FINANCIAL OMBUDSMAN SERVICE

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

Via email: economics.sen@aph.gov.au

Dear Sir

National Consumer Credit Protection Bill 2009

The Financial Ombudsman Service ("FOS") wishes to make the following submission in relation the National Consumer Credit Protection Bill 2009 ("NCCP Bill"). The views expressed in this submission do not necessarily reflect the views of the Board of Directors of FOS.

FOS welcomes the introduction of National Consumer Credit legislation and supports the Bill in its current form, save for two areas where FOS is of the view that improvements can be made.

Maladministration and Responsible Lending

The Financial Ombudsman Service ("FOS") and one of its predecessor schemes, the Banking & Financial Services Ombudsman has, for some time, had the ability to consider disputes where there has been maladministration in lending. "Maladministration" is defined in the current Terms of Reference as follows:

> "*The Ombudsman can consider any dispute described in 3 except:*
>
> *(a) to the extent the dispute relates solely to a financial services provider's commercial judgment in decisions about lending or security. A dispute will relate to commercial judgment if the financial services provider made an assessment of risk, or of financial or commercial criteria or of character.*

> *The Ombudsman may consider disputes about maladministration in lending or security matters which involve an act or omission contrary to or not in accordance with a duty owed at law or pursuant to the terms (express or implied) of the contract between the financial services provider and the disputant;"*

In the Proposed FOS Reference that will come into effect from 1 January 2010, maladministration is defined in clause 5.1 in the following terms:

> *"The Service may not consider a Dispute:*
>
> *.....*
>
> *b) about the Financial Services Provider's assessment of the credit risk posed by a borrower or the security to be required for a loan but this does not prevent FOS from considering a Dispute:*
>
> *(i) claiming maladministration in lending, loan management or security matters; or*
>
> *(ii) about the variation of a Credit Contract as a result of the Applicant being in financial hardship;"*

Maladministration is defined as:

> *"an act or omission contrary to or not in accordance with a duty or obligation owed at law or pursuant to the terms (express or implied) of the contract between the Financial Services Provider and the Applicant."*

It is likely that financial institutions will respond differently to an application for credit from the same applicant because of their different considerations of credit risk and the profile of the applicant. The Ombudsman is not able to interfere with the lending policies of its members to the extent that they reflect the lender's commercial judgment. So disputes solely about a lender's decision not to advance credit or its decision to demand repayment of a debt properly owed and exercise its legal entitlements to recover the debt are about the lender's commercial decision and, as long as no other claims arise, are matters which are outside the Ombudsman's jurisdiction.

If, however, a dispute raises a question about whether there was maladministration in a decision about lending or security, it falls within clause 5.1(a) of the Terms of Reference.

Our approach to dealing with maladministration has always been that, in determining whether there has been maladministration in the lender's decision, the issue of the applicant's ability to repay is critical. This is reinforced by clause 25.1 of the Code of Banking Practice (CBP) and sub section 70(2)(l) of the UCCC.

Clause 25.1 of the CBP contractually binds adopting banks to "*exercise the care and skill of a diligent and prudent banker in selecting and applying* [its] *credit assessment methods and in forming* [its] *opinion about a* [customer's] *capacity to repay.*"

Banks have a duty under the banker-customer contract "*to exercise reasonable care and skill in carrying out* [the bank's] *part with regard to operations within its contract with its customer*". The standard of care for a bank is that of "*the reasonable competent banker acting in accordance with accepted current practice.*"[1]

Section 70 of the UCCC gives a court the power to reopen contracts it concludes are unjust. One of the factors the court may have regard to when assessing a particular contract is the enquiry made of the debtor as to his or her capacity to repay as set out in s. 70(2)(l):

> *"(l) at the time the contract, …… was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship;"*

We have issued the following Bulletins dealing with our approach to maladministration:

- Bulletin 45 - Maladministration and credit card limits;
- Bulletin 50 - Maladministration and Unconscionable conduct; and
- Bulletin 60 - Maladministration and secured lending;

These Bulletins are available on our website, www.fos.org.au

The Responsible Lending Provisions of the NCCP Bill

It is our view that the Responsible Lending provisions of the NCCP Bill will enhance our long standing jurisdiction in relation to maladministration, save for one aspect where we believe it will lower the standard of responsible lending rather than raise it.

Section 130 of the NCCP Bill provides that before entering into, or increasing a consumer's liability under, a credit contract, the lender is required to make reasonable inquiries of the consumer about the consumer's requirements, objectives and financial situation and to verify the consumer's financial situation.

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[1] *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555

Section 130(3), however, provides that if a preliminary assessment has been undertaken by a person providing credit assistance, the lender is not required to verify the information obtained in the course of that preliminary assessment.

We often see cases where it is alleged that pay slips have been forged by a credit assistant (a mortgage broker) and have been accepted by the credit provider with no further enquiry. The consumer later alleges they had no knowledge of the forgery. For example, in one recent case we have seen, the broker forged the supporting documents because it appeared the broker stood to benefit from the underlying transaction as a vendor of the property. The lender was in possession of sufficient information to discover this had it made further inquiries, including verifying the information provided by the broker. It failed to do so to the detriment of the customer. Unfortunately, cases where the broker (with or without the knowledge of the customer) has provided false information are not isolated ones.

We are of the view that where the circumstances of the transaction "ring alarm bells" the lender should make further enquiries to ensure that the concerns are without foundation. To allow a lender to rely on the verification conducted by a credit assistant without further enquiry is not in accordance with good industry practice, nor is it of a standard expected of a diligent and prudent lender.

In the vast majority of cases, it will be reasonable for a responsible lender to rely on the information verified by the credit assistant without further inquiry. In other cases, it is our view that a diligent and prudent lender should conduct their own verification in order to ensure that the lending meets the consumer's requirements and objectives and that the consumer can repay the loan without undue hardship. Section 130(3) treats all cases on the same level by excusing a lender from making further inquiry even though "alarm bells" are ringing. It is our view, therefore, that Section 130(3) should be modified

In our view, if information provided to the credit provider is inadequate or equivocal, we would expect the credit provider to make reasonable inquiries about the consumer's financial situation (as required by section 130(1)(b). This may necessitate the credit provider verifying information which has been provided by a credit assistance provider. We are concerned that some credit providers may not make these enquiries (even though a diligent and prudent credit provider would do so) relying on s 130(3) of the Bill. This will result in lending that is not, in our view, responsible. Merely relying on the credit assistant also being a licensed person would not alleviate the potentially detrimental consequences for the borrower.

It is our view, therefore, that it would be preferable, if s 130(3) were amended to allow a credit provider to rely on the verification of information by the credit assistant provided that to do so is reasonable in all of the circumstances.

If the section were qualified in this manner, it would maintain the existing standard of responsible lending as we presently apply it in cases about maladministration in lending and ensure that credit providers operate in a manner that is efficient, honest and fair. Without such an amendment, it is our view that the view that the Bill in its present form arguably introduces a standard of responsible lending that is actually lower than presently exists for financial services providers who are members of FOS.

Consumer Remedies

We have been provided with a draft of a submission we understand that the Credit Ombudsman Service intends to make in respect of the question of whether the Bill adequately addresses the ability of an EDR Scheme to make an award of compensation for a breach of the responsible lending provisions of the Bill.

For a number of reasons, we do not necessarily agree with the content of the draft submission. However, we agree that it would be preferable to remove any doubt that a consumer can claim compensation for a breach of the responsible lending provisions without the need for a determination of a breach of a civil penalty provision.

This could be achieved by making it clear that a person who suffers loss as a result of a contravention may recover the amount of the loss from the person involved in the contravention, in a similar way that a consumer can obtain compensation for a breach of the ASIC Act (see section 12GF of the ASIC Act) or for a breach of the National Credit Code (that is, Schedule 1 of the NCCP Bill under s 124 of the Code). Neither of these provisions is dependent on a declaration that a civil penalty breach has occurred (or that an offence has been committed).

If you wish to discuss the matter further or have any further questions, please do not hesitate to contact me or Philip Field, Ombudsman – Banking & Finance (telephone number (03) 9613 7306 / email pfield@fos.org.au).

Yours sincerely

Colin Neave
Chief Ombudsman