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The Secretary  
Senate Economics Legislation Committee  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

17th July 2009

Dear Committee Secretary

**Re: Inquiry into the National Consumer Credit Protection Bill 2009 (The Bill)**

**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.

National Legal Aid provided comments in the consultation phase of the Draft Exposure Consumer Credit Protection Bill (**Exposure Draft**) by letter dated 22 May 2009, which is attached at **appendix A**. NLA welcomes the opportunity to comment on the Bill in its current form through this Senate Inquiry. NLA would be pleased to give evidence to the Inquiry on both our earlier submission and the comments made below.

Our comments are informed by the delivery of front-line legal services to thousands of consumers in dispute with credit providers and/or intermediaries in relation to the provision of credit. These services include the provision of legal advice and casework to assist consumers in all States and Territories. Our comments are also

informed by working closely with other key service providers including consumer advocates and financial counsellors.

NLA supports the development of a national regime to regulate consumer credit. However there are certain aspects of the Bill, which in our view if left in their current form, pose very significant barriers to the effective operation of a national consumer credit regulatory framework, and will work against providing essential protection of consumers from unjust lending practices.

### **1. Responsible Lending**

NLA is concerned about the delayed implementation of the Responsible Lending Conduct provisions of the Bill, which will not come into force until January 2011. This concern is in relation to the conduct of brokers and fringe lenders in particular.

Some States (such as NSW, ACT, Victoria and Western Australia) have varying degrees of broker regulation at present. However if these States relinquish this responsibility at the commencement of the Bill in January 2010, there will be no regulation of the conduct of brokers anywhere (including in the some of the most populous States) for 12 months. This will result in a very significant gap in the protection of consumers, at a time when consumers are more vulnerable to unjust lending practices due to the tightening availability of credit through more mainstream credit providers.

A related concern in relation to this is the provision<sup>1</sup> in the Bill which absolves a credit provider, who has obtained a credit application through a broker within the last 90 days, from the responsibility of independently verifying the information used to assess a consumer's suitability to enter into the credit contract, where such verification has apparently been undertaken by a credit assistant (broker).

By providing immunity to credit providers who do not go through the proper process of verifying a credit application, such a provision has the potential to directly undermine the effectiveness of the national regime to protect consumers from unsuitable credit contracts.

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<sup>1</sup> S 130(3) National Consumer Credit Protection Bill 2009

Australia's long and proud history of financial stability has been based primarily on the stability and security of our credit providers, particularly the banks. Since the banking system began in this country, the assessment of risk has remained a core business function of credit providers.

The unusual provisions in s 130 directly challenge the legislative intent of the Bill by, for the first time, endorsing a new culture in lending where credit providers will be permitted to outsource their assessment of risk where credit is provided through credit assistance providers such as broker services.

Consumers who obtain credit through credit providers will be assessed with all of the precautions one would naturally expect from a corporation who carries the financial risk in relation to default. Consumers who obtain credit through credit assistance providers will be assessed by those credit assisters, who bear no direct risk in respect of default, but who have a direct financial incentive for ensuring the credit contract is approved. This sets up an inherent potential conflict where a credit assistance provider (whose client is the borrower) is being empowered to verify the information used in an assessment of the suitability of a credit product (on behalf of the credit provider).

Finance brokers have come under increasing criticism for a culture that has developed over the last decade, which has not been consistent with prudent lending. It is this culture, which has included activities known as equity stripping and predatory lending, that has been one of the key drivers in developing national legislation to regulate broker activity. In our view it will be extremely risky to enable credit assistance providers such as finance brokers to verify the capacity borrowers to meet repayments and other information pertinent to product suitability.

This provision might also result in consumers being forced to bear the risk because:

- o Credit providers will seek to avoid risk of liability for an unsuitable loan by pointing to the activities of credit assistance providers;
- o Credit assistance providers often do not have the financial resources to pay successful claims for damages by consumers; and<sup>2</sup>

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<sup>2</sup> Whilst licensees will be required to hold professional indemnity policies, recent experience from the sub-prime crisis demonstrates that underpinning financial products with insurance policies is no guarantee to the stability of the market. Many investors who had claims on the professional indemnity policies with financial planners did not cover their losses.

- o Consumers cannot stop enforcement action by the credit provider whilst they take legal action against the credit assistance provider (this means they could lose the house that they live in despite ultimately having a decision made in their favour against the credit assistance provider).

Credit providers, particularly banks, have the skills, resources and capacity to assess risk as part of their core financial competence. This function lies at the very heart of their business and should not be outsourced to agents who although licensed, will not have the same capacity, independence and objectivity on the suitability of credit products and the capacity of consumers to meet repayments.

## **2. Financial Hardship Provisions**

In our submission of 22 May 2009, we drew attention to the importance of the financial hardship rules, currently contained in sections 66-68 of the Uniform Consumer Credit Code (UCCC).

We are pleased to see that the proposed requirement for credit providers to respond to borrowers requesting hardship assistance within 21 days and in writing has been confirmed in the Bill, via the new section 72(3) in Schedule 1.

Unfortunately however, a number of other key concerns have not been addressed.

In particular, the following problems have not been addressed, which in our view will result in substantial barriers to effective access to the process for obtaining relief on the grounds of financial hardship:

- There has been no consultation to date on the procedures that will operate in the Small Claims Division of the Federal Court;
  - There is no requirement for credit providers to supply reasons if a request for hardship assistance is rejected;
  - It remains unclear as to what will constitute 'applying' for hardship relief;
  - There is no provision for an automatic stay on enforcement proceedings when a borrower refers a matter to an External Dispute Resolution (EDR) scheme or makes a hardship request;
  - There is a lack of certainty regarding the powers and capacity of EDR schemes;
- and

- There is no requirement that mandatory default notices provide information about the free legal services available to borrowers in their State or Territory of residence.<sup>3</sup>

The National Consumer Credit Protection (Transitional and Consequential Provisions) Bill provides for UCCC regulated contracts to be picked up under the new regulatory regime, save for a number of specific provisions – one of which is the section increasing the hardship cap to \$500,000. The only contracts to which the increased cap will apply are those written after commencement of the Bill. Instead, for contracts written before commencement, the hardship cap will continue to be determined by the floating system currently administered by the States and Territories under the UCCC. Without making any comment on the legal basis for making this change in the Bill, the operation of a two-tiered cap will be at best confusing for borrowers.

In addition to this limitation, credit providers who are not involved in new lending, usually as a result of the tightening of availability of credit, but continue to manage an existing loan portfolio, have no requirement to be licensed or join an external dispute resolution scheme (Part 3, clause 18 of the Transitional Bill). Assignees of an existing portfolio will be similarly excluded unless they are collecting debts arising from contracts entered after the commencement of the Bill. It could take some years before this is the case. This coupled with the lack of clarity over the procedures in the Federal jurisdiction, and its interaction with debt enforcement procedures of the State Courts, may make hardship assistance for affected borrowers more difficult to access in some States under the proposed legislation than under the existing UCCC regime.

The net result is that the intention of the proposed legislation to improve access to hardship relief may not be achieved in some cases as it may be more difficult to access these protections than under the current regime.

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<sup>3</sup> Section 88(3) of Schedule 1 of the Bill contains a list of information that must be included in the pre-enforcement default notice. We note that information about free legal services is not included. Section 88(3)(j) provides for '*any other information prescribed by the regulations*' to be included. We note however that the regulations are not yet ready for review.

### 3. No regulations available for consultation

In our response to the Exposure Draft, NLA suggested that unlike the UCCC, the proposed framework allows for consumers to be sued in a State where they are not ordinarily resident. NLA is concerned that consumers will face many difficulties as a result of the removal of previous restrictions on the location in which proceedings can be commenced.

The Bill remains silent on this issue but suggests this might be addressed in forthcoming regulations. Without the opportunity to read any proposed regulations NLA remains concerned that consumers may be worse off when litigation is commenced against them under the new law.

For example, currently consumers can defend proceedings where they live. The Bill proposes that court proceedings can start anywhere in Australia regardless of where a contract was formed or the consumer lives.

NLA recommended that this could be remedied by a restriction in the Bill to provide that any proceedings commenced by a credit provider must be instituted in the registry nearest to where the debtor resides. Instead, s 330(3) provides that regulations may proscribe the location of court proceedings.

NLA agreed with the commentary to the Exposure Draft where it noted that the lack of restriction as to where proceedings can be commenced may be a '*material barrier to justice for consumers*'. Proceedings in another state are a significant barrier to access to justice for consumers and a costly impost on the provision of legal aid services.

Another example of a critical regulation is that which we are told will list which requirements of the Bill affect the validity or enforceability of a transaction (see s 333).

In both the above examples which are not exclusive, the regulations may depending on their content, mean that consumers are worse off as a result of the transfer of power to the Commonwealth.

**The availability of support services**

NLA remains concerned about the lack of low cost legal services, which will in some cases significantly impede access to the protections provided by this legislative package. On many occasions consumers will be able to navigate their own way through the primary vehicle relied upon in the Bill to resolve to disputes - external dispute resolution (EDR) – but our experience is that there will also be consumers, who will still need legal advice and assistance in order to effectively participate in the process whether before the courts or in EDR.

The consumers NLA is most concerned about include those who will be required to be a party to court processes where their homes are being repossessed, but who also may be entitled to a hardship variation or some other relief, that might save their homes. There are many borrowers in the credit market, who are financially unsophisticated and unable to adequately represent their own interests against credit providers (who in most cases are represented through in-house legal teams).

Low cost legal services (such as legal aid commissions and specialist community legal centres) provide vital legal advice and assistance to support vulnerable consumers to access protections provided by legislation.

We are also told by financial counsellors that access to legal advisers enables them to properly assist consumers, particularly where credit providers are increasingly taking a more conservative (and at times inconsistent) approach to the interests of consumers.

While there has been an increase to the Commonwealth Financial Counselling Program in 2008-09 there has been no corresponding increase in funding for legal assistance for people experiencing difficulties meeting mortgage payments where the credit provider is not prepared to negotiate a hardship variation.

NLA is able to provide numerous examples where in this situation, with the assistance of a small amount of legal assistance, a hardship variation has been obtained and repossession of the borrower's home has been averted. NLA is aware that there are many borrowers facing this situation who are unable to access legal assistance and who have lost their homes unnecessarily.

The Senate Committee may also wish to note that whilst some major credit providers such as the *Big 4* banks have publicly committed to varying loan repayments where a borrower has been recently employed, the overwhelming experience of consumer advocates and legal aid lawyers is that major lenders are applying this policy inconsistently, the policy itself is not well advertised, and consumers still need access to advice to ensure that they are pursuing the best outcome for their situation.

Thank you for the opportunity to provide these comments. Should you require further information in relation to any of the issues raised in this submission, please contact Louise Smith, Executive Officer, on (03) 6236 3813 or by email to [louise.smith@legalaid.tas.gov.au](mailto:louise.smith@legalaid.tas.gov.au).

Yours sincerely



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