# SUBMISSION 33

Submission to:

**House of Representatives Standing Committee on Economics**

## Inquiry into Competition in the Banking and Non-Banking Sectors

July 2008

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Care Inc Financial Counselling Service
and the Consumer Law Centre of the ACT

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## About Consumer Credit Legal Centre NSW Inc:

Consumer Credit Legal Centre (NSW) Inc ("CCLC") is a community-based consumer advice, advocacy and education service specialising in personal credit, debt and banking law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. CCLC provides legal advice, financial counselling, information and strategies, and referral to face-to-face financial counselling services, and limited direct financial counselling. Last financial year CCLC took over 13,000 calls for advice or assistance.

A significant part of CCLC's work is in advocating for improvements to advance the interests of consumers, by influencing developments in law, industry practice, dispute resolution processes, government enforcement action, and access to advice and assistance. CCLC also provides extensive website resources, education resources and workshops, and media comment.

## About Care:

Care Inc has been the main provider of financial counselling and related services to low to moderate income and vulnerable consumers in the ACT, since 1983. Care's core service activities include the provision of information, counselling and advocacy to low income and vulnerable consumers experiencing problems with credit and debt. Care also has a Community Development, Education and Research program, makes policy and law reform comment on issues of importance to its client group and has operated the ACT's only No Interest Loans Scheme since 1997.

In late 2002, Care was selected as the host agency for the Consumer Law Centre of the ACT. The CLC was officially opened in January 2003 and offers a range of legal services including representation and litigation in relation to consumer law issues. The service employs a full-time practicing solicitor. Across Care's service delivery programs, the agency responds to over 2000 new requests for assistance every year.

## Summary of key recommendations:

1) All consumer lending, regardless of type, should require a proper and prudent assessment of the payment capacity of the borrower.

2) The Commonwealth should develop a framework for distinguishing between healthy competition that consumers can access and activate, from market activity driven by unsustainable over-selling.

3) Consideration should be given to developing a set of minimum standards and features that must be met in all residential home loan facilities.

4) Consideration should be given to expanding the rationale for prudential regulation, recognising the importance of residential home ownership to Australia's economic security and social fabric.

5) There should be a comprehensive regulatory framework for all types of lending including licensing and conduct provisions and compulsory external dispute resolution. Regulators should have the capacity to identify and exclude predatory conduct and other inappropriate conduct or product innovations that create unhealthy competitive pressure to decrease lending standards

## Comments against the Committee's Terms of Reference:

### *General introductory observations*

CCLC and Care have found the Committee's Terms of Reference difficult to tackle because of the apparently pre-concluded view that the mere existence of competition will always deliver good outcomes. The operation of the Australian housing finance market over the last 10 to 15 years, in our submission, provides considerable evidence to suggest that this view is not always or automatically correct.

Competition at its most effective can encourage innovation, improve the quality of products and services, expand consumer choice and put downward pressure on prices. Suppliers try harder to win and keep consumers' business. In turn consumers, through increased understanding of and access to improving markets, *activate* competitive pressures so that the improvements are sustained.

Not all market activity however represents a safe or sustainable interaction between supply and demand sides. In a recent presentation to the Australian Bankers' Association's financial literacy summit on 2 July, Ian McAuley referred to '*structurally corrupt markets'*, the term coined by Louise Sylvan when she was CEO of the Australian Consumers' Association. According to McAuley:

> *These are markets where competition is based not on long-term profit (the "rational ideal"), but on competition for growth or market share, and these are markets where overselling is most likely to develop, to the detriment of consumers and businesses.*[1]

The amount of debt being carried by Australian consumers is at record levels and as Government acknowledged in the recent Green Paper on Credit Regulation, the vast bulk of that debt is housing related finance.[2] Domestic and international factors have combined in recent years, producing substantial increases in the cost of maintaining credit commitments.

Australia is not the only country grappling with the fallout from the global credit crisis. At its simplest the crisis has been caused by too much debt being sold to people who could not afford it. Fujitsu Consulting has predicted that around 1,000,000 Australian households will be experiencing mortgage stress by September 2008.[3] If correct, almost one fifth of all of the homes in Australia subject to a home loan and associated mortgage will be struggling financially. CCLC and Care submit there is a direct link between the depth and breadth of the financial hardship now being felt in ordinary Australian homes and the operation of the home lending market. Before encouraging more activity in that market the Commonwealth should have a better understanding of that link and, where practical, act to prevent the same problems occurring again.

The observations to follow relate to specific items in the Terms of Reference.

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[1] McAuley, Ian, *You can see a lot by just looking: Understanding human judgment in financial decision making,* Paper present to the Australian Bankers' Association: Broadening financial understanding – financial literacy summit, 2 July 2008, page 34.

[2] The Treasury, *Financial Services and Credit Reform – Improving, Simplifying and Standardising Financial Services and Credit Regulation, Green Paper June,* Canberra June 2008, page 2. The paper noted that as of March 2008, credit for housing accounted for $940.2 billion or 86 per cent of nationally aggregated levels of credit outstanding.

[3] Browne, Rachael, *Mortgage stress to hit 1m homes,* Sydney Morning Herald 29 June 2008. The report was referring to a series of reports on mortgage stress produced by Fujitsu Consulting.

***The Committee should examine competition in the retail and non-banking sectors in Australia.***

The Committee will no doubt have an opportunity to consider the development of the Australian mortgage market post-deregulation. We urge Committee members to undertake that consideration without the sometimes 'rose-coloured' tint encouraged by the Commonwealth Treasury as the agency centrally involved in delivering the policy change. Similarly, there are strong views held by those segments of industry that have either benefited or lost in the deregulation process.

Deregulation of the Australian mortgage market was intended to broaden accessibility to housing finance. New market entrants would develop new products and pricing and, as was clearly intended at the time, break the banking sector's stranglehold on determining which consumers were able to access housing finance and on what terms.

If numbers alone are to be considered a measure of the success of this policy, then the growth in housing finance, the development of alternative methods of delivering that finance (particularly in the area of lo-doc lending) and significant shifts in market share from bank to non-bank lenders, would suggest it was a success. The proportional rate at which loans applying a more relaxed approach to credit assessment have subsequently failed and the dramatic swing back in recent months to essentially the same shares of market as between bank and non-bank sectors that existed before the shift invite far deeper consideration. Yes there was a surge in market activity. The surge did provide access to the home loan market to a larger number of consumers and offered those consumers a choice of more providers. Property prices moved higher as the surge escalated, increasing the amounts of money required to be borrowed to obtain entry.

Now, as the surge subsides, we see large numbers of consumers with loans they cannot afford, downward pressure on property prices, a significant stalling in the home loan market and the very real prospect that many non-bank lenders will fail and close. This does not look like a picture of success for a sustainable, competitive market.

Our interest, having regard to our brief, is in the impacts of this activity on the low to moderate income families represented in our client intake. To that end, we believe it is important to note that the majority of our clients:

- Receive very low incomes;
- Predominantly report Commonwealth benefits as their main source of income; and
- Are neither home owners nor purchasers with the assistance of a home loan.

Nevertheless, the fastest area of growth in demand for our services over the last three years, in both NSW and the ACT, is in relation to problems with home loans. Similarly, the most noticeable shift in the demographic makeup of the clientele seeking our assistance over the same period has been an increase in the proportion of households reporting incomes over $45,000 and being home purchasers with a mortgage. The following tables provide examples of those trends.

*Table A – CCLC NSW*
*Credit and Debt Hotline Statistics – calls by Loan Type*

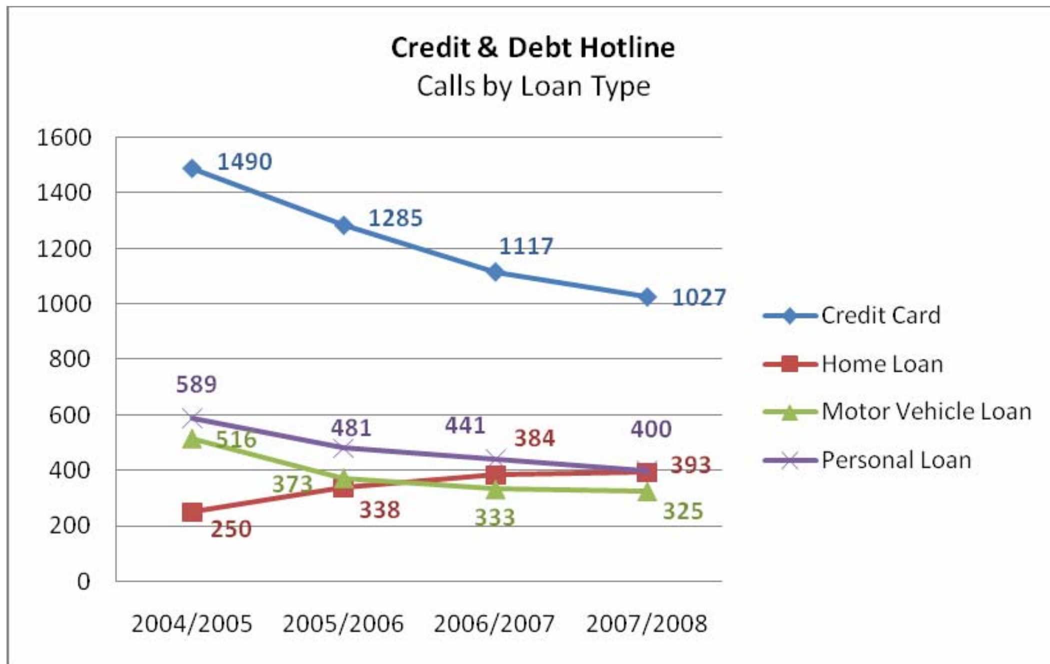



*Table B – CCLC NSW*
*Legal Advice statistics - Advice given by Financial Product Type*

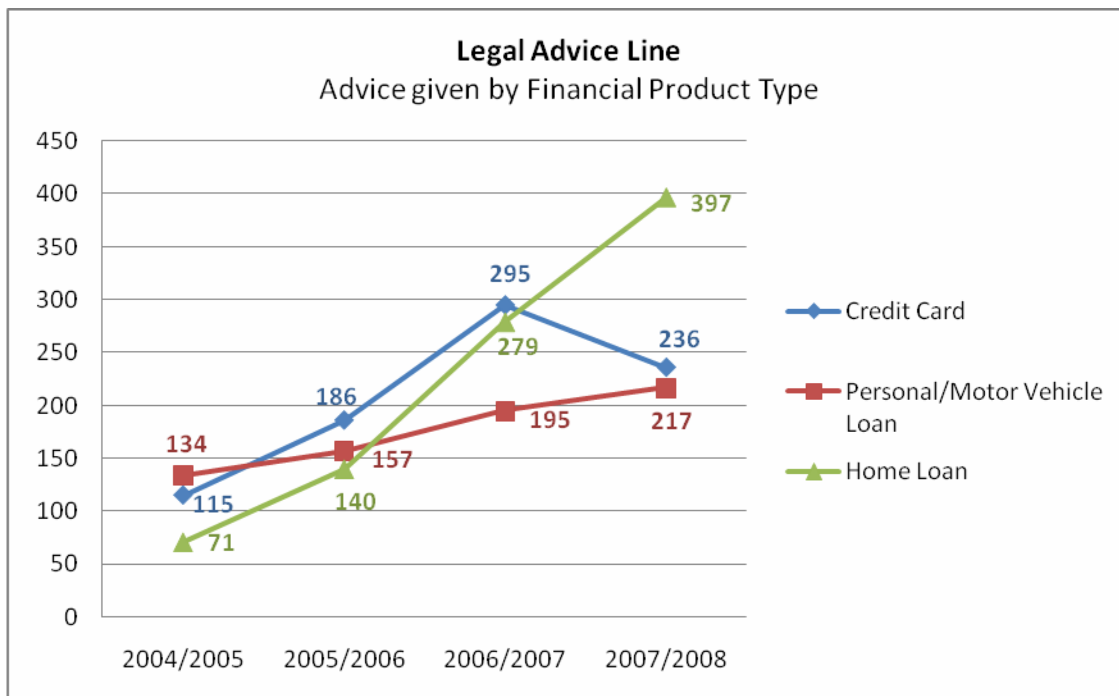


*Table C – Care Inc ACT*
*New intake income levels 2005-2006*

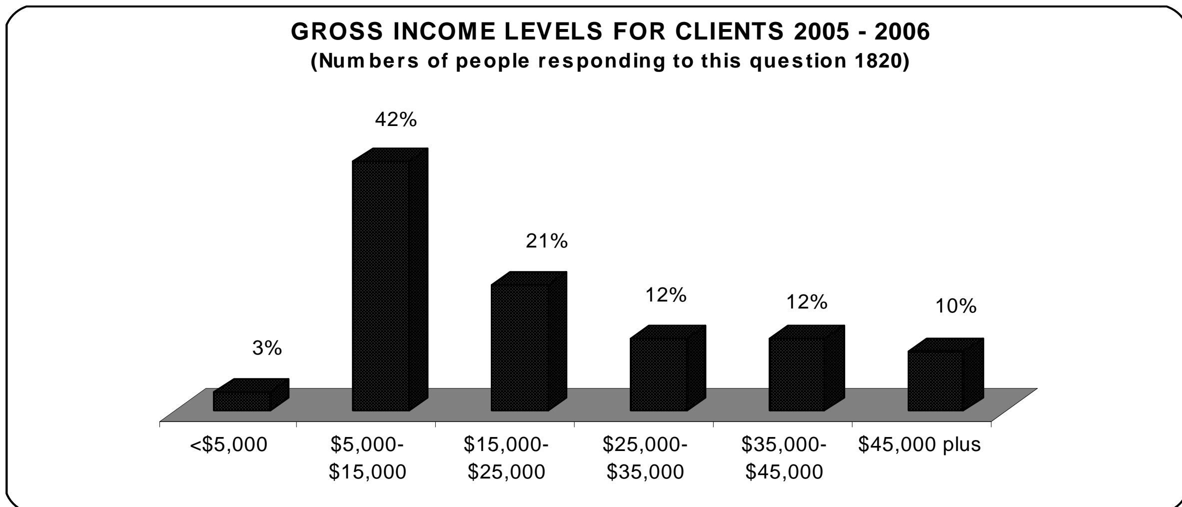
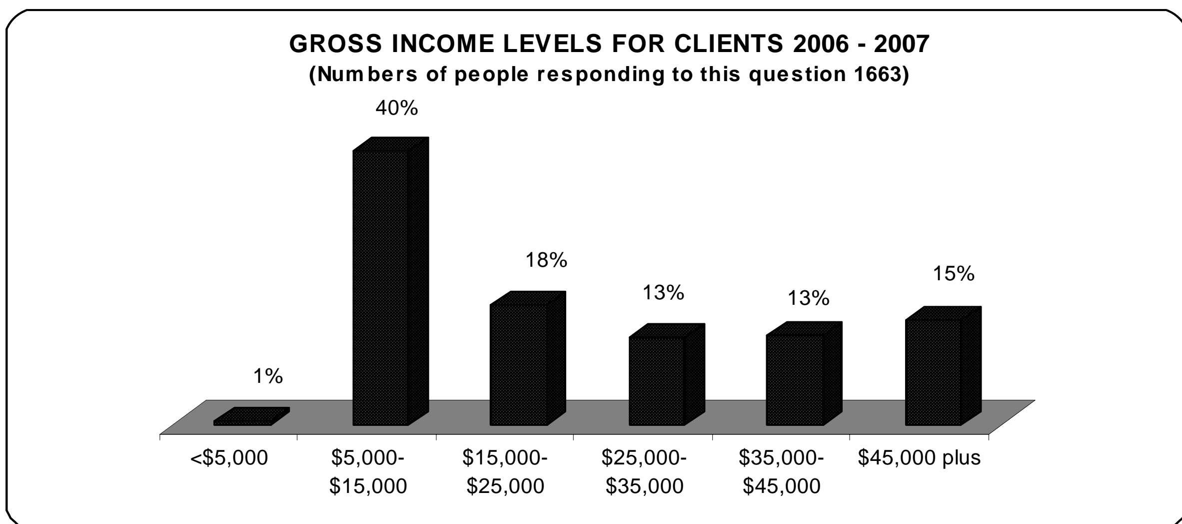



*Table D – Care Inc ACT*
*New intake income levels 2006-2007*[4]




Both our agencies have noted the multiple impacts of these shifts in client demand. Particularly in the delivery of legal advice and representation, the demand for assistance in relation to mortgage foreclosure has escalated considerably. It is stressful, demanding and time consuming work. Increasingly it has exposed us to common themes, including:

- The prevalence of loans that appear to have been unaffordable from the outset;
- Multiple refinances that have eroded any equity available in the home[5];

[4] In its reports to ACT Government on the final six months of 2007, Care noted that 19 per cent of new client contacts to general services reported incomes over $45,000. The same result appears likely in provisional figures for the first 6 months of 2008.
[5] Reserve Bank figures show a steady trend upwards in mortgage refinancing since 1993, with a sharp surge upward from about 2001 (Survey on Housing Equity Withdrawal and Injection", Reserve Bank Bulletin, October 2005) While falling briefly from a period in late 2003, refinancing activity increased substantially in 2005 (Reserve Bank of Australia, "Financial Stability Review", September 2005, p11). Both CCLC and Care have noted that many of

- The over-representation of non-bank lenders in problem home loans, escalated collection activity and foreclosure action;
- A majority of failing loans having involved one or more brokers in the sale process; and
- A pattern of failed, inadequate or non-existent processes for understanding and responding to borrowers' financial difficulties.

Similar themes were explored in our submission to the Committee's Inquiry into Home Lending Practices in 2007. Whilst welcoming that Inquiry and the Committee's subsequent Report, to the best of our knowledge there is still no coordinated research activity to investigate the incidence, causes and frequently involved financial services providers in this range of problems.

In our introductory comments, we refer the Committee to Fujitsu's research in relation to mortgage stress and in particular the prediction that as many as 1,000,000 households will be experiencing mortgage stress by September 2008. That estimation is dramatically different to the benign picture painted by both the Reserve Bank and the Treasury. In his opening comments to the Senate Select Committee on Housing Affordability in Australia's hearing in Melbourne on 24 April 2008, Deputy Governor of the Reserve Bank Ric Battellino noted:

> *The arrears rate for loans on banks' balance sheets is about 0.3 per cent, while that for securitised loans is about 0.6 per cent in total, or about 0.4 per cent for prime mortgages. We estimate that there are around 15 000 households in Australia which are 90 days or more in arrears on their housing loan repayments. An additional 30 000 or so are between 30 days and 90 days in arrears. These are quite low numbers for a country the size of Australia.*
>
> *From a macroeconomic perspective, there do not appear to be any major problems here.* [6]

How is the Reserve Bank's view so different to that increasingly being reflected by industry commentators? It is an issue we would encourage the Committee to investigate further. From our own service delivery perspective, what is occurring now in our services is unprecedented. We are increasingly forced to describe to our clients the inevitable loss of their homes. As the returns for selling those homes under pressure, or through mortgagee sales continue to fall there will inevitably be more people who carry forward significant shortfall debts.

**Recommendations:**

1) All consumer lending, regardless of type, should require a proper and prudent assessment of the payment capacity of the borrower.

2) The Commonwealth should develop a framework for distinguishing between healthy competition that consumers can access and activate, from market activity driven by unsustainable over-selling.

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our clients have refinanced one or more times before presenting for assistance, often only when their equity has been entirely depleted. It is apparent from these clients' experiences that refinancing can mask an essentially unsustainable loan for several years.

[6] Battellino, Ric, *Background Notes for Opening Remarks to Senate Select Committee on Housing Affordability in Australia,* Reserve Bank of Australia, 24 April 2008, pages 5 and 6.

***The Committee will pay particular attention to home mortgage products and linked facilities frequently offered to consumers such as credit cards and savings accounts.***

In the general introductory comments on page 3, we question the apparent presumption in the Terms of Reference that all competition will produce positive results. Similarly the subtext of this particular reference appears to be that linking, bundling and otherwise extending the operation of mortgage products is a good thing. We would encourage the Committee to query whether this is necessarily the case, or how broadly and equitably the benefits of product development are shared.

The prime purpose of home lending is to facilitate the purchase of a property. The sums involved are substantial, the commitments made significant and the normal term of the facility in the range of 20 to 30 years. The 'chatter' of package sales should not get in the way of ensuring that the importance of the transaction is effectively communicated, along with a clear understanding of rights and obligations. This is especially important for low to moderate income consumers, for whom the purchase of a home and the selection of an appropriate, affordable home loan facility are amongst the most significant life decisions they will make for themselves and their families.

Packaging home loans with entirely unrelated products and services such as frequent flyer points and holiday accommodation discounts, is in our view of dubious benefit. Short of prohibition however there is little that can be done to prevent 'gimmick' marketing and presumably consumers would rarely make their choice on the basis of such features alone.

More useful additional functionality to a home loan package, such as the linking of credit cards and savings accounts, can provide utility and savings. In our experience however, packages of this type are more regularly the preserve of higher income consumers, often sold through professional associations or linked with exclusive membership lists. Frequently the costs associated with each of the bundled financial services are reduced or waived, adding to the attractiveness of keeping all business with one provider, or linked providers. Again, we do not suggest that ending these practices is practical, achievable or even worthwhile. We do however question, on a return for effort basis, whether there is advantage in investigating the development of additional options for consumers already well valued and pursued by the market.

Instead, attention should more readily be focused on the fairness, efficiency and cost-effectiveness of home loans and related facilities offered to low to moderate income consumers. In our various service delivery programs the overwhelming majority of clients presenting with problems paying their home loans have facilities with non-mainstream lenders, delivering often significantly higher fees and charges than normal market rates and a range of punitive additional charges in the event of default or early termination.

Industry will often present the pricing for this segment of the market as reflective of risk. We prefer to consider it as predatory. The so-called democratisation of credit through deregulation has afforded many lower income households the opportunity to be ripped off, rather than access to secure, affordable housing.

We urge the Committee to consider ways in which appropriate home lending standards might be benchmarked, to ensure that all market participants, regardless of whether they are eligible to be offered premium packages of discounted additional products and services,

receive essential information, features and protections. For example, we agree with the Treasurer's assessment that certain fees and charges associated with leaving a home loan are unfair and should be prevented.

At the application stage, we have already recommended that all home lending and indeed all consumer lending, should require a proper assessment of the consumer's capacity to repay the credit being offered. More specifically in relation to home loan lending, lo-doc loans should still require a collection and assessment of the best information available to establish capacity to pay. There should be a presumption against providing a low-documentation product to any borrower who is employed and receiving a regular wage/salary, or who is in receipt of social security benefits. There is no place for no-doc lending, in our view, because it will invariably involve a decision to lend based on the value of the secured asset alone.

A home loan should also be sold in a manner that anticipates the normal lifespan of the facility and provide useful and reliable relationship information. If the person who sells the loan, or manages it on a day-to-day basis is not the same person or organisation that makes decisions about whether to provide relief during a period of hardship, then it is for the supply side to solve this conundrum and make sure that communications work effectively and fairly. In other words ***every*** consumer home loan contract should contain an accessible and reliable contact point for the consumer to raise issues regarding that loan and its ongoing conduct. That information could usefully be updated annually. Further, there should be equivalent access to dispute resolution and other remedies for consumers, regardless of the complicated, multi-party supply chain usually associated with non-bank lending.

**Recommendation:**

3) Consideration should be given to developing a set of minimum standards and features that must be met in all residential home loan facilities.

1) ***The Committee will undertake a stock take of the Australian retail banking and non-banking industries, focussing on:***

   a) ***Recent developments in relation to products, providers and distribution channels;***
   b) ***The current state of retail and non-banking industries;***
   c) ***The likely drivers of future change and innovation in the retail and non-banking sectors including the continuing impact of technological developments; and***
   d) ***Comparisons with relevant international jurisdictions.***

We have made a number of previous submissions in relation to item 1) a) as it relates to mortgage and finance brokers and the need for appropriate standards and regulation. We will not reproduce those comments here, however would be happy to provide the Committee with additional documentation and/or respond to any specific questions.

Items 1) b) and c) are perhaps best left to other commentators.

In relation to item 1) d) we refer to comments earlier in this submission regarding the often bullish summaries of the Australian home loan market provided by the Commonwealth Treasury and the Reserve Bank of Australia. The assurances that all is well and that hardship is not widespread do not accord with our experiences. Our own longitudinal data, along with other public record information such as the surge in mortgage foreclosure actions particularly through the Supreme Court of NSW, invite a greater recognition of the scope of the difficulties being felt rather than a deferral to a still comfortable macro-economic picture.

We contrast these local observations with those made by the Bank for International Settlements on the release of its 78th Annual Report on 30 June 2008:

> *The fundamental cause of today's problems in the global economy is excessive and imprudent credit growth over a long period...*
>
> *This always threatened two unwelcome outcomes: a rise in inflation and an accumulation of debt-related imbalances which at some point would prove to be unsustainable...*
>
> *The BIS notes that the experience of the recent financial turmoil shows the need for a new macrofinancial stability framework to resist actively the inherent procyclicality of the financial system. This would require a primary focus on systemic issues and a much more countercyclical use of policy instruments.*[7]

Earlier we referred to the movements in market share in the home loan market – first from the banks (and other ADIs) to a surging non-bank sector, then just as abruptly back again. Prices for housing were booming in the first stage of the process as were the rates and amounts of borrowing. Both have now stalled and many consumers who took on expensive home loans just to 'break into' the market are now struggling to hold on, have already lost or are in the process of losing their homes[8]. How might this set of bad outcomes have been mitigated?

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[7] Bank for International Settlements, *The unsustainable has run its course and policymakers face the difficult task of damage control,* Statement on release of the BIS 78th Annual Report, Basel, Switzerland, 30 June 2008.
[8] The economic boom in WA, for example, has led to a sharp rise in low-doc and no-doc loans, totalling 28.8% of mortgages written in 2007. Moody's noted this as a" troubling phenomena which may lead to inferior

We would suggest the time is right to check some of the fundamental principles of our core regulatory structures and see how they performed, or whether they were even relevant. The recent Green Paper on credit regulation noted the more intrusive and blunt system of prudential regulation that underpins the security of Australia's key financial services players. That system overseen by the Australian Prudential Regulation Authority (APRA) is built on the foundation principle that peoples' savings should remain secure. As the regulator of Deposit Taking Institutions, APRA can and does provide rules and frameworks for the lending activities of its supervised entities. It was however reduced to the role of observer and occasional, reserved commentator while the wave of often imprudent non-bank home lending grew, because those institutions stood outside the prudential regulatory framework.

Perhaps it is time for the notion of what constitutes saving to evolve. There is no more important saving vehicle, or asset to the individual and collective consciousness in Australia than the family home.

**Recommendation:**

4) Consideration should be given to expanding the rationale for prudential regulation, recognising the importance of residential home ownership to Australia's economic security and social fabric.

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performance should the economic boom unravel". Chong, F. *NSW worst for home mortgage delinquency*, viewed at http://www.theaustralian.news.com.au/story/0,25197,23880976-25658,00.html, 18 June 2008. A Fitch ratings study released slightly earlier noted that while NSW remains the worst performing states and WA the best, mortgage performance in WA is deteriorating at the fastest rate of all the states despite the mining boom. *Mortgage defaults rise, NSW hit hard,* Business Spectator, viewed at http://www.businessspectator.com.au/bs.nsf/Article/Fitch-Ratings-F4DD4?OpenDocument, 2 June 2008

***2) The Committee will also identify any barriers that may impact on competition in the retail and non-banking sectors, and policies to enhance further competition and product choice for consumers.***

Earlier in this submission we have made observations about the need to better understand the differences between effective competition and potentially dangerous and unsustainable market activity. One of the elements in ensuring appropriate competition is the delivery of a framework of "regulatory neutrality".

The differences in regulation for different types of home loan providers have been discussed extensively elsewhere.[9] Specifically the key differences in the home loan market have been between ADI's and non-ADI's (usually referred to as non-bank lenders) and include:

- No licensing obligations;
- No requirements to belong to EDR; and
- No oversight by APRA.

While the most heinous examples of problematic and predatory lending have occurred in the non-bank lending sector, many other worrying trends have emerged among mainstream lenders, arguably as a result of this less fettered competition, including:

- High loan to valuation ratios (up to 100% or more)[10];
- Increased use of "low doc" and "no doc" loans (including for PAYG earners and social security recipients)[11];
- Increased use of brokers/intermediaries, some of whom participate in a number of activities of concern, from "up-selling" consumers into loans larger than they want or need to encouraging or perpetrating fraud;
- Decline in the quality of property valuations;
- Acceptance of a wider range of income types from more insecure sources;
- Creative but arguably dangerous product design (older people sold lines of credit secured over their home with no capacity to repay the loan once it is fully drawn except to sell their home, for example); and

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[9] This issue was a key focus of the *Financial Services and Credit Reform Green Paper(ibid),* in particular in Table 3 on pages 14 and 15.

[10] Moody's Investor Service released a report in June 2008 analysing a million loans between 2004 and 2007. "The report said defaults were most prevalent among borrowers with high loan to value ratios (more than 90 per cent), "low doc" (limited documentation) and "no-doc" (no documentation) loans." It noted that loans with 95 per cent LVR had risen from negligible to 4.7% in 2006 and 14.2 % in 2007. Low-docs peaked in 2006 and 2007, representing almost 17% of loans issued in the latter year. Chong, F. *NSW worst for home mortgage delinquency*, viewed at http://www.theaustralian.news.com.au/story/0,25197,23880976-25658,00.html, 18 June 2008.

[11] ibid

- Deterioration in quality control and verification processes within lenders.

Many of these factors have also been noted by parties other than consumer representative organisations including APRA[12] and in submissions to the House of Representatives Standing Committee on Economics, Finance and Public Administration Inquiry into Home Lending Practices and Processes used to deal with people in Financial Difficulty.

This culture and the resultant practices are difficult to reverse once they have taken hold. Promoting competition within the context of an uneven regulatory framework is a fraught exercise. While the point will no doubt be made in other submissions that many of the current problems in the non-bank sector are not due to problems within the Australian market, but as a result of the problems in the US market which are reverberating around the world, our organizations' experience suggests that local practices have been a contributing factor, the effects of which are now being exacerbated by the international situation.

CCLC has analysed calls to its legal advice line in relation to home finance in the 07/08 financial year. Many of these calls were from borrowers who had received statements of claim, or who were further advanced along the process for the repossession of their homes, or were seeking time to sell their home to avoid repossession. After deleting repeat calls in relation to the same loan (callers often seek advice more than once as their situation evolves), and calls for which insufficient data was available to accurately identify the lender, there were 238 calls analysed. Of these 140 or 59% were about loans from non-banks, 53 or 22% concerned loans with major banks, 38 or 16% were in relation to other banks, and only 7 or 3% related to mutuals such as credit unions and building societies (also regulated as ADIs). The proportions bear no relationship to market share and support observations made by the Consumer Law Centre of the ACT in its research regarding foreclosure activity through the ACT Supreme Court.[13] While some of the calls to CCLC related to genuine unforeseeable hardship such as recently onset serious illness, the staggering disproportion to market share suggests a more fundamental problem.

### RAMS - a case study

RAMS was one of the better known, "above board", non-bank lenders. They were a high profile alternative to the to the banks, members of the Mortgage Finance Association of Australia and the Credit Ombudsman Service Limited ("COSL"), who lent at competitive rates and did not profess to be sub-prime or "non-conforming" lenders. One to two years ago CCLC solicitors became aware of weaknesses in the RAMS lending guidelines as a result of representing a client. Further, anecdotal evidence also suggested that RAMS had become a target for unethical or overzealous

[12] Research released by APRA in June 2007 found evidence of deteriorating lending standards among ADIs including: only five of forty-seven lenders compared to about half of those surveyed in 1998 used the 30% of income for repayments rule, others preferring net income surplus models, some of which estimated the amount required for day-to-day expenses at below the poverty level; 5% of loans were for more than 95% of the value of the security property, compared to 1% in 2002-03; about half the lenders surveyed offered riskier "low-doc" loans which allow borrower to self-certify their income, representing 10% of all home loans by value. These findings prompted warnings to lenders from the APRA Chairman, John Laker. Reported by Washington,S, *Banks throw out loans rule book*, Sydney Morning Herald, 23 June 2007, http://www.smh.com.au/news/business/banks-throw-out-loans-rulebook/2007/06/22/1182019375951.html

[13] Copies of the reports from 2006 and 2007 can be obtained from Care's web-site www.carefcs.org/publications

brokers as a viable source of loans for people with questionable capacity to pay. Examples included:

- A single mother on social security obtained a modest inheritance. She decided to buy a house for herself and her children. She went to a broker who arranged a home loan with RAMS. She could not pay the loan from the outset and will shortly lose not only her house but also the inheritance as a result of the cumulative effect of interest and default charges and declining property values.
- A couple in their 50's who had borrowed money from another non-bank lender to invest, lost every cent of their capital as a result of the advice from a person later suspended by ASIC from holding an FSL. Unable to repay that loan they then refinanced to RAMS on a line of credit facility with no ability to pay apart from to draw down against the line of credit. They were eventually forced to sell their house with significantly reduced equity.
- A couple in their 70's who were seriously physically disabled and had refinanced to RAMS after borrowing from another lender to give a modest amount to relatives, were also given a line-of-credit on which they had drawn to repay the loan for a period of five years and now owed significantly more than their original debt due to the compounding effect of drawing on their loan to meet their interest payments. They now have no choice but to sell the home they previously owned outright.

In the wake of the first shockwaves to come out of the US sub-prime crisis RAMS announced funding difficulties. The RAMS brand name and franchise business was sold to Westpac in October 2007[14], with existing borrowers continuing to deal with the old entity now known as RHG. In December 2007 RHG announced its withdrawal from COSL, leaving dissatisfied borrowers with disputes over the initial lending process, or current financial hardship, or both, with nowhere to take their grievances except the courts and tribunals.

Many callers to CCLC have RHG loans above the hardship threshold applicable under the UCCC and therefore have no option available to them to pursue a variation of their obligations in situations of hardship[15]. While other complaints may be taken to the CTTT[16], many callers had some equity in their property at the time of seeking advice, though often rapidly diminishing, that they were reluctant to risk over running uncertain arguments around unjustness or unconscionability. Some opted to sell their homes and cut their losses. In the 238 calls analysed for the last financial year, 23 different callers (about 10% of the total) identified a dispute over a RAMS/RHG loan. This was highest number for any single non-bank lender (except Perpetual Trustees and Permanent Custodians, which become the lender for loans obtained from a wide variety of originators through the securitisation process), and significantly higher than self professed "non-conforming" lenders such as Liberty (9 calls) and Bluestone (10 callers). For customers of RAMS the regulatory framework has largely failed them.

[14] *RAMS claws back from subprime brink,* posted at http://www.abc.net.au/news/stories/2008/01/11/2136607, 14 January 2008

[15] Lenders who are members of the Mortgage Finance Association of Australia, or subscribers to the Code of Banking Practice, for example, have obligations under their respective industry codes to work with borrowers in financial hardship. Failure to comply with those obligations is an issue which can be reviewed by the Financial Ombudsman Service (formerly Banking and Financial Services Ombudsman) or the Credit Ombudsman Scheme Ltd provided the lender is a member.

[16] In the case of homes purchased for personal domestic purposes. This option is not available to borrowers who have purchased investment properties.

Analysts are divided on the extent of sub-prime lending in Australia. Official figures are relatively low at between 1-10% but other commentators have estimated up to 20% as a result of the broker practice euphemistically referred to as "sexing-up" loan applications[17]. Our organisations' experience certainly supports a higher estimate than the official figures. What is also clear is that the obvious gaps in regulatory oversight have also enabled predatory lending to thrive at the fringes. This practice, sometimes referred to as equity stripping, involves luring potential borrowers in financial difficulty with the unrealistic promise of saving their home, placing them in expensive loans on which they are destined to default, and loading up the loan with tens of thousands of dollars of set-up and default costs, which are realised at the almost inevitable sale of the home[18]. The Predatory Lending Project set up by CCLC, NSW Legal Aid and the Public Interest Law Clearing House receives new referrals of these types of loans every week.

**Recommendation:**

5) There should be a comprehensive regulatory framework for all types of lending including licensing and conduct provisions and compulsory external dispute resolution. Regulators should have the capacity to identify and exclude predatory conduct and other inappropriate conduct or product innovations that create unhealthy competitive pressure to decrease lending standards.

[17] Iain Cottrell, loan fraud expert with March Insurers estimates 10% of loans may not be as sound as assumed as a result of broker fraud. Martin North from Fujitsu Consulting was reported as saying "non-prime" loans could even be 20%. Phil Naylor of the Mortgage Finance Association of Australian disputes both estimates. Linden, A. *Non-prime loans higher: analyst,* viewed at http://smallbusiness.smh.com.au/starting/finance/non-prime-loans-higher:-analyst-911068001.html

[18] For examples see the Report by the Australian Securities and Investment Commission titled "Protecting wealth in the family home: An examination of refinancing in response to mortgage stress", released in March 2008.