significant civil penalties should apply if they are breached.

In NLA's view, systemic change can only be achieved through a combination of:

- New provisions prohibiting credit being provided where it would result in substantial hardship (#1 ranked issue);
- Where credit was provided in breach of these obligations such debts be made unenforceable and be subject to civil penalty for breach (#3 ranked issue);
- New provisions on assessment of capacity to repay within 2 years (#2 ranked issue);
- Nominating time to repay (#5 ranked issue); and
- Bans on unsolicited credit card increases (#4 ranked issue).

[22] It may be, for example, that without the easy credit, the consumer may not have made decisions about spending on luxury items or believed that cash advances were viable ways to fund shortfall in mortgage payments when things got tough.

Currently lenders are motivated to create debtors who keep an outstanding balance rather than debtors who repay each month in full because this is more profitable. This is in direct conflict with responsible lending.[23]

11. What impact, if any, would these options have on consumer behaviour and default levels?

Consumer spending patterns are likely to adjust to the availability of credit.

Consumers burdened with credit card debt tend not to be in a position to reduce that debt so options forcing greater levels of repayment (MCCA Option Six), should not apply retrospectively.

12. What percentage of consumers make minimum monthly repayments?

Commission casework experience suggests that many consumers suffer credit card stress and struggle to make minimum monthly repayments.

13. What impact would any proposed minimum monthly repayment have on default levels?

For the reasons outlined above we see the development of concurrent obligations on consumers of new credit card loans to repay minimum monthly repayments as worthwhile. It has been suggested that this might be set at 3%.[24] Given the potential for financial hardship if this were to apply to existing loans, such obligations should not be prescribed to apply retrospectively. Existing cardholders should have the option to increase their minimum repayment to 3% at any time, to bring their repayment requirements in line with new accounts.

Equally, we support the development of a requirement for new credit card loans that repayments be made within a particular period. However, again, such requirements should be flexible and not inadvertently result in further financial hardship for consumers. This rule might be developed on a sliding scale – eg that the minimum

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[23] CCLC Submission to the Ministerial on Consumer Affair Consultation – RIS on the Responsible Lending Practices in relation to Consumer Credit Cards, 2008, p.9
[24] op cit p 22

monthly repayments will pay off a $1000 loan in one year, $2000 loan in two years and $10,000 loan in five years.

14. If mandated, what level should the minimum monthly repayment be set?

Please refer to the response to Question 13.

15. What is the extent of consumer detriment in receiving these unsolicited credit limit offers?

Unsolicited credit card increases should be prohibited. In principle, unsolicited credit card increases do not accord with the new responsible lending provisions which require a current, relevant and realistic assessment of an account holder's ability to repay credit. Any cardholder who is offered credit without having to consciously consider their ability to repay that debt within a reasonable time – by going through the process of accounting to a credit provider about their ability to service the debt - should not be offered credit.

Commission casework experience is that unsolicited credit card increases have caused significant financial stress for many disadvantaged consumers. Given their social and economic vulnerability, disadvantaged consumers are more likely to be induced into accepting an offer for a credit increase without considering the consequences.

NLA supports a ban on unsolicited limit increases especially where the consumer is carrying an ongoing debt each month on the credit card. If the consumer is carrying a debt this usually indicates some debt stress, and should not be further exacerbated by an unsolicited offer to increase the level of the debt.

Given the importance of this issue and the need to obtain more detailed data on it, requests for such information should form part of new compulsory ongoing public reporting obligations by credit providers to the Reserve Bank.

16. Do unsolicited credit limit offers translate to increased debt levels?

Yes. Please refer to the response to Question 15.

17. What impact has the ACT Fair Trading Act 1992 had on credit card borrowing and default rates in the ACT?

We are not aware of any independent research or analysis of the ACT experience. We suggest however, that take-up and default rates are only part of the picture.

The ACT provision was the first in Australia that sought to tackle the problems associated with pre-approved credit cards and limit increases. It did so by requiring credit providers to conduct an assessment of a borrower’s repayment capacity before credit was advanced. This concept is at the heart of the new responsible lending provisions.

It is our understanding from communications with Care Inc Financial Counselling and the co-located Consumer Law Centre of the ACT that a number of breaches were identified after the provision commenced. Their view was that its existence focused the minds of credit providers on the fact that failing to assess capacity was a breach of the law, rather than a question of whether it was appropriate to make a loan to the particular borrower. The ACT provision may have been an incomplete mechanism for addressing broader problems in the marketing of credit cards. We suggest however that it is a critical first step.

18. Should regulations be introduced to specify or standardise the balances to which repayments are to be allocated? What would the cost be to industry if such an approach were adopted?

Current practices maximise profits by allocating repayment to the least profitable balance on the account. So, for example, a cardholder who transferred a large balance $15,000 at a low rate of 4% but has taken out a relatively small cash advance of $1000 will not be able to repay the $1000 cash advance charged at a rate of 27% until the whole of the balance transfer has been paid off. During that extended period the $1000 cash advance at interest of 27% pa has accrued to a significant debt in itself.

Regulation of standardised allocation of repayments to balances will only work if such rules also incorporate concepts of fairness within them. Despite the general importance of the legislation, we do not expect that the new unfair terms regulation will lead to sufficient change in this area in that credit providers will make a case that they are simply protecting a legitimate business interest.

They may also argue that unfair terms legislation does not apply under the subject matter exception. This area is too technical for unfair terms law application. It is suggested that it would be preferable to develop a consistent but fair rule around allocation of repayment.

Without standardising these processes, the Reserve Bank will never be able to collect reliable data on how the unfair allocation of repayments is connected with credit card stress and financial hardship generally.

19. What impact will the protections against unfair contract terms have on the allocation of repayments? Will the unfair contract terms legislation provide sufficient safeguards for consumers?

Please refer to the response to Question18.

20. ***Are consumers aware of how interest is applied on credit card balances?***

No. As outlined in the Green Paper, credit providers use a host of different and complicated methods for applying interest on credit card balances. Prescriptive rules which standardise these processes is necessary so that consumers can make informed choices about their credit cards including whether they are good value for money or not.

Equally, as outlined in our response to Question.18, without standardising these processes, the Reserve Bank will never be able to collect reliable data on how the unfair allocation of repayments is connected with credit card stress and financial hardship generally.

21. How much do different policies in relation to interest rates impact on the amount of interest paid by consumers?

As outlined in our response to Question 20, different policies in relation to interest rates compound the confusion for consumers in relation to the amount of interest to be paid. It is our experience in relation to credit cards, as with pay-day lenders, that calculation of interest on a daily basis, as opposed to a monthly basis can have a significant impact on the amount of money which needs to be repaid. We refer to our response generally on Chapter 5 for further details.

This situation is not helped by the fact that credit providers set commercial card rates, including on no frills credit cards, well above official interest rates, as outlined in our response to Question 4.

22. Should the calculation of interest be standardised across the industry?

Yes. Please also refer to our responses to Questions 20 – 21.

23. What would be the impact of longer notification periods for interest rate increases on consumers and the industry?

A longer notification period in respect of increases to interest rates would give consumers more time to adjust to changes in interest rates, and where possible, reorganise their finances to reduce any risk of hardship. There should be no minimum notification period for a decrease in interest rates.

24. What impact does exceeding credit limits have on consumers?

Industry has maximised profits over a sustained period based on consumers who exceed their credit limits. Consumers have paid out some $954 million in fees, including exceeding credit card limit fees, that could have been avoided. Offering cards that permit the consumer to spend beyond their means – and then penalise them for doing so is inconsistent with responsible lending. Please also refer to our response to Question 4.

Chapter 3 - Reverse Mortgages

1. What evidence is there that borrowers consider home reversion schemes and reverse mortgages to be alternatives?

Please refer to our response to Question 2.

2. Are there potential detrimental consequences of home reversion schemes and reverse mortgages coming under different regulatory arrangements?

The need for specific legislative protections and safeguards for consumers considering entering into reverse mortgages is critical given the particular

vulnerability of older consumers, who are attracted to these products often using their only significant asset as security for credit, and doing so without an income stream. Research also suggests that older people are also often in a poor position to protect their interests.[25]

NLA does not support industry self-regulation as not all providers of reverse mortgages are members of Senior Australians Equity Release Association (SEQUAL). The result would be that consumers are left with varying levels of protection as not all lenders comply with the industry Code of Conduct.

3. Is there any need for specific measures to address issues relating to any of the product features discussed above, or any other product features of reverse mortgages?

Yes.

There is a need for specific pre-contractual disclosure regarding information about:

- the risk to borrowers of over-depleting their equity before the end of their life expectancy; and
- default clauses and their potential effects.

Non-title holding residents should be afforded uniform protection by ensuring that lenders allow for that person to be added to the loan or designated as a nominated resident.

In relation to a uniform procedure upon default by a borrower, it is suggested that the SEQUAL guideline should be made mandatory requiring lenders to personally contact (or make reasonable attempts to contact) the borrower prior to the expiry date of a default notice and ensure the borrower has received the notice and understands the consequences of not rectifying the default.

4. Are any of the issues raised above relevant to the regulation of home reversion schemes?

No comment.

[25] *Legal Needs of Older People in NSW*, NSW Law and Justice Foundation, Dec 2004.

5. Is there a need for specific responsible lending conduct obligations applicable to reverse mortgage providers and other intermediaries such as brokers?

Yes, these should be tailored to the features of reverse mortgage and applicable to reverse mortgage providers and brokers.

The requirement that lenders provide a product that is *not unsuitable* for the borrower is not sufficient protection in the case of reverse mortgages, as the enquiries are limited to the customer's financial circumstances, requirements and capacity to repay.

The reverse mortgage should also be suitable for the consumer in light of alternatives, such as downsizing, pension loans scheme, utilising existing assets and so on.

Consumers considering reverse mortgages have a range of needs that are not always about income and capacity to repay and therefore the enquiries that need to be made are more specific to ensure the product is appropriate for the borrower's requirements.

There are other reasons for having responsible lending conduct obligations that are specifically tailored for reverse mortgage products: These are

- Reverse mortgages involve unique risks to borrowers different to more traditional credit products;
- Consumers may not adequately understand the inherent risks and long term financial impacts of a reverse mortgage at the time they enter into the contract;
- The equity release industry has expressed some concern that there is uncertainty regarding how responsible lending will apply to reverse mortgage products;
- Borrowers often use their largest asset as security for the loan, the impacts of being placed in an unsuitable reverse mortgage may have severe financial

and quality of life impacts, which, for older borrowers may potentially be irreversible; and

- As a matter of public policy, if older people are left with insufficient equity in their homes to fund their aged care accommodation needs, this will be an increasing cost that Government will need to meet.

6. *Are the examples of possible mandatory reverse mortgage -specific responsible lending enquiries and assessments listed above appropriate?*

Yes. NLA considers that they should be adopted (see p.42 Green Paper).

7. Are there additional requirements that should be imposed on licenses in relation to responsible lending for reverse mortgages?

No comment.

8. Are any of the issues and options raised above relevant to home reversion?

No comment.

9. Which of the above regulatory approaches is preferred and why? Are there other options which should be considered?

NLA supports the adoption of Option Two in relation to statutory protection against negative equity.

For the purpose of reverse mortgages the broker should be considered to be the lender's agent.

Any misrepresentation by the borrower must be deliberate.

10. If Option 2 is preferred, are the terms mentioned above which may void the statutory protection against negative equity appropriate? Are there others that should be considered?

Yes.

11. Which of the above regulatory approaches is preferred and why? Are there other options which should be considered?

NLA considers that both Option One and Option Two should be adopted to ensure that consumers are provided with information and advice that is meaningful and appropriate prior to entering into a reverse mortgage.

Option Two on its own will not be an effective consumer protection tool. An information statement may be a useful starting point for information for some consumers but is no substitute for independent advice that is specific to the individual's circumstances.

Further, we submit that consumers should be required to obtain both free legal and financial advice before entering into a reverse mortgage through a one-stop-shop provider such as the National Information Centre on Retirement Investments Inc (NICRI).

NLA supports the proposal for the Government to fund the Equity Release Information Centre (ERIC) model proposed by NICRI.

12. Is there merit in considering both options?

Yes - see above.

13. What advice could be usefully provided pre-contractually and which post contractually?

See above.

14. Would there be any merit in the options raised above being applied to home reversion schemes?

No comment.

15. Are current arrangements provided under the Code and industry practice adequate, or are other measures required? Please provide details.

NLA considers that the current arrangements are not adequate. See above responses.

16. If a reverse mortgage specific default procedure is required, what would this involve?

A mandated default procedure should require lenders to personally contact (or make reasonable attempts to contact) the borrower prior to the expiry date of a default notice and ensure the borrower has received the notice and understands the consequences of not rectifying the default.

Chapter 4 - Regulation of investment lending

No comment.

Chapter 5 - Regulation of Short Term Small Amount Lending

NLA supports Option Two to implement a national interest rate cap.

1. Please provide information on the average size and number of short-term, small-amount loans that you offer.

No comment.

2. Please provide information on the terms of the loans that you offer or that are available in the market.

No comment.

3. Please provide information on the profile of consumers who access these loans (for example, income (including source) and expenses, dependents and other sources of credit used) and the purpose for which this type of credit is sought.

NLA's experience is that the majority of consumers with small loans (often with multiple small loans) are Centrelink recipients or on low incomes who seek assistance to purchase items such as a car or to pay bills.

According to the recently released University of Queensland report "*The Experience of Using Fringe Lenders in Queensland: A Pilot Study*[26]*",* 75% of respondents were exclusively reliant on Centrelink, a further 10% had only part time or casual employment, only 10% had full time employment.

4. Please provide information on the number of loans that customers apply from an individual lender over a 12 month period.

No comment.

5. Please provide information on the amount of capital lost as a result of defaults.

No comment.

6. Please provide information on why these consumers use this type of credit in preference to other forms of credit.

Commission experience is that these loans are heavily marketed and promoted to people with a history of credit defaults. People with this history often appear to believe that they have a better chance of securing small amounts of cash quickly with this type of credit.

This issue was canvassed in a report "*Interest Rate Caps, Protection or Paternalism?*" prepared by Griffith University in December 2008[27] where one reason advanced for choosing these loans was the lack of market choice for people seeking to borrow less than $2000.

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[26] Gregory Marston and Lynda Shevellar *The Experience of Using Fringe Lenders in Queensland: A Pilot Study*[26]University of Queensland 2010 ('the University of Queensland Report)

[27] Nicola Howell, Therese Wilson and James Davidson "*Interest Rate Caps Protection or Paternalism?*" a report from the Centre for Credit and Consumer Law at Griffith University, December 2008

A report into credit contracts and vulnerable consumers showed that consumers tended to think about whether or not a loan was affordable in the context of their fortnightly or weekly budget. As a result, the repayment rate tended to be the most important aspect of the contract.[28] Many people felt that their options were so limited that they had decided to take the risk and proceed with the loan.

In Commission experience, clients tend to be unaware of their rights in relation to accessing hardship provisions or services in order to pay bills and instead frequently opt for short term credit which increases the risk of non-payment of other bills and necessities due to the high cost of this type of credit.

7. What is the average cost to the lender of providing short-term, small-amount loans, (for example, administration costs, profit margins, risk)? Are these costs standard? Are there any factors that are likely to result in significant variation among lenders? Does the interest rate vary to reflect the risk to the lender, particularly in those jurisdictions where there is no interest rate cap?

No comment.

8. What is the breakdown of profit on loans, for example, interest, fees and charges?

No comment.

9. Please provide information on the size of your loan book/volume of capital.

No comment.

10. Are there alternatives to high-cost loans in addition to those listed above?

No comment.

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[28] Genevieve Sheehan, Therese Wilson and Nicola Howell *Coming to grips with credit contracts,* Steps to protect vulnerable borrowers" A report prepared jointly I November 2008 by Brotherhood of St Laurence and Griffith University Centre for Credit and Consumer Law (at p v)

11. What are the main obstacles to consumers accessing alternatives to short-term, small-amount loans?

People who are at risk of hardship as a result of short term small amount loans tend to be unaware of alternatives to expensive short term loans. A case example provided in the University of Queensland Report[29] discussed a woman suffering from cancer who borrowed from a payday lender for parking fees at the hospital. Hospital social workers are able to assist clients with parking in these circumstances but the woman was seemingly unaware of these options.

12. What are the main costs and risks associated with use of these alternatives?

No comment.

13. Are borrowers aware of the availability of Utility Financial Assistance Programs? What proportion of short-term small-amount loans are used to pay utility bills?

We suggest that there is only limited awareness of Utility Financial Assistance Programs. Further, many of the programs depend the individual policies of the providers of the service or the State in which the borrower lives. For example, Telstra provides direct assistance to people experiencing hardship and financial counsellors and other organisations are provided with vouchers that they can give to a customer of Telstra for payment of their telephone account. This is not matched by other utility providers.

In addition, it is clear that each utility provider has different hardship policies and many customers are unaware of the existence of these policies, how to access them or where to complain to if the hardship offered is inadequate or refused.

14. What proportion of users of short-term, small-amount loans are benefit recipients? Are these users aware of the availability of advances on income support payments? What are income support recipients using the advance payments for?

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[29] Gregory Marston and Lynda Shevellar *The Experience of Using Fringe Lenders in Queensland: A Pilot Study*[29] page 44

According to the University of Queensland Report[30], 75% of users were benefit recipients. We believe the figures may be underestimated given that the part time or casual workers identified in the report might also be Centrelink recipients and that as with any self selecting group, the most vulnerable are less likely to respond than the rest of the community.

Commission experience suggests that there is general knowledge about availability of advances on income support payments. We do not have access to the sort of data which would enable us to answer the latter part of this question.

15. Do users of short-term, small-amount loans know of and use budgeting/debt management services?

Commission experience suggests that people who use short term lenders do not tend to use budgeting or debt counselling services until they are unable to borrow from another source and cannot meet the repayments on these accounts.

16. How effective have interest rates caps been at restricting the cost of credit to borrowers?

A 48% Interest Rate Cap, inclusive of all fees and charges has been very effective at reducing the cost of credit to borrowers.

Example - Queensland

Prior to the introduction of an interest rate cap in Queensland, the short term small amount lending market had the following characteristics:

(a) The average effective interest rates in the market were over 240%. Less than 5 lenders (that LAQ were aware of) that were operating in the market had interest rates less than 240%. One lender had an effective interest rate of over 3000%;

[30] Gregory Marston and Lynda Shevellar *The Experience of Using Fringe Lenders in Queensland: A Pilot Study*[30] University of Queensland 2010

(b) There were over 1000 lenders in the Queensland market, some with less than 100 loans in their loan book;

(c) The average loans across the market were in excess of $1,000;

(d) One of the major fringe lenders had moved to a “credit card type product” without providing a credit card but with the ability to redraw the principal sum thus avoiding disclosure of the total cost of the loan; and

(e) It was extremely difficult for consumer advocates to obtain settlements on grounds contract was unfair because of excessive interest.

Following the introduction of an interest rate cap, the average effective interest rates (inclusive of brokerage fees and charges) fell significantly from an effective interest ranging from 240% to between 140% to165%.

It is now relatively easy for consumer advocates to settle matters on behalf of vulnerable clients where the issue is a breach of the interest rate cap even where the lender has attempted to avoid regulation by using a 'sham' brokerage fee.

A recent example of the interest rate cap changing the behavioural norm of the industry was where a short term loan contract that was in operation prior to the introduction of an interest rate cap had an interest rate of 90% per annum. On the introduction of the interest rate cap the interest rate was reduced to 48% despite the fact that as an existing contract the lender had no obligation to do so.

17. How do the different regulatory approaches among the jurisdictions affect the short-term small-amount lending market including the availability of credit, the terms on which it is offered and the number of credit providers?

In Queensland there are less of these lenders in the market. In Queensland, after the introduction of the cap, initially the numbers of loans also decreased.

18. In those jurisdictions with a cap, how have lenders responded (for example, have they exited the market, revised prices, changed business structures or resorted to avoidance techniques)?

Example - Queensland:

Before the Cap, examples of avoidance of consumer protection regulation include:

(a) A major fringe lender introduced a "credit card type product" without providing a credit card but with the ability to redraw the principal sum thus avoiding disclosure of the total cost of the loan and the ability to compare different products;

(b) The use of interest free finance to purchase goods at a greatly inflated price that did not reflect the value of the goods. This was particularly prevalent in the sale of cars; and

(c) The use of business purposes declarations to avoid regulation. In one case the default rate on a $200,000 mortgage was 96% or $16,000 per month in interest.

Since the introduction of the Cap:

(a) The effective interest rates on small amount loans have fallen substantially;

(b) Most fringe lenders now use a brokerage model that has yet to be tested in court;

(c) A major fringe lender has attempted to avoid legislation by setting up a business selling diamonds at inflated prices;

(d) Another major fringe lender has unsuccessfully attempted to use the pawn broking exemption; and

(e) There has been an increase in the use of consumer leases.

19. Is there evidence of an increase in avoidance or unlawful lending in jurisdictions that have introduced a cap?

We have not seen any evidence to suggest that an interest rate cap has led to an increase in avoidance of regulation or unlawful lending.

20. What proportion of borrowers makes use of available internal dispute resolution processes? How effective are they in resolving disputes?

No comment.

21. What will be the impact of licensing and responsible lending obligations on short-term, small-amount lending?

NLA is hopeful that responsible lending obligations will result in a reduction of the number of small and short-term loans a borrower has at any given time.

22. Is there evidence of a need for further Government intervention to address specific issues with high-cost lending?

NLA supports the introduction of an interest rate cap.

23. Which option(s) do you consider would be effective at addressing the concerns associated with high-cost credit?

NLA supports Option Two, implement a national interest rate cap.

It is suggested that disclosure (Option Three) is ineffective as borrowers often do not see the warnings. Reasons for people accessing loans include a perception that they have no option. This perception is unlikely to be impacted on by a warning.

NLA does not support Option Four as it does not address the problem borrowers face when paying out a loan and re-borrowing a similar or higher amount from the same lender within a few days or a few weeks.

NLA does not support Option Five because although it may assist consumers, it does not address the detriment caused by the high cost of these loans when entering the contracts (such as interest fees and charges) as opposed to the charges associated with default fees.

This is illustrated by the following case study:

A borrower obtained a loan for $1715 (including $215 for fees) at 240%. The repayments were $80 per week. In week 3 she missed a payment. From that date on the payments she made barely met the interest component. In week 12 she missed another payment. From that date the interest exceeded the weekly payment. She missed one more payment in week 27 and sought advice after week 84. At this time she had paid $6340. The outstanding balance on the loan was $5050, but only $60.00 was added in default fees.

24. Are there other mechanisms which should be considered?

In the experience of Commissions, access to timely financial counselling and legal advice to explore alternatives when faced with financial stress or hardship is critical for borrowers before they approach high cost lenders.

Chapter 6 - Regulation of Consumer Leases

NLA is concerned about the targeted marketing of consumer leases to vulnerable consumers (for example through promotions such as '*credit impaired*', '*no credit history checks*'), and suggests that there are good reasons why these products should be further regulated under the NCCP.

NLA supports Option Two of the Green Paper for further regulatory intervention.

NLA supports amendment to the NCCP to provide equal treatment of consumer leases (no right to purchase) and hire-purchase contracts (where ultimately the client can purchase the product). The mere fact of ultimate ownership ought not to determine the quality of the protection available to the consumer (particularly vulnerable consumers) or the quality of information available to the consumer to make a choice of product.

NLA is primarily concerned with the lack of protection for vulnerable consumers in relation to consumer leases rather than hire-purchase contracts, because they are treated differently under the NCCP as described in the Green Paper[31].

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[31] At 74.

The Micah report[32] suggested that all member agencies receive a disproportionate number of consumer complaints about consumer leases including misrepresentations about the nature of the finance, unfair terms, heavy-handed repossession tactics and inflated prices of the goods leased.

1. ***Are there any businesses that only offer short-term or indefinite term leases where the cost of hiring and other charges under the contract exceeds the cash price of the goods?***

   NLA is not aware of any.

2. ***If so, in what circumstances are consumers being provided with these types of leases?***

   No comment.

3. ***To what extent are consumer leases and credit contracts directly competitive products? Please provide examples of any circumstances where leases and credit contracts may be directly competitive?***

   While leasing companies claim that they provide a competitive product by supplying essential household goods at affordable prices to low income consumers, research has shown that these agreements and market practices are often misleading and exploitative.[33] On that basis, consumer leases are not directly competitive in reality.

   Historically consumer leases were a product for the purchase of new cars for business in order to gain perceived tax benefits. Leases offer no particular tax advantage or other advantage to vulnerable clients who purchase used cars on finance.

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[32] The Micah Law Centre, *A Loan in Lease Clothing: Problems identified with instalment based rent/purchase contracts for household goods*, 2007, http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Credit_Grant_Resources/$file/credit_grant_resources_micah_law_centre_consumer_leases_project.pdf, cited in The Green Paper at 70.

[33] Ibid.

The market is skewed towards consumer leases as outlined above, but despite the fact that these products offer the least regulatory impost for lenders and enable lenders the greatest access and control over the product, they are generally the most expensive form of finance on the market.

4. ***To the extent that these products are directly competitive, which differences in regulation should be addressed?***

No comment.

5. ***To the extent that these are not directly competitive products, would it be desirable to extend provisions regulating credit contracts to consumer leases?***

Yes.

6. ***If so, what elements applying to the regulation of credit contracts should be extended to the regulation of leases? Will any such extension enhance consumer protection?***

NLA suggests that the only way to stop the detriment to consumers from the abuse of this product is to ensure that it is placed on an equal footing with other forms of lending.

This would entail disclosure requirements equivalent to those for other forms of lending, as well as equivalent treatment of breaches.

Consumer leases are currently preferred by leasing companies because they are motivated by the artificially decreased regulation of these products. Further regulation may impact on the market by removing that preference and creating a level playing field, thereby increasing competition.

NLA supports regulation of consumer leases that mirrors the regulation for hire purchase agreements under the NCC.

Such an extension will enhance consumer protection particular for vulnerable consumers.

7. ***To what extent does the absence of a right or obligation to purchase the hired goods affect disclosure of the cost of a consumer lease relative to a section 9 lease?***

   NLA suggests there should be no difference between a consumer lease and a *section 9 lease* in relation to the requirement to disclose the cost of the lease.

   The cost of a lease can be more than a loan and there is no compensation for the consumer to balance the lesser legal rights they have with this form of finance.

8. ***Which requirements applying to credit contracts but not to consumer leases could be extended to leases?***

   All requirements applying to credit contracts should apply to consumer leases to prevent any attempts by leasing companies to avoid the regulation of the leases.

   NLA is concerned that many consumers are confused as to whether they have a right to purchase/own the goods at the end of the rental term.

   Disclosure requirements should include clear warning in the contract that the consumer has no right to purchase the goods. This warning should also be repeated in the Information Statement.

   Commissions have seen cases where car yards, who are self-insuring, charge consumers “insurance premiums” in-house. This leads to confusion and increased risk for the consumer when there is a car accident about the extent of the “insurance cover”. Disclosure requirements relating to insurance (e.g. name of insurer, amount payable to insurer and a description of the kind of insurance provided) would ensure that details of any purported insurance would be disclosed to consumers.

   The present requirements in relation to default and repossession for consumer leases particularly need to be extended in order to protect vulnerable consumers from unscrupulous tactics by leasing companies.

NLA is aware of some situations in Queensland where car yards have threatened clients with stealing charges when they have refused to return a vehicle following a dispute about payment. Some consumers have bowed to this kind of pressure by allowing cars to be repossessed, in contravention of their rights.

9. Which requirements applying to credit contracts would raise practical difficulties if they were extended to leases?

NLA is not aware of any.

10. What are the implications of extending the linked credit provisions to consumer leases?

As discussed above, an extension of linked credit provisions to consumer leases would enhance consumer protection.

11. Is there a need to broaden the scope of the definition of consumer leases in the Code?

Equal treatment of consumer leases with hire-purchase (section 9) leases would greatly assist vulnerable consumers.

12. If lessors become subject to a broader range of requirements under the Code, will this reduce the incentive for persons to provide consumer leases?

The demand for consumer leases is likely to continue. While a broader range of requirements may increase the cost of product, the current high cost of such a product suggests that leasing companies should be able to absorb these costs with very little impact.

13. Is there a need to change the disclosure requirements applying to consumer leases? If so, what factors should be taken into account in changing the requirements?

Yes, please refer to our responses above.

The current disclosure requirements relating to the cost of consumer leases (i.e. amount of each rental payment, total amount of rental payable, additional charges etc.) should extend to a disclosure of the cash price of the goods and the cost of the lease as a percentage per annum. This will allow consumers to see the actual cost of the whole contract and prevent any hidden cost by use of balloon payments and other tactics.

Further to the issues discussed above, NLA seeks the Government's consideration of the problem of liquidated damages. Leasing companies often have a clause that means that consumers have to payout the whole term of the lease even if they default early in the contract, and goods are repossessed in one month. Leasing companies would argue that liquidated damages represent the loss they would suffer. However, NLA is concerned that this is in fact a penalty, and does not in fact reflect the real cost to the lessee.

Chapter 7 - Enhancements to National Consumer Credit Protection

Enhancements to the hardship variation provisions

1. ***Should the range of variations available under hardship provisions be expanded?***

Yes. Commission experience is that the current range of variations available under the NCCP does not always accord with the needs of those in financial difficulty, or reflect the types of arrangements commonly negotiated through IDR and EDR in light of industry codes of practice.

Commission experience is that the significant majority of borrowers seeking a variation on the basis of hardship do so *during* a period of hardship rather than *in anticipation* of hardship. This means that the range of variations available needs to be flexible enough to remedy past defaults as well as accommodate the current and future needs of the borrower during a period of hardship.

A common scenario is where a borrower experiencing hardship has made inconsistent repayments prior to seeking a hardship variation; and wishes to have reduced repayments for a period of time before returning to contractual repayments.

While this is a situation commonly resolved through IDR and EDR, the current provisions do not allow for a Court ordered variation to this effect.

Our experience also suggests that there is little understanding on the part of consumers (and some lenders) of the current options available. If a consumer mistakenly asks for a variation that is not in strict accordance with the options in the Code, a consumer could be considered not to have taken the requisite steps needed to make a hardship application to a Court, or to be able to enforce the variation agreed by the lender. This seriously undermines the intended efficacy of the hardship provisions in the Code.

NLA supports the position that there is no limit to the type of variations that can be requested. An appropriate variation in any particular case may include any combination of postponing repayments, accepting reduced repayments for a period, capitalising arrears and extending the term of a credit contract, among others.

We do not see that this is inconsistent with codifying aspects of the industry codes of practice, which usefully (the MFAA in particular) place obligations on lenders to work with borrowers in a constructive way to overcome their difficulties. NLA supports the codification of these principles, which we believe will bring more strength and consistency to the hardship aspects of the NCC.

2. If so, what additional types of variations should be available?

Please refer to the response above.

3. Should there be any monetary threshold above which a statutory right to apply for a variation for hardship does not exist?

NLA's view is that it is not appropriate to impose a monetary threshold limiting the statutory right of a consumer to apply for a variation on the basis of hardship.

The policy motive of the threshold acting to exclude the sophisticated borrower from accessing a hardship variation is not necessarily well founded. Some people with high-value debts may still experience significant hardship as a result of illness, unemployment, or other reasonable cause.

For example, it is possible that a person with a large mortgage may become disabled and need to sell their home due a reduction in income. In such cases, hardship variations can usefully be negotiated through IDR and EDR to allow the borrower time to sell and maximise the sale price for the benefit of their family. It is unfair and inconsistent that this option is not currently available to the same borrower if applying to a Court.

The current hardship provisions – which require a debtor to be able to show that they reasonably expect to be able to discharge their obligations if the terms of the credit contract are changed in a manner requested – act as a 'threshold' preventing inappropriate hardship variations.

Importantly, removal of the threshold will also provide consistency with the approach of EDR schemes and the industry codes of conduct provide for hardship variations regardless of the size of the loan.

If a threshold is to apply, NLA suggests that the statutory position clarify that the threshold applies to the loan balance at the time the hardship application is made. This is crucial in capturing those who may enter into a loan that is over the threshold but fall into hardship some years later. It would be an unfair result if a borrower who has brought their loan balance down by meeting their regular repayments was excluded from the statutory right to make a hardship application in a subsequent period of hardship.

4. If so:

> ***a. what proportion of consumers do not have a statutory right under the existing $500,000 threshold?***

This question warrants an evidence based response about the proportion of consumers who are over the existing threshold, which we are unable to provide at this time.

> ***b. Should the threshold be subject to regular indexation?***

If a threshold is to apply it is appropriate for it to be indexed and regularly reviewed. Consideration should be given to how the index is appropriately calculated, such as

whether it should be sensitive to geographic zones for metropolitan, regional, rural and remote areas.

5. What are the implications for lenders, that is prudential concerns or compliance costs?

It is advantageous for all parties to maintain a tenable loan agreement where a borrower is reasonably able to meet their obligations under the loan if the variation is granted. For untenable loan agreements, the proposed amendments contained herein should not represent a notable cost impost to that already incurred by lender's progressing enforcement proceedings.

Enhancement to the stay of enforcement provisions

6. Should it be compulsory to consider a hardship variation before commencing default proceedings? If so, should there be any exceptions to this rule?

NLA supports a requirement that lenders conduct compulsory hardship assessments prior to commencing default proceedings or forced sale. Repossession rates in this country have risen in recent times to unprecedented levels,[34] with concerning evidence that repossession rates reflect but a small portion of homes repossessed by lenders through "agreed" forced sales.[35] Commissions, through their casework and advice services, have seen first hand the impact of this in the Australian community today, particularly amongst the most disadvantaged.[36]

Commission experience is that lenders tend to not consider the financial hardship circumstances of borrowers – choosing instead to enforce their strict legal rights under the mortgage agreement. This is reflected in leading research conducted this year on the causes of defaults in Australia today: less than 20% of survey defaulting

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[34] In Victoria, for example, rates of repossession increased 300% in the 6 years to 2008 cited in 'Crunch Time" About The House, aph.com.au September 2008 at p.38. See also 'Repossessions on the rise as interest rates go up', HeraldSun.com,.au, 3 August 2010; 'Queensland house repossessions at a record high', couriermail.com.au 10 June 2009;

[35] See "True rates of home defaults hidden", theaustralian.com.au, 16 May 2007

[36] For an insight into the social and economic cost of mortgage stress on the Australian community see "The Experience of Mortgage Distress in Western Sydney", University of Western Sydney's Urban Research Centre, 2010

parties were contacted by their lender to re-schedule mortgage payments to deal with mounting arrears and forestall repossession or forced sales.[37]

At the heart of this issue is that the balance of rights in relation to mortgages weighs far too heavily in favour of mortgagee rights to possession.[38] Such rights, which derive from outdated notions on the paramount nature of proprietary rights of lenders, do not accord with modern standards of fairness – including standards of fairness now prescribed in this area in the enhanced hardship and responsible lending obligations on lenders.[39]

It is suggested that it is an appropriate time to implement reforms which would require lenders to consider a borrower's financial hardship before taking the drastic step of moving toward repossession – either by writ or forced sale. We suggest that the development of such a compulsory obligation on lenders to consider the financial hardship of a borrower before repossessing is in line with the government's commitment to a program of addressing risks of social exclusion. There are tangible benefits to government, individuals and the community at large when consumers, where possible, are able to keep their home and thus avoid the enormous social and economic cost of repossession.

We welcome the changes to notice requirements already provided for under section 88 of the NCC, requiring borrowers to be notified of their rights to make a hardship application and complain to an EDR scheme. We look forward to monitoring the effect of this requirement on consumers' ability to access hardship arrangements prior to legal proceedings being commenced.

The view of NLA on this point is also informed by our positions in respect of Questions 1 and 7. If aspects of the industry codes of practice requiring lenders to work with borrowers in times of financial difficulty are codified, we anticipate this would provide the strength to the Code required to support consumers in periods of hardship. Further, if enforcement action remains on hold while a hardship application is being assessed, we anticipate this will lead to hardship arrangements being

[37] Mortgage Default in Australia: Nature, Causes and Social and Economic Impacts, Berry Dalton & Nelson, March 2010, p.4

[38] See for example "Lenders ruthlessly taking Sydney families to Court to repossess their homes", dailytelegraph.com.au, 3 August 2010

[39] To give a very basic example, it is easier in Australia today to get legal protection and remedy in respect of an electricity disconnection than it is to resist a claim for repossession for an unsatisfied default on a mortgage.

entered into at an earlier stage and avoiding the need for legal proceedings by the lender.

7. ***Should there be an automatic stay of proceedings where a request for a hardship variation is made? If so, should there be any exceptions to this rule?***

Yes. Although protections already exist for consumers where a hardship application is made to an EDR scheme or a Court, NLA believes there are significant benefits to a general requirement that enforcement under a credit contract be stayed while a hardship application is considered. Not only would this foster good faith, but it would significantly ease the pressure on EDR schemes which are heavily relied upon to ensure enforcement action remains on hold while a hardship application is considered.

The stay of enforcement should operate to include steps such as accelerating the loan, charging default costs and listing an adverse credit report on a borrower's credit file. It should also allow for a stay of enforcement for 14 days after a hardship application is refused, so that a borrower has the ability to seek advice about their options before enforcement action continues or commences.

In order for the stay of enforcement to work effectively, a less formal view of what constitutes 'making a hardship application' needs to be taken. The focus should be on whether the borrower has reported experiencing or anticipating hardship, or whether the lender is reasonably on notice that is the case. The focus should be on the substance rather than the form of the application.

In order to avoid abuse, safeguards could be included such as that the lender is not required to stay enforcement where a substantially similar application has been rejected within the previous month, for example.

8. Should there be any specific provisions in respect of legal costs incurred by the lender before any stay of proceedings?

Yes. Specific provisions should be included codifying the position in *McNally & Anor v AMP*[40] that the costs of considering a hardship application are not enforcement expenses.

Charging the costs of considering a hardship application to a borrower's loan as enforcement expenses often puts the borrower into further hardship and undermines the entire hardship framework. Given the inconsistency across the industry in relation to these costs NLA believes it is important that there are clear statutory provisions on this point.

9. Should the credit provider be prevented from listing a default while considering a hardship variation request?

Yes. If the hardship variation under consideration is granted, the effect should be that the relevant credit contract is no longer in default and an adverse credit listing is not necessary.

Further, it would be unfair for a consumer in financial difficulty to suffer the ongoing effects of an adverse credit listing in circumstances where they can show that they are reasonably able to meet their ongoing obligations under the credit contract.

10. What considerations should be taken into account in deciding whether or not to extend the remedy for unjust conduct to providers of credit services?

NLA supports the view that attention should be given to whether existing gaps in coverage, particularly in relation to third party conduct, have encouraged lending that is at least irresponsible lending, but in more serious circumstances has also amounted to predatory lending. Equity stripping, without any consequences for third parties who have financially benefited from such practices, which are sometimes utilised against vulnerable consumers is of significant concern.

[40] *McNally & Anor v Australia and New Zealand Banking Group* (2001) ASC 155–047

We support the enhancement in protection to provide a remedy for unjust conduct in relation to providers of credit services as providing the most chance of alleviating concerns in this area (**Option Two (b)**).

11. If the remedy for unjust conduct is to be extended to providers of credit services, what considerations should be taken into account in deciding whether to extend the existing unjust conduct provisions or creating a new remedy specifically for providers of credit services.

Please refer to the response to Question10.

12. Should the use of certain words or expressions be restricted?

Yes.

NLA is of the view that the use of the expressions "pre-approved", "reverse mortgage", and "financial counselling/financial counsellor" should be prohibited in the circumstances suggested in the examples provided in the Green Paper.

The example "independent, impartial or unbiased, not-for-profit, free" should also be prohibited in the circumstances suggested in the examples if possible.

In addition, NLA suggests the following prohibitions:

- "moratorium" and "repayment holiday" not to be used except where no payments are required and no interest is to be charged during the relevant period.

13. If so, do you agree with the example above? Are there other words or expressions that should be restricted?

Please refer to the response to Question 12.

Canvassing of Consumer Credit at Home

14. Are the limitations to the Hawking Provisions of the Code justified?

The current prohibition in section 156 of the Code on the marketing of credit at a person's residence is justified. NLA agrees with the concern expressed in the Green Paper that these provisions do not adequately cover telemarketing and forms of unsolicited contact such as "invited" home visits for the sale of credit products either linked with door to door sales products or credit sold as a result of an invited visit.

NLA suggests this problem is similar to the one discussed by the Senate Economics Legislation Committee in Pages 49-54 of its report into the Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010, where it put forward the view that door to door sales provisions should extend to circumstances beyond mere canvassing. "Unsolicited contact" should include circumstances where consumers are contacted and agree to home visits through indirect means such as being approached in a shopping centre.

This report highlights the concern that the pressure felt by vulnerable consumers from high pressure sales tactics is the same irrespective of whether the seller is by a solicited invitation or by canvassing.

Similarly, with respect to the canvassing of credit at home, the protections that are offered under section 156 of the Code to vulnerable consumers are justified. They should also apply to circumstances beyond mere canvassing of credit to circumstances where through indirect means an invitation is obtained from a vulnerable consumer to discuss credit in their residential home. Sale of credit in the home following solicited invitations into the home should be prohibited under section 156 of the Code.

15. Should the Sale of Credit Sold in 'Door-to-Door' to finance the sale of goods or services be prohibited or further regulated?

NLA's view is that the sale of credit in "Door to Door" sales of goods or services should be further regulated.

Commissions are approached by clients seeking assistance with consumer products they have purchased in their home which have a linked credit or finance contract in order to purchase the product. The prohibitions of unsolicited contact are often avoided by devices such as obtaining contact details from consent forms on promotional material.

NLA supports the implementation of Recommendation 5.16 of the Senate Economics Legislation Committee Report:

> *"5.16 The Committee recommends that the bill defines an 'unsolicited consumer agreement' as to include circumstances in which consumers are contacted (and contact dealers) through indirect means. This should include circumstances:*
>
> *• where a consumer is contacted in relation to the supply of goods or services after providing his or her name or contact details to a person, and the predominant purpose for providing those details was not to supply those goods or services; and*
>
> *• where a consumer contacts a dealer in response to a 'missed call'."*

NLA's experience is that door to door sales transactions with linked credit tend to involve:

§ Misrepresentations of the product or associated credit;

§ A lack of understanding by the consumer of essential terms of the transaction;

§ Attempted avoidance of cooling off periods by various avoidance practices;

§ High pressure sales tactics, including visiting at inappropriate hours, and overstaying;

§ Sale of unwanted, inappropriate or unmerchantable products including computer programmes and household appliances.

§ Consumers signing uncompleted documentation with details later entered by the salesperson being inconsistent with oral representations regarding the nature of the transaction; and

§ The product marketed being used as a means to sell overpriced credit or otherwise on the best terms.

By the time the consumer feels confident enough to complain about the quality of the goods purchased the company selling the products is usually uncontactable or no longer financially viable. As a consequence, vulnerable consumers, who in many instances suffer from poor English and financial literacy, are often left with a product that has little value and a finance contract paying for the goods that has 2-5 years still to run on the product. The consumer feels powerless because of the difficulty they face in contacting the company responsible for the substandard merchandise. Vulnerable consumers often continue to pay the finance contract because of the fear that a credit company will list the debt on their credit rating if the contract falls into default.

In response to this commonly arising situation, NLA suggests when a consumer who has purchased goods or services in a door to door transaction with a linked credit contract:raises, in writing or by a phone call to either company involved in the transaction, a complaint that

- the goods were faulty, or not of merchantable quality;
  - or for any other reason did not reach the standards the salesperson represented,

the linked credit provider should be prevented from:

- bringing or asserting an intention to bring, legal proceedings against the consumer; or
- placing the name of the consumer, or causing the name of the consumer to be placed on any list of defaulters or debtors; or
- taking any other action against the consumer,

unless the linked credit provider obtains a preliminary declaration from the Court that the sales contract has *not* been validly terminated.

The effect of this recommendation is that it moves the onus of proof from a vulnerable consumer to the linked finance company to show that the products sold with linked finance meet basic standards before they are able to attempt to enforce a linked credit product against a consumer.

This protection is currently available to vulnerable consumers in section 71 of the Fair Trading Act 1989 (Qld) and should be adopted as a national protection for all vulnerable consumers throughout Australia.

16. Would some or all of the Corporations Act provisions be appropriate if applied in the context of credit?

No comment.

17. How do the Code provisions compare with and operate in the context of other Commonwealth, State and territory laws?

Please refer to the responses to Questions 14 and 15 on this point.

Chapter 8 - Coverage of Credit under National Consumer Credit Protection Act and avoidance practices

1. Does the introduction of licensing and responsible lending requirements to persons who provide or arrange regulated credit increase the incentives to avoid the Code?

The requirement that holders of an Australian Credit Licence engage in responsible lending does mean that those who wish to be able to lend irresponsibly will need to remain unlicensed and attempt to avoid the Code. However, the civil and criminal penalties in the NCCP Act and the Code should have a deterrent effect. The key to deterrence is vigilance and effective enforcement. It is useful that the NCCP Act provides consumers with remedies for unlawful credit activities and the Code

provides civil penalties enforceable by consumers for breach of key requirements of the Code.

2. What current practices are being used to provide credit without the transaction being regulated by the Code?

Until recently the principal means of avoidance has been the use of false business purpose declarations for refinancing home loans into short term, higher interest, high fee loans. Many credit providers who engaged in this activity escaped detection because consumers either re-financed or lost their homes. The slowing of growth in home prices in the later years of the decade, has slowed this practice. Court decisions that have focused on the use to which credit has been put have been reasonably effective in overturning the false declarations in those relatively few cases that went to Court. However legislative oversight is still required in cases where false business purposes declarations are not deemed invalid by the Court.

Other practices include those identified in the Green paper: concealing the cost of credit in the price of goods, the use of bills of exchange and promissory notes, and short term lending with “brokerage” or “administration fees” paid to third parties.

A particular concern in the practice of using false declarations was the use of a third person, such as a legal practitioner, who, under the former Code, was not deemed to be associated with the credit provider, to procure the declaration. This issue has been addressed in the Code and the regulations.

While the use of “nod and wink” consumer leases is not, strictly speaking, an avoidance of the Code because the Code does regulate the lease, the Code does not regulate leases to the same extent that it regulates credit contracts (see responses above in relation to consumer leases). The use of leases that do not contain an explicit option to purchase is an avoidance measure because it seeks to avoid the more thorough consumer protection that is afforded under credit contracts. Many consumers enter these transactions in the mistaken belief that they are purchasers and not lessees. In the chapter on leases above we suggest that leases be subject to the same disclosure requirements as for credit contracts to discourage the use of leases as an avoidance measure.

3. How widespread are these practices?

In recent years global economic conditions have had the unexpected silver lining of putting some fringe credit providers and fringe brokers out of the consumer credit market. As regulation has improved, the number of people involved in credit activity designed to avoid the Code has declined. However, the use of leases to avoid the degree of regulation that applies to credit contracts is increasing.

It is suggested that large scale attempted avoidance occurred under the former Code. It is hoped that the avoidance has been made more difficult by the new Code.

It is to be expected that fringe lenders will return to the market as economic conditions stabilise.

4. Are these practices being targeted at particular classes of consumers, and what are the consequences for consumers?

The use of leases rather than credit contracts is becoming more prevalent as a form of credit for the most economically disadvantaged consumers to acquire household goods and motor vehicles. The effect of this is to increase the poverty of these vulnerable consumers because the cost of leasing can be very high and, especially in the case of second-hand motor vehicles, the value of the product can be very low. Because the consumers do not become the owners of the goods unless they pay a final balloon payment for the residual value of the goods, they are trapped in a cycle of leasing and never owning.

Consumer credit regulation should most importantly protect the most economically disadvantaged. It is a problem that economically and socially disadvantaged people have limited access to credit and at greater cost than less risky borrowers.

The use of false business purpose declarations is likely to continue at the fringes of the market. A regulatory difficulty arises because consumers desperate for credit can be complicit in the false business purpose declaration in order to obtain credit and are therefore vulnerable to allegations of fraud directed at them by lenders who disclaim knowledge of the conduct of the broker who procured the declaration.

The requirement for more extensive inquiries as to purpose may be met by more elaborate fraudulent conduct by unscrupulous brokers. This places vulnerable consumers at risk of being drawn into criminal conduct.

5. ***What are the consequences for lenders and brokers who are complying with the Credit Act?***

These practices tend to give the avoiders an unfair competitive advantage over those who comply with the Code and undertake the expense of having and monitoring compliance programs. These kind of practices can also damage the reputation of industry overall to the unfair detriment of the reputation of the lenders and brokers who do comply with the rules.

6. ***Should this type of lending (where intermediaries link borrowers to lenders who are not clearly carrying on the business of providing credit or providing credit in the course of a business) be regulated by the Code, and what issues should be taken into account in considering this question?***

The reach of the Code should be extended, as far as possible, to protect all consumers. Under the ASIC Act and the Trade Practices Act consumer protection is provided with reference to the product being under the prescribed value or being a kind ordinarily acquired for personal, household or domestic purposes. On the other hand, the rationale for confining regulation to credit provided in the course of a business is that it is not really possible to comprehensively regulate lending by friends or relatives of the borrower even in those circumstances where a charge is made for the provision of credit.

However, where the lender was first introduced by an intermediary who receives fees (from the lender or the borrower or both) both the lender and the intermediary should comply with the Code.

Lending on the security of a first mortgage over residential property has long been a form of investment seen as producing higher levels of return to the investor than saving in a deposit taking institution. Often these lenders are retirees or recipients of personal injury damages awards who have modest assets and are attempting to generate a slightly higher level of income without significant risk. The products are

promoted as having a low risk of loss of capital because they have first mortgage security and are based on a conservative loan to value ratio.

In recent years schemes of this kind have been promoted to potential lenders on the basis that the borrower will be using the money for an investment, thus taking the transaction outside the reach of the Code. When the Code in fact applies, the consequences for the lender can be serious and costly.

Under the new Code, investment in residential property is a use of credit that attracts the protection of the Code and perhaps the incidence of attempted avoidance of the Code on that ground will decline. However, if the question whether the Code applies to the transaction depends on whether the credit provider is carrying on a business of providing credit or providing credit incidentally to a business, this will cause uncertainty for borrowers, whose consumer protection in a particular transaction will depend on the circumstance over which they have no control and no means of knowing: the identity and nature of the lender. Therefore, it is essential that the credit be provided in accordance with the Code.

7. If it is to be regulated should the lender be required to hold a licence or should they be exempt provided the intermediary is licensed?

The best way of ensuring that this type of credit is regulated by the Code is to require the intermediary to be licensed and to expand the definition of credit provider in the Code to include intermediaries who facilitate this kind of transaction even though they do not risk their own funds to provide the credit.

In view of the use of this type of scheme as an investment by individuals, often of relatively modest means, it would be administratively difficult to require the ultimate lender to have a license unless they carry on a business of providing credit or provide credit incidentally to a business. However, there is a concern that, if the lender - who is in privity of contract with the borrower and holds the securities - is not licensed, does not have an IDR process and is not a member of an EDR scheme, the lender will be able to commence or continue enforcement processes even while a dispute or hardship variation is being dealt with by the intermediary.

If the lender is to be exempt from the licensing requirement, some other regulatory change will be required to ensure that enforcement cannot take place while the borrower and intermediary engage in IDR or EDR.

8. Is there a need to amend the definitions of credit or regulated credit in the Code?

As noted above, one way of ensuring that consumers have the full protection of the Code in the situation where the lender may not be in business, but an intermediary is operating a business is to redefine “credit provider” to include intermediaries.

The practices identified in the Green Paper of concealing the cost of credit in the cost of land or in the cost of goods sold on instalments have been addressed in sections 10, 11 and 12 of the new Code.

There is a risk that a change to the definition of credit or the removal of the requirement that a charge is imposed for the provision of credit may complicate and perhaps lessen the availability of credit in other consumer transactions; such as provision of goods and services on a deferred fee basis where no charge is made for the credit and the goods or services are provided at standard prices.

A more comprehensive change would be to remove the requirement that credit be provided wholly or predominantly for personal, household and domestic purposes and extend the protection of the Code to small business borrowers as canvassed in Chapter 1. NLA notes that the discussion in Chapter 1 did not specifically address the extension of the Code to small business as an anti-avoidance measure, it is worth considering it from that point of view.

9. If any particular elements of the definition need to be changed, what avoidance practices are they intended to prevent, and what mainstream practices might also be covered by any change?

Please refer to the response to Question 8.

10. Are there different factors to be taken into account in considering whether to extend the definition of regulated credit as it applies to intermediaries and to lenders?

If the matter is addressed by changing the definition of credit provider without changing the definition of credit, there may not need to be a change to the definition of regulated credit. If a change is made to the definition of credit, it may be necessary to confine that definition to this particular type of practice.

11. What are the advantages and disadvantages of this approach (of option 3 - responding to individual practices)?

A disadvantage of changing the definition of regulated credit for a particular type of transaction is the risk that regulation will be seen to be cumbersome and complex. There is also the risk that regulation of a particular model of transaction will give rise to attempts to modify aspects of the transaction to avoid the particular regulation.

It is to be expected that Federal regulation of consumer credit will be more adaptable in the face of newly identified avoidance measures than was possible in the former model of co-operative credit regulation.

However, an advantage of approaching avoidance on a case by case basis is that it can guard against unintended consequences of regulatory change.

11A. What issues should be taken into account in considering these options?

NLA notes that number 11 has been allocated to 2 questions in this chapter. This answer addresses the question posed on page 103.

The issue of prevention of avoidance involves weighing the risks of unintended regulatory consequences and the fact that avoidance often targets the most disadvantaged and vulnerable consumers, who have the greatest need of protection.

A case by case approach can protect future vulnerable consumers, but leave those caught up in an avoidance scheme behind.

NLA considers that the success of past avoidance practices resulted from the fact that most consumer claims were promptly settled before a Court could examine the transaction and enforcement action was not often taken by regulators. Many of those

avoidance practices were regulated by the Code, but the issues were not tested in Court.

If a robust approach to the enforcement of compliance with the Code is taken and identified avoidance measures are challenged by the regulator in Court, this could reduce the incidence of avoidance attempts. As noted above, regulatory vigilance and the enforcement of penalties have a deterrent effect on avoidance. If intermediaries are required to be licensed, the danger that intermediaries will create borderline credit products at the risk of the (perhaps unwary) lender will be reduced.

The establishment of a mechanism for prompt determination of whether credit of a particular type is regulated would mean that newly identified avoidance practices could be addressed before a great number of consumers became entangled in them.

12. Which option would be most effective in addressing the issue of avoidance?

NLA supports the option of a general anti-avoidance provision in combination with Option Three (respond to avoidance case by case) if the regulator is equipped with the resources to pursue vigorous enforcement.

NLA suggests that in combination with a robust approach to enforcement of the current laws, a case by case approach to avoidance practices is to be preferred.

A general anti-avoidance measure combined with a summary process of determining whether a type of transaction is regulated could provide both the deterrence and regulatory responsiveness needed to minimise avoidance.

13. Are there any other methods or strategies that could be used to address* the *issue of avoidance?

NLA considers that the civil penalty regime operating under the former Credit Acts which exposed unlicensed credit providers to payment of a penalty equivalent to the principal and interest had merit: it allowed for enforcement by consumers and was a strong deterrent to avoidance.

Conclusion

Should you require further information, please do not hesitate to contact us.

Yours sincerely,

Alan Kirkland
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