SUBMISSION 8

consumer action law centre

23rd July 2007

House of Representatives Standing Committee on
Economics, Finance and Public Administration
Parliament House
Canberra ACT 2600

Attention: Andrew McGowan
Inquiry Secretary

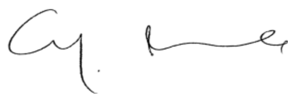
& by email to: Andrew.Mcgowan.reps@aph.gov.au

Dear Mr McGowan,

Re: Inquiry into Home Lending Practices and Processes Used to Deal with People in Financial Difficulty

Please find enclosed a submission from the Consumer Action Law Centre.

Yours faithfully,



Carolyn Bond
co-CEO

Consumer Action Law Centre
Level 7, 459 Little Collins Street
Melbourne Victoria 3000
Telephone 03 9670 5088
Facsimile 03 9629 6898
info@consumeraction.org.au
www.consumeraction.org.au

ABN 37 120 056 484 ACN 120 056 484

CONSUMER ACTION LAW CENTRE

SUBMISSION TO THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

in relation to the

INQUIRY INTO HOME LOAN LENDING PRACTICES AND PROCESSES

July 2007

This submission consists of:

Introduction – About Consumer Action and our casework experience.
Part 1 – A brief response to questions posed in the invitation to the Roundtable.
Part 2 – Key issues and case studies relating to two key issues:

- *lack of regulation of mortgage brokers and lenders (that are not deposit taking institutions); and*
- *lack of legal obligation to assess capacity to pay.*

Introduction – About Consumer Action

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. It was formed in 2006 by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service and builds on the significant strengths of those two centres.

Consumer Action provides free legal advice and representation to thousands of vulnerable and disadvantaged consumers across Victoria and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally recognised and influential policy and research body, pursuing a law-reform agenda across a range of important consumer issues at a government level, in the media, and directly with industry and in the community.

Consumer Action also conducts significant outreach activities and provides training to other community sector workers.

Our Casework Experience

Consumer Action has seven solicitors providing advice and legal representation for consumers. Half of the legal caseload relates to credit matters. Many of our clients are referred to us by community-based financial counselling services. We aim to ensure that our time is allocated to those matters that particularly require legal assistance. For this reason, Consumer Action does not generally have experience in relation to consumers who are suffering financial hardship alone. Our casework (and therefore our expertise) in relation to mortgages tends to focus on:

- consumers who have recently entered into mortgage loans which are totally unsuitable to their needs – often involving close links (even fraud) between the business selling the homes and a broker or financier;
- consumers who are facing loss of their home, after the original mortgage has been refinanced a number of times; and
- consumers who are facing loss of their home, after obtaining short-term, asset-based credit.

We note that unfortunately, many consumers choose to refinance when they get into financial difficulty – and often only approach services such as ours after a number of refinances have put them into an even worse situation. The easy availability – and heaving marketing – of mortgage refinancing presents this option to the public as the best (and often only) option. At this stage, it is often too late to do much to assist. Even when we are successful in arguing that the loan was inappropriate, or that conduct was misleading or unconscionable, the consumer will usually still lose their home. The benefit of our assistance is often that in some cases excessive fees, and interest, are reduced, giving the consumer some funds to get re-established in the rental market - rather than walking away with nothing.

Part 1 – Response to Questions

Questions 1 & 2

While the casework of our centre, and of community-based financial counsellors, strongly indicates a decline in credit standards and an increase in arrears and repossessions, we are not in a position to provide broad data.

We note however, that it is not simply the increase market share of “low-doc” and similar products, but the fact that they are being marketed and sold in many cases where these products are grossly inappropriate for the borrower, for example “low-doc” loans being sold to low-income, employed (or even unemployed) consumers. It has always been the case that many consumers, when faced by the inability to meet mortgage commitments, choose to put their house up for sale, before any legal proceedings are issued. This may be with, or without an arrangement with the lender. However, it is possible that this is more likely to be the case in relation to bank, or main-stream lenders, who are generally prepared to give the borrower more time to resolve the situation than non-bank lenders. We understand that there may be some external requirements on some lenders (in relation to investment structures) to foreclose early to limit arrears.

We have seen some evidence of lenders assisting borrowers to access superannuation for repayments in a situation where the borrower is going to lose the home in any case, so the superannuation is used by the lender to limit it losses – particularly where there may be negative equity in the home. Some lenders complete the relevant form for the borrower to sign to enable access to super – a service to consumers, but open to abuse by lenders. Access to superannuation can be of great benefit to consumers in difficulty, but it is important to ensure that this option is simply not used to cover the lenders’ potential losses.

Question 3

The work of our centre focuses on the more extreme cases where borrowers require legal assistance, so we do not have the extent of experience that financial counsellors do in relation to the treatment of incapacity to pay. However, we understand that in general, those consumers who borrow from non-banks, high risk lenders and particularly from short-term lenders are often given very little time prior to the commencement of legal action. It is not surprising, for example, that a lender that provides a 100% mortgage, is at greater risk by giving the borrower time to pay, than a lender who provides a mortgage to the value of 80% of the home. In relation to some of the short-term, interest only loans, we suspect that the lender may often receive more profit by foreclosing than by negotiating or allowing time to pay. This is due to high fees charged up-front that are not refundable for early payment, and close relationships with the firms who do the expensive legal work – all of which is added to the loan and taken from the sale proceeds.

Question 4

Our experience and expertise is primarily based on the conduct of lenders and the experience of individual borrowers, rather than on the broad economic impacts of these practices. However, the problems that have emerged from the United States show that failure to adequately regulate home lending practices can have a broad impact on the economy as well as having disastrous implications for individuals and families.

Part 2 - Key Issues and Case Studies

Lack of Appropriate Regulation

The problems arising from the lack of regulation of the finance broking industry has been widely documented, and there is general support from all stakeholders – industry (lenders and brokers), consumer advocates, regulators and Government – that such regulation is desperately needed. The result is that while there are responsible brokers in the market, the lack of regulation can also attract individuals and businesses which may be unable to obtain licensing or accreditation in other similar industries.

In many ways, advice about, and the provision of credit – in particularly mortgage credit – has similar risks for consumers as other financial services such as insurance or superannuation. However, unlike other financial services there are generally no licensing requirements, no obligation to consider the suitability of the product to the consumer's circumstances, and no obligation to provide alternative dispute resolution.

In almost all of the cases we take on relating to mortgage financing, a broker was involved in setting up the loan, and in many (possibly the majority) of these cases the broker has been involved in some level of dishonesty. This can range from encouraging non-business consumers to sign a business purpose declaration, to completing false income details on an application form, though to producing fraudulent pay slips and group certificates. In the case of business purpose declarations, we believe that many lenders welcome – even encourage – such conduct, which enables the lender to avoid the requirements of the Uniform Consumer Credit Code (UCCC), but claim ignorance and blame the broker if accused of deliberate Code avoidance.

In relation to other fraudulent activity, the brokers present various "strategies" to our clients – in some cases clients who are desperate and agree, or clients who are recent arrivals from non-English speaking backgrounds who may not understand what is happening.

While we do not believe that lenders condone this broker conduct, we believe that non-mainstream lenders in particular, rely significantly on broker referrals to generate business. The combination of their dependency on brokers and the lack of broker regulation means that they do little to prevent such conduct.

Lack of Legal Obligation to Assess Capacity to Pay

As stated above, neither brokers nor lenders have any obligations under FSR to take the individual's circumstances into account when advising on or providing a particular credit product. If they had such an obligation, such consideration would take into account the borrower's income, the term of the loan, and whether the loan posed a serious risk of losing the home or other assets.

The Uniform Consumer Credit Code (UCCC) contains provisions allowing a consumer to apply to a Court or Tribunal for the re-opening of a contract that is unjust, and one of the matters that the Court or Tribunal can take into account is whether the credit provider could have ascertained that the debtor could not pay without hardship.[1] It is sometimes claimed that this provision places a legal obligation on lenders to assess ability to pay, and that no further legal requirement is necessary.

In practice, the provision only applies when an individual makes an application to the Tribunal or Court. Lenders know that only a handful of such applications are made – and they are able

[1] S.70(2)(l) whether at the time the contract, mortgage or guarantee 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.

to settle individual matters. As a way of encouraging responsible lending practices, the provision is worthless.

We note that despite there being no legislative obligation to assess ability to pay, a commitment along these lines was inserted into the Baking Code of Practice. That Code is enforceable by consumers as it forms part of the contract between a signatory bank and its customers. The Banking and Financial Services Ombudsman, to which all the banks belong, can help to enforce the provisions.

However, apart from this obligation accepted by the banks, the lack of any legal obligation to assess capacity is a serious omission to the regulation of credit in Australia, and the effects can be seen and are illustrated by the case studies below.

Asset-Based Lending

"Asset-based lending" refers to a loan where the lender is unconcerned – and probably doesn't assess – the borrower's ability to pay, but relies on the value of assets supporting the loan. Reverse mortgages are a type of asset-based lending, however, if done properly, a reverse mortgage takes into consideration the borrowers need to retain their home until a particular time.

Other forms of asset-based lending put the asset (usually the borrower's home) at risk. One particular form, that involves short-term, interest-only credit, is often provided in circumstances where it is difficult to imagine that the borrowers won't lose their homes. In these cases the fees and charges are often high, and are profitable for the lender and broker, while the risk of loss is non-existent or very small because the lender has security over real property. These loans often leave a borrower with a choice of refinancing a further short-term loan or losing their home. The lender virtually has a "captive" borrower, who may not even question excessive fees on subsequent loans.

Consumers often don't understand the nature of these loans, but once entered, for many borrowers, they are a trap with no escape. The case studies below illustrate this issue.

Case Study 1 – Asset-Based Lending

Mortgage Masters; asset-based lending; failure to assess ability to pay; short-term interest-only loan.

We recently had a client contact us who had been served with a Writ for possession of his house by his mortgagee, an individual who had loaned our client money as a result of a solicitor loan through Home Wilkinson Lowry.

Our Client's Background:

Our client is self-employed, and has not earned more than $1,000 per month from his business for the past 4 years. He cares for his ex-wife who has schizophrenia and their young child who is twelve years old.

The loan contract the subject of the Writ was entered into in order to refinance a previous loan contract that was also a refinance in itself of a loan that was obtained some four years ago. His entry into the first of the three loans, arranged by "Mortgage Masters" is essentially the cause of his current situation.

The First Loan:

Four years ago he had a loan secured by his house with NAB, the balance of which was $39,000.00.

However, he was falling into financial difficulty. He needed a new car and had to pay for parking fines. At the time, he received a letter in the post apparently addressed to him from a company called "Mortgage Masters". The letter had words to the effect: 'Having money problems? We'll say yes, when the banks say "no"'. He therefore contacted this company and arranged an appointment with them.

The client was ultimately signed up to a loan for one year on interest only terms with a non-bank lender, with assurances from the broker that 'this year we will just get you a loan for the year because you are in a hurry for the money but next year you will get a loan that you can work with'. For the client, this meant a normal principal and interest loan.

The total of the credit provided under the first loan was $70,000.00. The client says that $39,000 went to paying out the loan to NAB and he got about $16,000 after fees and charges came out. The client thought he could cope with the repayments but soon discovered he was struggling and he ultimately fell into default.

The Second Loan:

The client then sought a further refinance through Mortgage Masters to pay out the previous loan. This loan was also for a year and was also, apparently, interest only. He says that he thought he only had to pay $2,500 for procuring the loan, but he discovered that they also charged him fees for going through another broker, being the solicitors: Home Wilkinson Lowry (HWL). So he ended up paying them approx $4,500.00. The second loan was through HLW and the actual lender was an individual investor. The loan was for $90,000.00.

The Third Loan:

When the year was up for the second loan, client could not repay the principal and had to obtain a further refinance. He claims he had no choice but to enter the third loan to pay out the second.

He therefore obtained another, interest only loan through Home Wilkinson Lowry for $120,000. Apparently all of this (except $6,000) went towards paying out the second

refinance, despite the client believing that he would get at least $13,000 out of these loan proceeds.

The repayments for the third loan were $900 per month which is most of his income. He quickly fell into default.

The client ultimately lost the house which was worth approx $250,000.

Case Study 2 – Asset-Based Lending

Rengay Nominees; asset-based lending; failure to assess ability to pay; short-term interest-only loan, business purposes declaration to avoid the UCCC.

The matter of *Neuendorf*[2] shows how intermediaries can "protect" a lender from knowledge of the borrower's circumstances. This case has been broadly cited[3], it is typical of a type of case we see. Similar matters are however rarely reported.

Mrs Neuendorf, an elderly retired woman, contacted Fishley Financial Services Pty Ltd with a view to refinancing a loan she had written with Bailey O'Neil Pty Ltd, which had in turn been taken out to pay various personal debts.

Fishley Financial Services Pty Ltd were finance intermediaries and mortgage consultants. Mrs Neuendorf met with Mr Fishley of that firm three or four times over a period of a month. In the course of the transaction Fishley wrote to Rennick & Gaynor, Solicitors (of which Rengay was a subsidiary) requesting "residential finance". That letter stated that the current mortgage was with Bailey O'Neil and that Mrs Neuendorf wished to refinance the current loan to effect repairs to her home and to cover costs. Mr Rush of Rengay stated that he drew no conclusion about the purpose of the loan from this letter as he understood that Bailey O'Neil only made loans not subject to the Code, that is, not for personal, domestic or household purposes. In any event Rengay approved the loan application and forwarded the loan offer through a company called McDuff Thompson, an associated company of Fishley Financial Services, which then arranged for the offer to be completed by Mrs Neuendorf.

The case confirms the view that where a credit provider uses an intermediary for the purpose of obtaining a business purpose declaration then it can rely upon a Business Purpose Declaration by simply ensuring that the intermediary makes no inquiries as to the purpose of the loan. Indeed, in the course of the evidence, Rengay made it plain that their reasons for insisting upon Business Purpose Declarations in every transaction they entered into was to ensure that those transactions were not regulated by the UCCC. This approach, when coupled with ensuring that the person taking the Declaration is not associated with the credit provider or a finance broker, will ensure that the conclusive presumption of business purpose can never be displaced. The effect of this is that by this relatively simple loan application structure the UCCC essentially becomes voluntary in its application to consumer credit contracts.

It is remarkable to consider the outcome of the *Neuendorf* case when one considers that:

- the consumer was an elderly retired woman;
- the letter sent by the finance intermediaries to Rengay requesting finance stated that it sought "residential finance", and further went on to state that Mrs Neuendorf
- wished to refinance the current loan to effect repairs to her home and to cover costs; and

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[2] *Neuendorf* v. *Rengay Nominees Pty Ltd*, 3 September 2002, Victorian Civil and Administrative Tribunal.

[3] For example, Decision-Making Regulatory Impact Statement and Final Public Benefit Test, March 2006.

- it appears that Fishley Financial Services (the finance intermediaries) were aware that the loan was for a personal purpose.

The loan offer contained a condition that the loan would be for predominantly business purposes and required a Business Purpose Declaration to be signed. Mrs Neuendorf completed the loan application and as part of this process was taken by Mr Fishley to the offices of C A Italia & Associates, Solicitors, where she signed the Business Purpose Declaration which had been forwarded to that firm by Rengay. The Tribunal found that in the course of the interview with Mr Italia Mrs Neuendorf told Mr Italia that the purpose of the loan was to refinance the Bailey O'Neil loan. There was no evidence that Mr Italia was told anything more about the purpose of the Rengay loan. The Tribunal found that the purpose of the loan was personal, however the Declaration was effective to exclude the operation of the Code. The reasoning of the Tribunal appears to be that it accepted the evidence that Rengay did not realise the loan was for a personal purpose due to its erroneous assumption that all loans made by Bailey O'Neil were for business purposes. It further held that Mr Italia was not explicitly told that the loan was for a business purpose and had no reason to believe otherwise. Finally it held that Mr Fishley's knowledge of the true nature of the transaction was irrelevant as he was not the person taking the declaration.

Case Study 3 - Failure to Assess Ability to Pay, Inappropriate Loan

Our client and her husband approached a broker for a loan. While the clients sought approximately $60,000, the broker arranged a "Lo Doc" line of credit through a significant non bank lender, with a maximum credit limit of $143,000. Even before our client's husband died, the amount of credit was more than they could pay, as their sole income was derived from Centrelink benefits.

After the husband died, our client developed a gambling problem. She drew out $50,000 from the line of credit and her house was sold to pay the debt.

"Lo Doc" loans are mainly designed for the self-employed and those with irregular income who do not have documentation for a conventional loan. The lender ought to have known that such a loan was inappropriate for these borrowers due to their age, the nature of their existing home loan (ie small regular payments), the lack of information provided about their income and the failure to provide an ABN. Given the borrowers' circumstances, it is also arguable that a line of credit which allowed the borrowers to draw down far more than they initially borrowed was not the most appropriate type of loan.

This loan was based on the value of security alone, and the lender did not assess capacity to repay. The clients lacked financial sophistication and the lender failed to make any enquiries in relation to the borrowers' capacity to repay. It required self-certification by the borrowers of their capacity to repay, yet was provided with information which should have alerted it that the self-assessment was inappropriate.

Case Study 4 – Asset-Based Lending

Asset-based lending; failure to assess capacity to pay; misuse of business purpose declarations and poor broker conduct.

Our clients were in their seventies, had a very limited knowledge of English and were retired factory workers in receipt of Centrelink aged pensions.

Perpetual Trustees had issued proceedings against them in the Supreme Court of Victoria to obtain judgment for monies owed pursuant to a loan secured by mortgage and to obtain possession of the secured property (their home).

Consumer Action brought proceedings in VCAT against Perpetual Trustees and against State Securities, the broker involved in three loans made to Mr and Mrs Zaparenkov, to have their loan contract re-opened as unjust under the Consumer Credit Code. There were 'business

purpose declarations' signed by the clients for the loans. However, no checks had been done to see if there was any business in existence, nor to reconcile the contradictory evidence of 'self employed/investors' (the description on their loan application forms) with the fact that they were in receipt of Centrelink income only. Consumer Action was able to establish that both the broker and the lender had seen the clients' Centrelink cards.

The matter was settled at mediation to the satisfaction of our clients and the terms are confidential.

Case Study 5 – Marketing of Asset-Based Lending

Mortgage Masters; asset-based lending; failure to assess ability to pay; marketing.

The website [http://www.mortgagemasters.biz/] and commercial illustrate how finance brokers target desperate borrowers for asset-based loans. While these advertisements usually refer to no income assessment for those who are self-employed, there are many low-income consumers who are self-employed – and an ABN, or even a signature that a consumer is self-employed is usually adequate to meet this requirement.

A 30 second commercial can be viewed on this website. The script is as follows:

> Background: 'When the Bank Says "No", We say "No Problem"'
>
> Audio: 'We apologise if you've been turned down by any mortgage lender, because if you have equity in your home, Mortgage Masters can refinance all your loans and consolidate them into one low monthly payment. This means more money in your pocket. At Mortgage Masters we've been able to help hundreds of people change their financial position, even if they had a bad credit rating – and now we want to help you. Call the people who care at Mortgage Masters, because when the banks say "no", we say "no problem".'
>
> Visual:
> 'Do you have equity in your home?
> - Reduce interest charges
> - Have one low monthly payment
> - No proof of income for self-employed
> - Defaults paid out
>
> Call the people who care.'

Case Study 6 – Marketing of Asset-Based Lending

Just two examples of many advertisements in daily newspapers:

> **FIX YOUR CASH FLOW**
> $2,000 - $150,000
>
> Flexible loans
> Secured against vehicles or property
> No application forms
> Approval in 5 minutes
> Deal direct with the lender
> Flexible Short-Term Finance
> 1300 166 639
> Commerce Credit Pty Ltd

ALL PERSONAL LOANS

Same Day Approval
Loans $3,000 - $100,000
Secured $10,000 – NO LIMIT
Car, Bike, Boat, Caravan
Pensioner Loans
Investment Loans
Debt Consolidations
Refinance Existing Loans
Home Improvement Loans
Other Loans
Must Have Good Credit
Banks say NO we say YES
(03) 9510-5380
Easy Finance Group
Conditions Apply

Consumer Action Law Centre
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