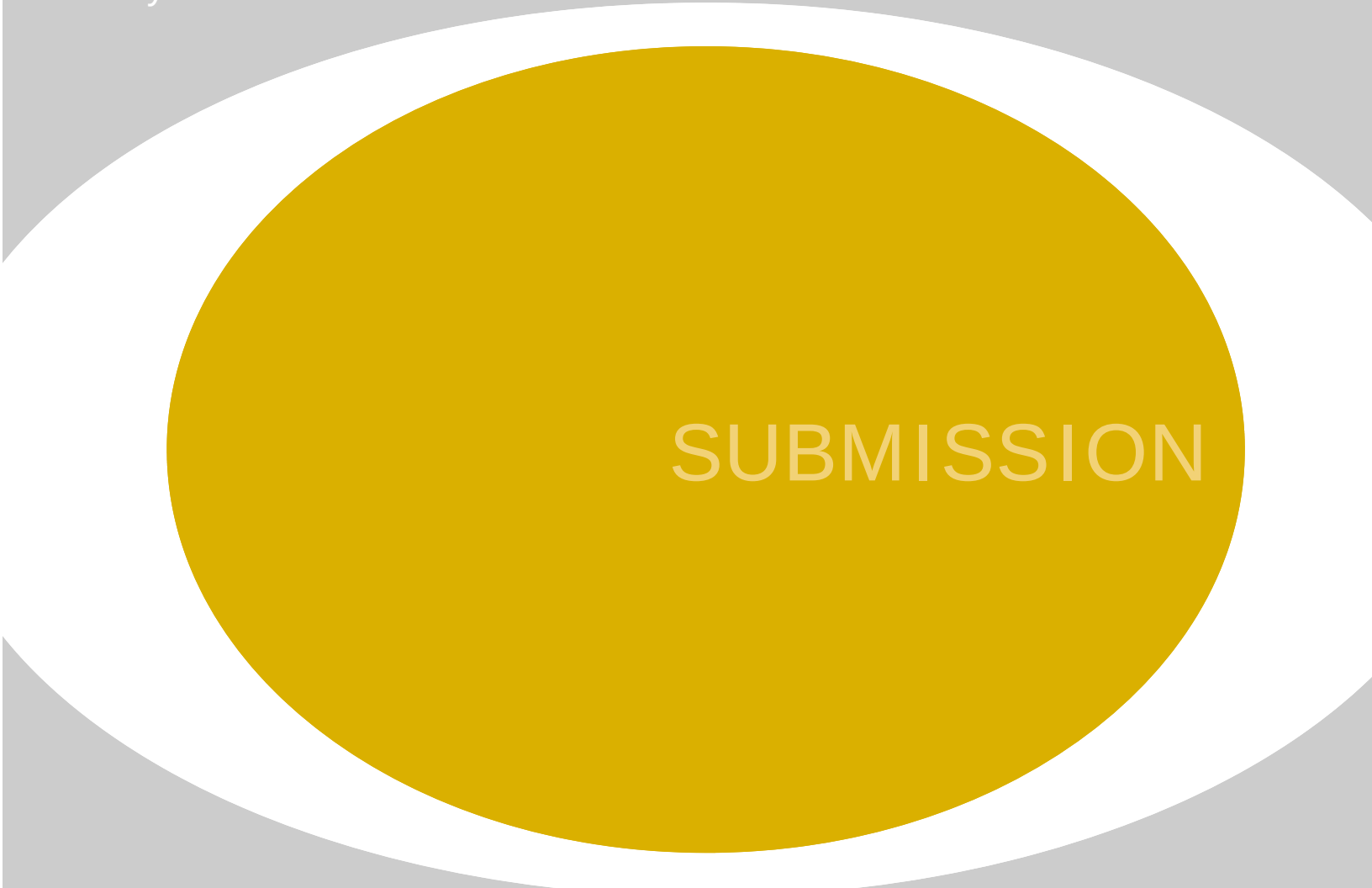
Credit Ombudsman Service

National Consumer Credit Protection Bill 2009 and related bills

Submission to Senate Economics Committee

July 2009



National Consumer Credit Protection Bill 2009 and related bills

1. Our organisation

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

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

The key objects of COSL are to:

(a) act as the primary complaints resolution body for the credit industry; and

(b) provide an alternative to legal proceedings for the resolution of complaints between consumers and financial service providers who are members of COSL.

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

COSL is the largest EDR scheme in Australia with about 8,600 members, and covers a further 11,300 (non-member) loan writers.

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

2. This submission

Given the nature and composition of its membership, COSL is in a unique position to comment on the Bills[1] and, in particular, the regulation of credit providers, credit services providers and credit representatives in the context of external dispute resolution.

NATIONAL CONSUMER CREDIT PROTECTION BILL ("the Bill")

3. Delay in the commencement of responsible lending provisions

We are disappointed that the commencement date of the responsible lending provisions has been deferred to 1 January 2011; that is, twelve months from the date that was originally announced.

Quite simply, the delay will mean that consumers will miss out on the important consumer protections and remedies prescribed by the Bill. This will be made worse when NSW, VIC, WA and ACT 'switch off' their own broker regulation on 31 December 2009.

[1] National Consumer Credit Protection Bill 2009 and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009

4. Consumer remedies

The Bill is significantly deficient in that it severely limits the ability of a consumer to seek compensation for loss suffered as a result of a contravention of a responsible lending provision by a licensee or credit assistant.

Under sections 178 and 179 of the Bill, a consumer can only seek compensation if (and only if) a civil penalty breach has been declared (or an offence is found to have been committed). This qualification is significant but entirely unnecessary.

An EDR scheme is not of course in a position to declare that a civil penalty breach has occurred (or that an offence has been committed). Consequently, as presently drafted, sections 178 and 179 of the Bill will not permit an EDR scheme to award compensation to a consumer for a contravention of a responsible lending provision unless and until a civil penalty breach has been declared (or an offence is found to have been committed).

Furthermore, the responsible lending principles prescribed in the Bill have no equivalent under existing law. Consequently, an EDR scheme will not be able to rely on existing law to found a cause of action that would provide a consumer with redress for loss suffered as a result of a licensee or credit assistant contravening responsible lending principles. Of necessity, an EDR scheme will have to rely on sections 178 and 179, subject to the qualification that a civil penalty breach must have been first declared (or an offence must first have been found to have been committed).

Significantly, the qualification in sections 178 and 179 do not appear in, for example, section 12GF of the ASIC Act which provides that a person who suffers loss as a result of a contravention of certain provisions of the ASIC Act (dealing with unconscionable and misleading conduct) may recover the amount of the loss from the person involved in the contravention.

Similarly, section 124 of the National Credit Code expressly provides that a court can order compensation to be paid to a debtor who has been caused loss as a result of breach of that Code.

Neither of these provisions is dependent on a declaration that a civil penalty breach has occurred (or an offence has been committed).

We therefore consider that it is imperative that the Bill incorporate a provision similar to either section 12GF ASIC Act or section 124 of the National Credit Code to provide consumers with private remedial redress for contraventions of the responsible lending provisions.

5. Section 130(3) – Reliance on verification performed by credit assistant

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

However, we have significant concerns about section 130(3) which we consider undermines the intent and potential effectiveness of the responsible lending provisions.

Section 130(3) states that a credit provider is not required to take steps to verify the consumer's financial position, where the preliminary assessment of the credit assistant (ie. broker) suggests that the credit contract or increase to the credit limit is not unsuitable for the consumer.

This has the effect of allowing the credit provider to rely on the information that was used by a credit assistant for the purpose of making its preliminary assessment.

This represents an undesirable shift in the Bill's responsible lending obligations from the credit provider to the credit assistant. This is also inconsistent with the Explanatory Memorandum's stated policy objective of having different levels of credit assessment for credit providers and credit assistants. In fact, the effect of section 130(3) is that significant obligations of the credit provider under the Bill are relegated to a level equivalent to the obligations owed by a credit assistant.

We appreciate that section 130(3) is intended to avoid the credit provider having to verify information already obtained by the credit assistant.

However, our experience suggests that some credit providers will contend that they relied on the broker's verification (as they are entitled to under sections 130(3)), and were not therefore on notice that the loan application was, for example, fraudulently completed by the broker or that the declaration as to capacity to repay was falsely made by the consumer. Yet in these cases, the most perfunctory of inquiries by the credit provider may have uncovered these deficiencies.

It should be noted that under existing law, a credit provider has no obligation to obtain proof of the stated income of the borrower, either directly from the borrower or from a third party.[2] Furthermore, section 76(2)(l) of the National Credit Code does not impose a positive obligation on the credit provider to make reasonable enquiries as to the borrower's capacity to repay. But for section 130(3), the Bill offered the prospect of overcoming these limitations under the existing law.

We therefore consider that the objective of the responsible lending provisions in the Bill will be severely undermined by the very real likelihood that section 130(3) will be exploited by predatory lenders as a defence to not undertaking verification, relying instead on the preliminary assessment and information provided by the credit assistant.

[2] Accom Finance Pty Limited v Mars Pty Limited, Accom Pty Limited v Kowalczuck (2007) NSWSC 726

We consider that if section 130(3) is retained, the responsible lending obligations of the Bill will add little, if anything, to the existing law on unjustness. This would be an unintended consequence and undermine the Government's objective to stamp out predatory lending practices.

There is also a plausible argument that the responsible lending provisions of the Bill are intended to 'cover the field', and a Court would now be precluded from applying existing case law that permits, in certain circumstances, the failings of an intermediary to be sheeted home to the credit provider.[3]

We therefore ask that section 130(3) be deleted in its entirety. By doing so, it is still open to a credit provider to either rely on the verification and information received from the credit assistant or undertake further verification. The significant difference is that section 130(3) will not be used by predatory lenders as a defence to avoid undertaking proper verification of the consumer's financial position.

6. Credit representative's quote

Before providing credit assistance to a consumer, a licensee must provide a quote for the credit assistance that is to be provided.[4] The quote advises the consumer of the maximum cost of the credit assistant's services.

The quote must also set out information about the credit assistance and other services to be covered. The Explanatory Memorandum to the Bill at 3.49 suggests that this *might* include the scope of the credit assistance to be provided, such as the consumer's requirements or the type of loan the consumer is looking for.

However, we consider that it should be made an express legislative requirement that the quote set out the consumer's credit requirements, namely:

(a) the amount of credit sought by the consumer or (if the amount is not known) the maximum amount of credit, or the credit limit, sought by the consumer;

(b) if the credit is to be for a fixed term, the term of the credit sought by the consumer;

(c) the maximum interest rate that (at current interest rates) the consumer would be prepared to accept in respect of the credit;

(d) the date by which the credit is to have been secured for the consumer; and

(e) a description of any special loan features (such as redraw facilities) that are required by the consumer.

[3] Perpetual Trustee Company Limited v Albert and Rose Khoshaba [2006] NSWCA 41, per Handley JA
[4] section 114 of the NCCP Bill

Such an amendment to the Bill would be immensely useful to EDR schemes when determining if the product recommended by the licensee matched the consumer's requirements. Without this amendment, there is unlikely to be any documentary evidence of the consumer's requirements, leaving EDR schemes to ascertain, on balance, the veracity of each party's version of events. This is not an ideal outcome.

7. Requiring credit representatives to join an EDR scheme

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

Recent developments in relation to Timbercorp and Great Southern Plantations, both of which have now gone into administration, lend compelling support for this requirement.

ASIC has already received 708 complaints relating to the managed investment schemes operated by these AFS licensees. Both these companies used authorised representatives extensively to sell managed investments. Consequently, investors in these products will have no recourse but to seek to recover their losses through costly legal proceedings against these authorised representatives.

More accessible and cost effective redress would have been available had the authorised representatives been required, under Chapter 7 Corporations Act, to join an ASIC-approved EDR scheme.

We therefore commend the Bill's requirement for credit representatives (and individuals authorised by a body corporate credit representative), to join an ASIC-approved EDR scheme.

NATIONAL CREDIT CODE

8. Hardship threshold

We welcome the Commonwealth Government's decision to:

- increase to $500,000 the monetary threshold under which debtors with loans not exceeding that amount may seek assistance from credit providers if they are experiencing financial hardship; [5]
- allow a debtor to request the Court to postpone enforcement proceedings where the maximum amount of credit is not more than $500,000;[6] and
- require the credit provider to respond to the debtor within 21 days of the debtor's application for a payment variation on grounds of financial hardship.[7]

[5] section 72(5) of the National Credit Code
[6] section 96 of the National Credit Code

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

However, we note with disappointment that the new hardship threshold of $500,000 will not apply to credit contracts made before the Code commences. This means that borrowers with existing credit contracts will not have the benefit of the new threshold. This is inconsistent with the many announcements made by the Government.[8]

Furthermore, it appears that the cumbersome floating threshold prescribed by the State-based Consumer Credit Code will necessarily continue to apply to such contracts for years to come.

We also note that the National Credit Code merely entitles a debtor to apply for a hardship variation or a stay of enforcement proceedings. Surprisingly, there is no obligation on the part of the lender to do more than receive the application for a hardship variation.

It is also noted that under section 72(2), a Court is limited to changing the credit contract in a manner set out in section 74. Unfortunately, section 72 continues to limit the types of variations that a debtor may seek from the credit provider on grounds of financial hardship.

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

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

(a) genuinely consider the debtor's financial circumstances;

(b) consider in good faith an application for a payment variation (for example, assess the application without taking into account matters extraneous to section 72 such as the debtor's previous payment history[9] or previous hardship applications[10]);

(c) if legal proceedings have already commenced, consider in good faith an application by the debtor for a stay of enforcement proceedings;

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[7] section 94(2) of the National Credit Code

[8] For example, Minister Sherry's press release of 27 April 2009

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

[10] Harding v National Australia Bank Ltd (Credit) [2007] VCAT 1234 (9 July 2007) - C. McKenzie, Deputy President

(d) if legal proceedings have not commenced, desist from commencing legal proceedings to recover the debt while the credit provider is considering the debtor's financial circumstances and hardship application;

(e) desist from listing a default while it is considering the application;

(f) consider other types of temporary payment arrangements, including reducing interest rates, allowing interest-free payments, postponing loan repayments, increasing credit limits and deferring or waiving arrears and fees and charges; and

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

We consider that these proposed amendments will:

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