

## Credit regulation and consumer protection for borrowers

- 5.1 Credit regulation should provide important consumer protections for all borrowers. These protections are particularly important for borrowers facing financial hardship. First and foremost credit regulation should protect borrowers from the predatory lending practices discussed in the previous chapter. It should also impose basic obligations on lenders to assist borrowers facing financial hardship.
- 5.2 Evidence to this inquiry argued that the current regulatory framework is not sufficient to discourage predatory lending practices, and could be more effective in providing guidance on lenders' obligations to borrowers. The current framework and proposals for reform are discussed below.

### **The current regulatory framework for credit**

#### **Regulation of financial services**

- 5.3 The Financial Services Reform (FSR) regime amended the Corporations Act to introduce new practices and procedures for the finance industry. Under the FSR regime the Australian Securities and Investments Commission (ASIC) is responsible for administering licensing, disclosure and quality of advice requirements for financial products and services. One aspect to this is that providers of personal financial advice and products are required to hold an Australian Financial Services (AFS) licence.

5.4 However, as ASIC noted in its submission, 'these requirements do not apply to credit products or related services such as advice about credit products.'<sup>1</sup> The reason for this is that credit is not regarded as a 'financial product' for the purposes of Corporations Act.<sup>2</sup>

5.5 ASIC does have a role in the regulation of credit, albeit a limited one. The ASIC Act:

Contains provisions modelled on the consumer protection provision in the Trade Practices Act 1974 ... [which] contain prohibitions on misleading and deceptive conduct and unconscionable conduct.<sup>3</sup>

5.6 The Australasian Compliance Institute, among others, believes that non-classification of credit as a financial product is a major concern:

If we place the impact both superannuation and home lending has upon total household income it is very surprising to see how tight the restrictions are for those who provide financial planning advice versus those who provide home loans. That is, in order to provide financial services advice of a personal nature, a financial planner must be PS146 accredited, however for the average Australian, superannuation only accounts for approximately 9% of their total income. Based upon recently released research, mortgage repayments can account for between 30 to 40% of total household income, however no such training or education requirements exist for those who provide or sell mortgages.<sup>4</sup>

## The Uniform Consumer Credit Code

5.7 Consumer credit transactions are regulated by the Uniform Consumer Credit Code (UCCC). The UCCC was enacted as template legislation in Queensland in 1994 and was subsequently adopted in the other states and territories. According to its website the UCCC:

Not only introduces standardisation, it also presents credit information in a clear and easy to understand format. Credit providers such as banks, building societies, credit unions, finance companies and businesses, must tell you what your rights and obligations are in any credit arrangement. They are required by law to truthfully disclose all relevant information about your

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1 ASIC, *Submission no. 15*, p. 1.

2 ASIC, *Credit*, ASIC, Canberra, viewed 20 August 2007, <<http://www.asic.gov.au/asic/asic.nsf/byheadline/Credit+homepage?openDocument>>.

3 ASIC, *Submission no. 15*, p. 1.

4 Australasian Compliance Institute, *Submission no. 11*, p. 2.

arrangement in a written contract, including interest rates, fees, commissions and other information which in the past was often hidden.<sup>5</sup>

- 5.8 The UCCC attempts to offer some protections to consumers, who are able to apply for changes to their loan contract on the 'grounds of hardship and unjust transactions':

The Code recognises that it is still important to protect consumers if they get into trouble. If you lose your job or are sick, you can ask to have your contract changed so that you can better meet your repayments. Credit providers are required to be careful not to make contracts with consumers who would find it difficult to meet their repayments. A court can also order changes to a contract if it is considered unjust.<sup>6</sup>

- 5.9 While the uniform national approach to credit transactions is clearly desirable, there are a number of criticisms of the UCCC. Firstly, the fact that it is state-based means it is very difficult to amend. Greg Kirk of ASIC noted this during the roundtable:

The problem for the UCCC is that it was designed at a particular point in time and is very difficult to change because of the national uniform arrangements and so as new products and issues arise it has not been quick to adapt.<sup>7</sup>

- 5.10 There are also criticisms about the effectiveness of the UCCC's hardship and unjust transaction provisions. Care Financial Counselling Service and the Consumer Credit Legal Centre asserted the hardship provisions:

Have been a source of enormous disappointment to consumer advocacy agencies. The provisions do not impose positive obligations on credit providers to respond to requests for variation at all, let alone within reasonable timeframes or providing reasons for rejection.<sup>8</sup>

- 5.11 The Consumer Action Law Centre argued that the unjust transaction provisions are equally ineffective:

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5 Uniform Consumer Credit Code Management Committee, 'How will the code help you', *The consumer credit code website*, viewed 30 July 2007, <<http://www.creditcode.gov.au/display.asp?file=/content/consumer.htm>>.

6 Uniform Consumer Credit Code Management Committee, 'How will the code help you', *The consumer credit code website*, viewed 30 July 2007, <<http://www.creditcode.gov.au/display.asp?file=/content/consumer.htm>>.

7 Mr G Kirk, ASIC, *Transcript of evidence*, 10 August 2007, p. 13.

8 Care Financial Counselling Service & Consumer Credit Legal Centre, *Submission no. 4*, pp. 5-6.

It is sometimes claimed that [the UCCC] 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 to settle individual matters. As a way of encouraging responsible lending practices, the provision is worthless.<sup>9</sup>

5.12 It further argued:

Apart from the 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.<sup>10</sup>

5.13 The Consumer Credit Legal Centre was critical of the fact that the UCCC does not apply to small businesses and individual investors:

The failure of the UCCC to afford protection to small business borrowers, and individuals borrowing for investment, is out of step with the remainder of financial services regulation. The general regulation of financial services under the *Corporations Act 2001* (Cth) includes small business and investors, as does the limited credit jurisdiction under the *ASIC Act 2001* (Cth). Important industry codes, such as the Code of Banking Practice, cover small business and investors. The forthcoming national finance broking regime will also cover small business and investment broking.<sup>11</sup>

5.14 As a result of these exclusions, some fringe lenders side-step the requirements of the UCCC by requiring borrowers to complete a ‘business purpose declaration’, even when a loan is for a private purpose.<sup>12</sup>

## EDR schemes

5.15 One of the requirements of an AFS licensee is that they must be a member of an ASIC-approved external dispute resolution (EDR) scheme.<sup>13</sup> Many providers of credit products (such as banks) are holders of an AFS licence by virtue of the fact they provide a range of non-credit financial services. They are therefore required to be members of an EDR scheme.

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9 Consumer Action Law Centre, *Submission no. 8*, pp. 4-5.

10 Consumer Action Law Centre, *Submission no. 8*, p. 5.

11 Consumer Credit Legal Centre, *Exhibit no. 1*, p. 41.

12 Consumer Action Law Centre, *Submission no. 8*, pp. 7-8; and Credit Ombudsman Service, *Submission no. 18*, p. 3.

13 ASIC, *Submission no. 15*, p. 1.

- 5.16 There are a wide range of businesses—including non-ADI lenders and mortgage brokers—that only provide credit products and/or credit advice. Such organisations are not licensed by ASIC and are not required to be members of an EDR scheme.
- 5.17 Many non-ADI lenders and brokers voluntarily choose to join an EDR scheme, or are required to join because of membership to a professional association. EDR schemes have a range of benefits:
- provide a speedy, low-cost way to resolve complaints and reduce the risk of the costs and lengthy delays that can arise from court proceedings;
  - allow consumers to have complaints that would not be brought before a court for financial reasons, aired and resolved;
  - have the power to make a binding decision if another resolution is not achieved;
  - allow industry to improve standards and conduct;
  - promote market confidence by encouraging, prompt, fair and consistent dealing for consumers and members;
  - are an essential part of the broader consumer safety net; and
  - are an important and necessary element of a just and fair society.<sup>14</sup>
- 5.18 One of the major EDR schemes is the Banking and Financial Services Ombudsman (BFSO). The BFSO considers and seeks to resolve disputes between members of the scheme (which includes all of the major banks) and their customers.
- 5.19 Another EDR scheme is the Credit Ombudsman Service (COSL). COSL's membership includes mortgage brokers and non-ADI lenders. Members of the Mortgage and Finance Association of Australia (MFAA) are required to be members of COSL.
- 5.20 But there are many lenders and brokers that are not members of the BFSO, COSL, or any other EDR scheme. Not surprisingly, it is the lenders that are not members of EDR schemes that are usually associated with improper practices. This point was made by the Consumer Credit Legal Centre:
- Unfortunately there are many other credit providers that are not members of an EDR scheme, including a number of unscrupulous small or fringe lenders who engage in predatory lending, and when the debtor cannot pay, harassing and coercive debt collection practices.<sup>15</sup>

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14 Credit Ombudsman Service, *Submission no. 18*, p. 2.

15 Consumer Credit Legal Centre, *Exhibit no. 1*, p. 44.

- 5.21 Raj Venga of COSL noted that '75 per cent of complaints that [he] receives are from non members of COSL.'<sup>16</sup> This underlines the point that the predatory-type lenders are not members of EDR schemes, and there is no incentive for them to ever join.

## Self-regulatory codes of practice

- 5.22 In addition to legislative requirements, many providers of credit products and advice also subscribe to voluntary codes of practice, usually through membership of a professional association.

- 5.23 One such code is the Code of Banking Practice (CBP), which is subscribed to by members of the Australian Bankers' Association (ABA). Under the CBP banks are required to make an assessment of a borrower's ability to service a loan before providing credit. Section 25.1 of the CBP outlines this requirement:

Before we offer or give you a credit facility (or increase an existing credit facility), we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay it.<sup>17</sup>

- 5.24 Section 25.2 of the CBP is particularly important to borrowers in financial difficulty. It states:

With your agreement, we will try to help you overcome your financial difficulties with any credit facility you have with us. We could, for example, work with you to develop a repayment plan. If at the time, the hardship variation provisions of the Uniform Consumer Credit Code could apply to your circumstances, we will inform you about them.<sup>18</sup>

- 5.25 The Code Compliance Monitoring Committee<sup>19</sup> (CCMC) argues that the CBP 'requires banks to provide assistance over and above their UCCC obligations.'<sup>20</sup>

- 5.26 Over the past few years the BFSO and the CCMC have reported some concern with banks' compliance with section 25.2. The BFSO released bulletins 46 and 53, which highlighted 'systemic' problems with the

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16 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 49.

17 ABA, *Code of Banking Practice*, May 2004, p. 12.

18 Australian Bankers Association, *Code of Banking Practice*, May 2004, p. 12.

19 The CCMC actively monitors and investigates banks' compliance with the CBP, where the BFSO only deals with specific customer complaints.

20 Code Compliance Monitoring Committee, *Submission no. 19*, p. 2.

application of this section.<sup>21</sup> Both organisations are working with banks to ensure section 25.2 is implemented appropriately.

- 5.27 Credit Unions and Building Societies also have a code of practice, which is being revised at present. The new code will include detailed requirements for dealing with members in financial hardship.<sup>22</sup>
- 5.28 Members of the MFAA, which includes non-ADI lenders and mortgage brokers, are required to comply with its code. The MFAA code is also in the process of being revised to include new provisions on dealing with consumers facing financial hardship. Raj Venga of COSL described the new provisions as 'best practice in the finance sector'.<sup>23</sup>
- 5.29 The membership of the MFAA does encapsulate the bulk of the broking and lending sectors. But because membership is voluntary, predatory and fringe lenders are unlikely to be members.

## Regulation of mortgage brokers

- 5.30 One of the concerns about the mortgage broking industry is that it is largely unregulated. This was raised with this committee by former RBA Governor Ian Macfarlane: 'There is no regulation at all of mortgage brokers, yet this is an industry that has grown up and is quite big now'.<sup>24</sup>
- 5.31 As noted above, unlike superannuation or insurance, credit is not regarded as a 'financial product' for the purposes of the Corporations Act. Mortgage brokers are therefore not obliged to have an AFS licence.
- 5.32 A number of groups argued that there needs to be more control over the conduct of brokers. The Consumer Action Law Centre reported that 'there is general support from stakeholders ... that such regulation is desperately needed.'<sup>25</sup>
- 5.33 ASIC noted that the state-based uniform regulation is in development:
- The Ministerial Council of Consumer Affairs is currently working to develop a uniform regulatory regime for finance brokers including licensing, minimum competence requirements and written broker agreements, including full disclosure of fees and commissions. Recommendations by brokers would be required to

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21 Banking and Financial Service Ombudsman, *Exhibit nos. 6 & 7*.

22 Mr L Lawler, Abacus, *Transcript of evidence*, 10 August 2007, p. 51.

23 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 52.

24 Mr I Macfarlane, *Transcript of evidence*, 4 June 2004, p. 18.

25 Consumer Action Law Centre, *Submission no. 8*, p. 4.

meet quality standards and brokers would be required to give reasons for their recommendations, as well as to belong to an external dispute resolution scheme approved by ASIC.<sup>26</sup>

## Options for reform

- 5.34 There is general consensus that regulation has not kept pace with the rapidly evolving credit market. There are two specific areas where greater controls are needed: Non-ADI lenders; and mortgage brokers
- 5.35 During the roundtable two direct questions were posed to participants:
- Does anybody not think there should be regulation?<sup>27</sup>
  - Is there anybody here who does not think it ought to be national regulation?<sup>28</sup>
- 5.36 There were no responses to either question indicating strong support for a new or updated national regulatory framework. But there was less agreement on exactly what form the regulation should take. The options for reform are discussed below.

## Commonwealth regulation of credit

- 5.37 One proposal to improve credit regulation is to make credit a 'financial product' for the purposes of the Corporations Act, thus harmonising regulation within the financial services sector.
- 5.38 The most obvious benefit of this option is that it would require providers of credit products and advice to hold an AFS licence. Licensees are required, among things, to provide advice and products appropriate to their clients. Therefore, lenders or brokers that consistently engage in predatory or dishonest conduct could have their licence revoked, and with it their ability to conduct business.
- 5.39 At this committee's most recent biannual public hearing with the RBA, Assistant Governor, Dr Philip Lowe, suggested that it's time to consider harmonising credit regulation with other financial services:

Under the Corporations Act, ASIC is responsible for the regulation of advice on financial products but not of advice on credit

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26 ASIC, *Submission no. 15*, p. 3.

27 Hon B Baird MP, *Transcript of evidence*, 10 August 2007, p. 15.

28 Hon N Greiner, PMI Mortgage Insurance, *Transcript of evidence*, 10 August 2007, p. 15.



products. That is an issue that today is being left with the states; therefore this ministerial council, at the state level, has been looking at the regulation of mortgage brokers. But I think we have got to the point where the question should be discussed as to whether that should be addressed at the federal level and whether regulation of credit products or advice on credit products should be done by ASIC in a similar way that ASIC does regulation licensing of financial advice.<sup>29</sup>

- 5.40 There were a number of advocates of this option at the roundtable. For example, Gordon Renouf of Choice stated:

Credit regulation needs to move national, and that is something which we did not do when the financial services reform package was brought in a good few years ago, for reasons that were convenient at the time. I think we now need to really seriously have a national debate about whether it is time to do that.

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It is just illogical to have a border line within financial services which says that some of it is regulated nationally and some of it is regulated within the state.<sup>30</sup>

- 5.41 Similarly, Luke Lawler of Abacus argued that credit's exclusion from the Corporations Act 'is kind of an arbitrary division; it's not really logical why credit is not there.'<sup>31</sup>
- 5.42 But there were concerns from several groups about simply moving credit regulation to the Corporations Act. One reason, as explained by Luke Lawler, is that 'the FSR regime is still a flawed regime.'<sup>32</sup>
- 5.43 Raj Venga of COSL agreed that the FSR regime is not yet perfect, but argued that moving credit into it 'is superficially attractive ... because a lot of the infrastructure is already there in the act.'<sup>33</sup>
- 5.44 There were also concerns that credit regulation has unique aspects to it that may not fit well with the existing FSR regime. As Raj Venga explained 'credit has its own bit about hardship that you will not find in other financial products'.<sup>34</sup>

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29 Dr P Lowe, RBA, *Transcript of evidence*, 17 August 2007, p. 17.

30 Mr G Renouf, Choice, *Transcript of evidence*, 10 August 2007, pp. 20-21.

31 Mr L Lawler, Abacus, *Transcript of evidence*, 10 August 2007, p. 51.

32 Mr L Lawler, Abacus, *Transcript of evidence*, 10 August 2007, p. 51.

33 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 51.

34 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 51.

5.45 A final concern lies in the fact that credit remains a state and territory regulated activity, and the respective governments may be reluctant to relinquish control to the Commonwealth. However, Phil Naylor of the MFAA asserted 'if the federal government wants to take it over, I do not think you will get any arguments from the states.'<sup>35</sup>

5.46 The Federal Treasurer, the Hon Peter Costello, has recently indicated that the Commonwealth would be willing to take over credit regulation:

We would say to the States that if they want to refer powers to us, then we would be willing to step in and take their powers and to legislate in this area.<sup>36</sup>

5.47 Summarising the case for credit regulation to move into Commonwealth responsibility, Martin Tolar of the Australasian Compliance Institute stated:

While the credit industry or the mortgage industry may not fit naturally into the financial services requirements, when you start to talk about using superannuation to try and get people out of home loan debt problems and then as I raised beforehand the issues surrounding reverse mortgages, it is very hard to artificially differentiate between financial advice around people's wealth protection and wealth growth and a mortgage and credit provision. I would argue that, while it is not perfect, let us try to find a way to try to have that continuum with regards to financial services advice around the time and type issues and then for most people, their largest financial asset, their home, and try to make it work in a fairly streamlined approach. It may mean some change and tinkering around with the financial services legislation as it is currently to try to meet that need, but let us not artificially create some new regulations.<sup>37</sup>

## Amend the UCCC

5.48 Another option for reform is to strengthen the UCCC. Greg Kirk of ASIC explained why the UCCC is in need of reform:

The current UCCC regime was established back in 1996 and was developed over a long period before that when a lot of the sorts of practices we are talking about today did not exist.<sup>38</sup>

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35 Mr P Naylor, Mortgage and Finance Association of Australia, *Transcript of evidence*, 10 August 2007, p. 56.

36 *Meet the Press*, television program, Channel Ten, Sydney, 19 August 2007.

37 Mr M Tolar, Australasian Compliance Institute, *Transcript of evidence*, 10 August 2007, p. 57.

38 Mr G Kirk, ASIC, *Transcript of evidence*, 10 August 2007, p. 13.

- 5.49 As outlined above, there are a range of concerns with the current UCCC regime. Broadly, these concerns are:
- The weak requirements on lenders to assess borrowers' capacity to repay;
  - The lack of positive obligations imposed on lenders to assist borrowers facing financial hardship; and
  - The ability for lenders to avoid the UCCC by requiring borrowers to sign business purpose declarations.
- 5.50 To address the first issue it is argued that the UCCC should contain explicit requirements for lenders to assess repayment capacity prior to granting a loan. John Moratelli from NSW Legal Aid argued:
- What we would like to see is a regulatory framework, which I do not think the UCCC provides at the moment, in which it is made clear that lenders should not lend to people for domestic purposes where they have no reasonable prospects of repaying.<sup>39</sup>
- 5.51 Of course, most lenders already do this as part of their standard lending practice, but it is claimed that some fringe lenders grant loans on asset value alone, knowing that the borrower has no capacity to repay and will eventually default. These loans are often low or no doc and require the borrower to self-certify that they can afford the loan.
- 5.52 Amending the UCCC to require lenders to assess repayment capacity would not spell the end for all low doc loans. Bona fide low doc loans still involve a fairly rigorous credit assessment. Peter Hall of Genworth Financial explained the process for genuine low doc loans:
- Their financial statements or their tax returns may be dated, so what they do to complement getting a loan is they go through a self-certification process but they would be supported by all other documents relevant to the loan, a financial position statement and assets and liabilities. There would be a credit bureau check done. Maybe financial statements were provided but they were 15 months old, or 13 months old. Self-certification was a substitute for not being able to provide your payslip for the last two weeks as a PAYG borrower would have.<sup>40</sup>
- 5.53 In terms of imposing positive obligations on lenders to assist borrowers facing financial hardship, Colin Neave of the BFSO suggested that it might

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39 Mr J Moratelli, NSW Legal Aid, *Transcript of evidence*, 10 August 2007, p. 11.

40 Mr P Hall, Genworth Financial, *Transcript of evidence*, 10 August 2007, p. 9.

be useful to amend the UCCC to insert a requirement similar to that imposed by section 25.2 of the Code of Banking Practice.<sup>41</sup>

- 5.54 Raj Venga of COSL argued that section 25.2 is not explicit enough for the non-ADI sector:

Our industry is one that has not fully developed. It is still very immature and we need a lot more guidance. I look at the banking code and its clause 25.2, which is a few lines. It might work for that industry. In our industry I think it has to be a lot more comprehensive.<sup>42</sup>

- 5.55 The final issue—lenders’ ability to avoid the UCCC by requiring borrowers to complete a false loan purpose declaration—is a concern for many. Among the concerned parties is John Moratelli of New South Wales Legal Aid, who argued that this loophole needs to be removed:

I would like to see the business purpose loophole in the UCCC closed so people cannot describe loans that are for personal use as business loans and avoid the UCCC.<sup>43</sup>

- 5.56 The solution to this problem is to amend the UCCC so it applies to investors and small businesses. Not only would this stop lenders’ avoidance, it would also bring the UCCC into line with other important financial services regulation, which also applies to investment and small business loans.

## Compulsory EDR membership

- 5.57 This is a reform option that received almost universal support in submissions and during the roundtable. The MFAA, for example, argued:

The MFAA considers that consumers will be assisted if all lenders of UCCC regulated lending must be members of an ASIC approved dispute resolution scheme. This would ensure the borrowers from the non-ADI sector would have recourse to have their complaints heard for free.<sup>44</sup>

- 5.58 Similarly, COSL argued:

It is vital that all credit providers and financial intermediaries are required to join an independent industry-based consumer dispute

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41 Banking and Financial Service Ombudsman, *Submission no. 5*, p. 8.

42 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 52.

43 Mr J Moratelli, NSW Legal Aid, *Transcript of evidence*, 10 August 2007, p. 78.

44 Mortgage and Finance Association of Australia, *Submission no. 2*, p. 4.

resolution scheme to address many of the access to justice issues facing consumers.<sup>45</sup>

- 5.59 The lone voice against compulsory EDR membership was Ron Hardaker of the Australian Finance Conference, who stated: 'Our position on EDR is that it should be voluntary'.<sup>46</sup>
- 5.60 If credit regulation were brought under the Corporations Act then providers of credit products and advice would be required to hold an AFS licence. Licensees are required to be a member of an EDR scheme.
- 5.61 Even if credit regulation remains separate from the Corporations Act, compulsory EDR scheme membership is still a reform option. One possibility would be for the states to amend the UCCC to require EDR membership for UCCC-regulated lenders.
- 5.62 Because EDR membership is voluntary at present, there is not a strong obligation on a rogue member to comply with an EDR scheme's findings against them. An EDR scheme has two possible recourses against a member refusing to comply with a finding. The first is to take legal action against the member for breach of contract. As Raj Venga of COSL told the roundtable this 'is an expensive option if we were to do that for every non-compliant member.'<sup>47</sup>
- 5.63 The other recourse is to expel the member from the scheme. Expulsion has little effect at present because lenders do not have to be members of an EDR scheme. But if EDR membership was compulsory, expulsion from a scheme would have serious consequences.
- 5.64 Another issue with the current operation of EDR schemes are their jurisdictional limits. The BFSO, for example, only has jurisdiction in complaints where the amount in dispute is below \$280,000. COSL's scheme limit is \$250,000.
- 5.65 The limit applies to the amount in dispute, not the total amount of the loan. In the vast majority of cases disputes are well below the limit, but the BFSO sees a few cases where the limit is surpassed. This almost exclusively occurs when a property has been used to guarantee a loan that is being used for the purpose of establishing or expanding a small business. In these cases the whole value of the guaranteed property can be in dispute, which can be much more than \$280,000. The BFSO can look into claims

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45 Credit Ombudsman Service, *Submission no. 18*, p. 2.

46 Mr R Hardaker, Australian Finance Conference, *Transcript of evidence*, 10 August 2007, p. 55.

47 Mr R Venga, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 49.

above \$280,000 but only if the member involved in the claim approves them to do so. COSL has not yet seen disputes of this nature.

- 5.66 Scheme limits are set by each scheme. ASIC grants approval for schemes to operate but only has a limited role in setting jurisdictional limits. ASIC's guidelines on approving an EDR scheme state:

A scheme's coverage should be sufficient to deal with:

- (a) the majority of consumer complaints in the relevant industry (or industries) and the whole of each complaint; and
- (b) consumer complaints involving monetary amounts up to a specified maximum that is consistent with the nature, extent and value of consumer transactions in the relevant industry or industries.<sup>48</sup>

## Regulation of mortgage brokers

- 5.67 Mortgage broker regulation is something that has been mooted for sometime, but has not yet eventuated. Recent reports suggest that the states are close to agreement on a regulatory regime. As noted above, the proposed uniform regime is likely to include licensing, minimum competence requirements, and written broker agreements. Brokers would also be required to be members of an EDR scheme.
- 5.68 There was unanimous agreement during the roundtable that greater controls over the conduct of brokers are needed, but there was less agreement on exactly how these controls should be implemented.
- 5.69 If credit regulation was moved to ASIC and the Corporations Act, as many people think it should be, there would be no need for separate, state-based broker regulation. Brokers would be required to hold an AFS license and to comply with the requirements of that licence.
- 5.70 But if credit regulation remains a state responsibility then separate broker regulation is needed. As was pointed out by Phil Naylor of the MFAA 'if the federal government ... does not do something about it, the states will do it.'<sup>49</sup>

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48 ASIC, *Regulatory guide 139: Approval of external complaints resolutions schemes*, ASIC, Canberra, July 1999.

49 Mr P Naylor, Credit Ombudsman Service, *Transcript of evidence*, 10 August 2007, p. 76.

## Committee conclusions

- 5.71 Credit regulation has failed to keep pace with the rapidly evolving and growing credit market. The current regulatory framework is ineffective in dealing with the new practices that have emerged.
- 5.72 Most financial services and products are regulated by the Commonwealth Government. One aspect to this is that under the Corporations Act ASIC is responsible for administering licensing, disclosure and quality of advice requirements. ASIC's responsibilities do not extend to credit products and services.
- 5.73 The Uniform Consumer Credit Code is the primary instrument for regulating credit in Australia. It is a uniform national code that was developed by the states and territories in the early 1990s in an attempt to introduce standardisation. The uniformity it brings is certainly welcome, but the code itself has a number of inadequacies.
- 5.74 The fact that the UCCC is state-based means it is very hard to change. This is probably the major reason it has been unable to adapt as the market has changed and predatory practices have become more prevalent. According to consumer advocates, problems with the UCCC itself include the lack of positive obligations on lenders to assist people facing financial hardship, and the lack of explicit requirements on lenders to only provide credit to people who can afford it. Also, because it does not apply to investment and small business loans, fringe lenders can avoid the UCCC's requirements by forcing consumers to complete a false declaration about the loan's purpose.
- 5.75 Other problems with credit's current regulatory framework include the fact that external dispute resolution scheme membership is voluntary for some credit providers, and that there are very few controls on the conduct of mortgage brokers.
- 5.76 There are a number of possible regulatory responses to remedy these concerns. The UCCC could be amended to strengthen some of its provisions, to include investment and small business loans, and to make EDR scheme membership compulsory. But, as already discussed, amendment is an inherently difficult task and is likely to take an extended period of time.
- 5.77 In terms of the conduct of brokers, the states are very close to releasing a draft bill to introduce uniform national regulation. This is certainly a welcome development, but, much to the frustration of the broking industry and consumer advocates, it has taken a long time to come to

fruition. If the regime needs to be amended in the future this would presumably involve another drawn out process.

- 5.78 The committee is of the view that a more sensible approach to reform would be to harmonise regulation within the financial sector by shifting responsibility for credit regulation to the Commonwealth Government. This would remove the arbitrary and illogical division of powers that currently exists, where all financial products and services are regulated by the Commonwealth, except credit.
- 5.79 Credit should be defined as a financial product for the purposes of the Corporations Act. Providers of credit products and services would then be subject to rules about quality of advice and disclosure, and would be required to hold an AFS licence. This would include *all* lenders and *all* mortgage brokers. Predatory lenders and brokers providing inappropriate loans or advice would be subject to sanctions from ASIC and may face the loss of their AFS licence.
- 5.80 AFS licensees are also *required* to be a member of an EDR scheme. The fact that EDR scheme membership is a mandatory condition of an AFS licence gives schemes more power when making a determination against a member. If a member fails to comply with a determination then they may be expelled from the scheme, which could jeopardise their AFS licence.
- 5.81 EDR schemes appear to be an effective and low-cost mechanism for resolving consumer complaints. The schemes' jurisdictional limits could be increased to enable more complaints to be dealt with. This is particularly relevant for the Banking and Financial Services Ombudsman because it often deals with complaints where loans have been guaranteed by property. In this type of complaint the amount in dispute can be the entire value of the guaranteed property, which would invariably be higher than the BFSO limit of \$280,000.
- 5.82 The committee is aware that transferring credit to a Commonwealth responsibility is not as simple as just defining credit as a financial product under the Corporations Act. As pointed out in evidence, there are aspects of credit products that are different to other financial services. Further, there are aspects of the UCCC that are important and not covered by any current federal legislation. An example of this is the UCCC's hardship provisions. The architects of the new arrangements would need to consider what legislation other than the Corporations Act needs to be amended, and whether there is a need for new legislation.
- 5.83 Another issue is whether or not the states and territories are willing to allow the Commonwealth to take over credit regulation. Anecdotal evidence to this inquiry suggests they would be. The Treasurer has



recently indicated that the Commonwealth would be willing to legislate in this area.

- 5.84 In summary, the committee is of the view that this new approach to credit regulation is needed. It will not only assist in reducing the number of predatory lenders and brokers, it will also harmonise regulation within the financial system, and make credit regulation more readily adaptable to future changes in the market.

### **Recommendation 2**

- 5.85 **The committee recommends that the Commonwealth Government regulate credit products and advice. This includes the regulation of mortgage brokers and non-bank lenders.**

### **Recommendation 3**

- 5.86 **The committee recommends that:**
- **The board of the Banking and Financial Services Ombudsman increase its jurisdictional limit to \$500,000. This limit should be indexed annually; and**
  - **Other external dispute resolution schemes consider the appropriateness of their limits.**

