Chapter 6

New credit laws

6.1 There can be no doubt that between 2002 and 2010 improper, lax and even predatory lending practices were not uncommon. Indeed, these practices led to major reforms in the provision of credit. Effective from 1 July 2010, the *National Consumer Credit Protection Act 2009* (National Credit Act) introduced for the first time in Australia stringent responsible lending obligations on credit providers and intermediaries such as finance brokers.

6.2 In this chapter, the committee considers ASIC's new role and the effectiveness of the new laws in stamping out irresponsible lending practices.

Background

6.3 The committee's consideration of inappropriate lending practices between 2002 and 2010 is not the first time that a parliamentary committee has recently identified irresponsible lending practices as a problem. It should be noted that the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) received evidence about poor lending practices from many investors caught up in the failure of Storm Financial. Borrowers reported that they had signed blank loan applications and, following Storm's collapse, discovered they had taken out additional loans of which they were unaware. They also claimed copies of forms provided by the banks post-collapse show overstated income figures or asset values that led to grossly inaccurate representations of their capacity to repay the loans.[1] Some of Storm's clients did not understand, or fully comprehend, that by borrowing against the equity in their family home they were, in effect, putting the ownership of their home at risk.[2] The PJCCFS found that practices by institutions lending for investment purposes were below community expectations and not subject to appropriate regulatory control.[3]

Need for reform

6.4 As noted in the previous chapter, from 2002 there had been a general and growing awareness in the industry of problems with inappropriate lending practices. This awareness led COAG to announce in March 2008 the need for a broad regulatory reform agenda that would include taking early action and progress on mortgage credit and advice, margin lending and non-deposit taking institutions.

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1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia,* November 2009, Parliamentary Paper No. 321/2009, p. 23.

2 PJCCFS, *Inquiry into financial products and services in Australia,* November 2009, p. 28.

3 PJCCFS, *Inquiry into financial products and services in Australia,* November 2009, p. 90 and ASIC, *Submission 378*, pp. 87–88.

6.5 The following month, the Productivity Commission found that a single national regulatory regime covering both mortgages and mortgage brokers would be 'an efficient response to the need to address a number of malpractices on the part of certain brokers'.[4] It recommended that responsibility for the regulation of credit providers and intermediaries providing advice on credit products ('finance brokers') should be transferred to the Australian government, with enforcement to be undertaken by ASIC. Amongst other things, the new national credit regime should:

- cover all consumer credit products and all intermediaries providing advice on such products (including through electronic or other arms-length means); and
- include a national licensing system for finance brokers, and a licensing or registration system for credit providers that would give consumers guaranteed access to an approved dispute resolution service.[5]

6.6 In July 2008, COAG agreed to measures designed to provide better protections for financial consumers across Australia. It announced that the Commonwealth would assume responsibility for 'the regulation of trustee companies, mortgage broking, margin lending and non-deposit lending institutions as well as remaining areas of consumer credit'. It envisaged that:

> National regulation through the Commonwealth of consumer credit will provide for a consistent regime that extinguishes the gaps and conflicts that may exist in the current regime. The new regime is anticipated to introduce licensing, conduct, advice and disclosure requirements that meet the needs of both consumers and businesses alike.

6.7 Over two years later, the Consumer Credit Protection Reform Package was introduced, which aimed to further this goal of a national, uniform approach to consumer credit laws. It included a national licensing scheme to overcome some of the current anomalies—a 'single standard and uniform regime for consumer credit regulation and oversight'.[6]

New credit laws

6.8 Under the new credit laws, credit licensees must comply with the responsible lending conduct obligations in chapter 3 of the National Credit Act. If the credit contract or consumer lease is unsuitable for the consumer, then credit licensees must not:

- enter into a credit contract or consumer lease with a consumer;

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4 Productivity Commission, *Review of Australia's Consumer Policy Framework,* Inquiry report no. 45, vol. 1, 30 April 2008, p. 9.

5 Productivity Commission, *Review of Australia's Consumer Policy Framework*, vol. 1, 30 April 2008, p. 66.

6 The Hon Chris Bowen MP, Second Reading Speech, National Consumer Credit Protection Bill 2009, *House of Representatives Hansard*, no. 10, 2009 (25 June), p. 7148.

- suggest a credit contract or consumer lease to a consumer; or
- assist a consumer to apply for a credit contract or consumer lease.[7]

6.9 These conduct obligations apply to credit providers—such as banks, credit unions and small amount lenders—and to finance companies, lessors under consumer leases and credit assistance providers such as mortgage and finance brokers. The legislation requires credit providers to make inquiries into whether the loan would meet the borrower's requirements and objectives. In other words, since the National Credit Act came into force in 2010, both lenders and brokers have 'a positive obligation to make inquiries into a borrower's financial situation (i.e. that the loan will not cause substantial hardship), and to verify that assessment'.[8] For non-ADIs, the responsible lending obligations came into effect on 1 July 2010 and for ADIs on 1 January 2011. Being banks and mutuals, ADIs had a pre-existing code of practice, which had a similar obligation.

6.10 Much consultation and negotiation took place before the legislation was introduced. According to Mr Philip Field, Financial Ombudsman Service (FOS), the process 'probably took the best part of two or three years of negotiations and roundtable meetings to get it into place and get people on board' including consumers, lenders, and brokers.[9] Two parliamentary committees also scrutinised the proposed legislation that would introduce the credit reforms. Mr Raj Venga, Ombudsman, Credit Ombudsman Service (COSL), stated that the legislation was 'frankly, long overdue'.[10]

6.11 The committee appreciates that this legislation had a fairly long incubation period and a definite purpose based on a clear understanding of the problems it was addressing. In addition, all stakeholders had the opportunity to engage in consultation and provide feedback. Even so, reforms of this nature, no matter how well-intended and considered, need time for their effectiveness to be tested.

Views on its operation

6.12 In early 2014, Mr Field informed the committee that the Financial Ombudsman had not seen a lot of cases arise yet and was 'just starting to get disputes around responsible lending under the National Credit Code'. He explained that FOS was a 'rear-view organisation' and people approached it sometimes many years after the original event. While his best guess was that the new legislation was 'working quite well', he would like the chance to see how the legislation settles down in terms

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7 ASIC, *Credit licensing: Responsible lending conduct*, Regulatory Guide 209, September 2013, p. 4.

8 Consumer Action Law Centre, *Additional Information 8*, p. 1.

9 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service, *Proof Committee Hansard*, 20 February 2014, p. 24.

10 *Proof Committee Hansard*, 20 February 2014, p. 18.

of changing lender behaviour. He suggested that it be given a fair opportunity to work and to see whether it actually solves the problem.[11]

6.13 Mr Gerard Brody, Consumer Action Law Centre, informed the committee that, since the introduction of the licensing regime and particularly the responsible lending obligations, experience in the mainstream lending area indicated that practices had improved. He explained:

> Our experience is that the new obligations under the national credit law have improved processes and that we are not seeing the type of loss that people have experienced in the past, particularly because of the responsible lending obligations and the obligations upon credit providers to assess someone's capacity to repay and assess that a loan is in line with their objectives.[12]

6.14 The CCLC agreed with the view that within mainstream lending there had been 'a noticeable tightening of lending procedures, particularly within the areas where the law applies'. It had certainly experienced a major reduction in the type of poor lending that was occurring beforehand. According to Mrs Karen Cox, CCLC, they 'get one-off cases where things have gone wrong' but:

> For consumer credit lending and residential investment lending we have not seen the sorts of cases seen in the past. That does not mean they do not exist, but we are not seeing them at all.[13]

6.15 Mrs Cox stated further that the CCLC had started to win a couple of cases at the dispute resolution schemes on the interpretation of the law. In her view, however, it was 'very early days yet in terms of what the law actually means'. Noting that it was also very early days in terms of the compliance reaction, Mrs Cox anticipated that:

> …perhaps in time, we might see some people trying it on again. That would require ASIC to make sure that does not happen.[14]

6.16 Thus, while those who commented on the new credit laws were generally satisfied that the legislation was working well, they still noted that the laws needed time to bed down before a more conclusive assessment of their effectiveness could be made. In this regard, Mr Field observed that, where someone has obtained a loan they could not afford, difficulties would generally become apparent within the first or second year, depending on the nature of the loan. He did note, however, that with self-funding, the borrowers would not realise problems until the self-funding ran out.[15]

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11 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 24.

12 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 42.

13 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 41–42.

14 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42.

15 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, *Proof Committee Hansard*, 20 February 2014, p. 24.

6.17 Challenging this point, Ms Brailey argued that some problems with lending practices remain. She explained that people who took out a loan in 2010 will 'not know that their loan is fraudulent, toxic, service calculators were used or the same model used by 85 per cent of the major lenders'. In her view, the contracts 'do not implode for five years'.[16] She explained:

> The loans are being approved on the idea that you can afford it because you have some money in the bank. So where does that money come from? When the banks set up the loan, they give people $300,000 to go and buy a small property. It is usually $300,000 to $400,000—that is the average. But they give them an extra $50,000 and in some cases $100,000 to afford it. So they are paying the payments with the bank's own money, and the bank approves it. Then you go on for another two or three years like that and that is where the refinancing comes in, which ASIC has been going on about a bit. The commissioner said to me, 'Denise, I can assure you refinances are finished.' They are not. It is still going on. I was seeing it written only six months ago. It is still there.[17]

6.18 Her concern was that when loans are taken out on the basis of the equity in an existing asset, the continuing refinancing and the continuing compounding interest on the debt increases the value of the loan which eats 'into the equity that is there'.[18]

Possible gaps or weaknesses

6.19 While in general the consumer advocacy centres recognised the benefits of the new legislation, they also identified a number of areas where there was a possible gap or weakness in the legislation. Mrs Cox from the CCLC noted that some areas of lending were not covered by the new law, including small business lending and other forms of non-residential investment lending.[19] So, in her view, there were potential problems, but because the CCLC was not funded to assist people in this area, it would not necessarily receive evidence of what was going on there.[20] Even so, the CCLC stated quite clearly its belief that:

> …investment lending has been instrumental in facilitating some spectacular investment failures with catastrophic results for many consumers, including self-funded retirees who have lost their homes and their life savings.[21]

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16 Ms Denise Brailey, President, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 47.

17 Ms Denise Brailey, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 49.

18 Ms Denise Brailey, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 50.

19 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42. ASIC also made it clear that the National Credit Act does not apply to all borrowings by SMEs or to borrowings for investment purposes, other than investment in residential property. ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 2.

20 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 41–42.

21 CCLC, *Submission 194*, p. 19.

6.20 The CCLC cited the Regulation Impact Statement (RIS) on credit for investment issued by the then Minister for Financial Services and Superannuation on 21 December 2012. The draft legislation recognised that consumer losses due to misconduct were 'amplified where the consumer has borrowed to invest'. The RIS indicated that the current legislative framework did not adequately address misconduct in the credit to invest area. According to the RIS, ASIC's enforcement activity was 'ineffective due to a combination of regulatory and enforcement gaps, the prohibitive cost and inefficiency of enforcement action and the unlikeliness of targeted enforcement action by ASIC resulting in behavioural change in the industry as a whole'.[22]

6.21 The previous chapter referred to cases where people borrowed to invest and found themselves in difficulty. Also, as noted in the previous chapter, as early as 2003 there were warnings about brokers arranging for borrowers to declare, incorrectly, that a loan was for investment rather than personal use (with the result that the consumer lost statutory protections provided under the Uniform Consumer Credit Code). Clearly, this is an area that requires careful monitoring.

Fringe areas of lending

6.22 Currently, the Consumer Action Law Centre's concern and focus is on the fringe areas of the marketplace, such as payday lending and consumer leases, also known as rent to own products. It highlighted concerns about systemic problems with compliance in some of these areas.[23] For example, the Centre noted that property spruikers were not regulated and not licensed by ASIC. It suggested that 'there may well be commission arrangements between spruikers and certain brokers or lenders who encourage individuals to purchase property (with or without a loan) that are inappropriate'. The Centre cited the Victorian Parliament Law Reform Committee's 2008 report that made a raft of recommendations including that the Australian government regulate property investment advisers under its financial services laws in the same way as financial advisers.[24]

6.23 Mr Brody also drew attention to concerns and consumer complaints about businesses established purportedly to help consumers in financial difficulty that charge significant fees. He explained that such businesses are termed the 'for-profit financial difficulty' businesses and target people who are in financial difficulty,

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22 Treasury, *Regulation Impact Statement: Credit for investment purposes*, December 2012, p. 1.

23 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 42.

24 Consumer Action Law Centre, *Additional Information 8*, pp. 1–2. The report cited is Parliament of Victoria, Law Reform Committee, *Inquiry into property investment advisers and marketeers,* Final report, April 2008 www.parliament.vic.gov.au/images/stories/committees/lawrefrom/property_investment/final_report.pdf. One recommendation called for the Victorian Government to propose to the Ministerial Council on Consumer Affairs that the Australian government amend the ASIC Act and chapter 7 of the Corporations Act so advice about direct property investment is included in the financial services regime.

ostensibly to help them.[25] According to Mr Brody, this type of business model does 'not fit neatly within current regulations or ASIC's purview, but they are related to issues within ASIC's responsibility'. He stated:

> An effective regulator needs to be one that has the power to identify and act on new forms of consumer detriment in financial services…and we think that if the regulator's tools were improved this could improve the overall performance of ASIC.[26]
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> …
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> One of the problems in raising those sorts of issues with ASIC is that within the current regulatory framework they do not neatly fit within ASIC's responsibility. They are not providing a regulated service, and that can mean there are challenges in getting action on those sorts of problems. To the extent that it can I think ASIC assists us in understanding and raising these issues as far as possible. We have recently had a roundtable with them on that exact business model. But there is a limitation in the scope of what ASIC can do in relation to those businesses because of the regulations.[27]

6.24 Mr Brody informed the committee that the Consumer Action Law Centre was seeing a number of businesses adopting the 'for-profit financial difficulty' type of model and was of the view that it was a 'growing sector'.[28]

6.25 As an example of this type of practice, a committee member cited a recent case that had come to his attention, where:

> …a farm was in financial trouble and consultants came along and said, 'We'll refinance you. Pay us $40,000 and we will get the money.' The $40,000 was squeezed out of every last bit of juice and there was never any loan…[29]

6.26 Mrs Cox informed the committee that the CCLC had dealt with a very similar situation involving a smaller amount. She explained:

> There was a woman who had a range of debts after her marriage broke down, and they charged her a percentage—which amounted to somewhere between $11,000 and $17,000 in her particular case—to negotiate with her creditors. She could not raise that money, so they said, 'That's fine; we'll set up a direct debit arrangement and you can start paying us off.' By the time we came along, I think she had paid a fair amount on the direct debit arrangement. Absolutely nothing had been done, and her financial position was deteriorating. I assume that either they never intended to do anything or they were waiting till she had paid the entire fee before they began. We

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25 *Proof Committee Hansard*, 20 February 2014, p. 43.

26 *Proof Committee Hansard*, 20 February 2014, p. 40.

27 *Proof Committee Hansard*, 20 February 2014, p. 44.

28 *Proof Committee Hansard*, 20 February 2014, p. 43.

29 *Proof Committee Hansard*, 20 February 2014, p. 44.

> quickly became involved and were able to resolve a lot of her issues with the help of another financial counselling agency, and in that particular case we managed to argue to get her out of the money that she had also paid.[30]

6.27 Mrs Cox observed that the person who was supposed to assist the individual in debt in the above example previously had a financial services licence but was now banned from providing financial services. She noted that there was absolutely nothing that could be done about this new activity.[31] According to Mrs Cox, in order to be captured by the credit regulation, a person has 'to suggest that someone either take out or stay in a particular credit product'. She explained further:

> The people providing such advice 'would argue—and, some legal advice suggests, successfully—that they are not actually suggesting any particular credit product; they are actually offering to negotiate with your creditors, and that is not caught as a credit activity or a financial service'.[32]

6.28 In her experience, such practices were on the rise.[33] Mrs Cox also noted that the CCLC was still dealing with complaints in particular areas such as payday lending where it was 'seeing a lot of problems' including where people were 'blatantly avoiding the law'. She indicated that although ASIC had taken action and was working on some cases in that area, the Centre was 'usually frustrated because we want it go faster'. According to Mrs Cox:

> Certain other members of the industry who believe they are complying and are upset that others are not being hung out to dry also express that frustration. Even those who believe they are complying in that sector we do not always agree with their interpretation of the law.[34]

6.29 Mrs Cox noted that it was very important for ASIC to 'use the new tools that they have got under the new law to do whatever they can to actually prevent the type of behaviour that occurred between 2002 and 2010 from happening in the future'.[35] Clearly, this area of regulating the provision of credit services still requires close monitoring to ensure that the laws are providing the required level of consumer protection and to identify gaps that exist and should be covered by the credit laws.

ASIC's assessment

6.30 ASIC informed the committee that the National Credit Act had 'largely addressed the regulatory issues and market problems prevalent before 2010', although, in its view, 'it may be too early to make a final assessment of how effectively it has

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30 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 44–45.

31 *Proof Committee Hansard*, 20 February 2014, pp. 44–45.

32 *Proof Committee Hansard*, 20 February 2014, p. 44.

33 *Proof Committee Hansard*, 20 February 2014, p. 45.

34 *Proof Committee Hansard*, 20 February 2014, p. 42.

35 *Proof Committee Hansard*, 20 February 2014, pp. 40–41.

been done.[36] Nonetheless, when asked whether there were any areas of concern emerging as the new credit laws bed down, ASIC cited two substantive issues. The first was concern that there could be 'a lack of competitive neutrality' where players offered products that were 'functionally similar to regulated products but without having to meet, for example, the licensing and responsible obligations through the National Credit Act'. ASIC explained that there were two different contexts in which this might occur:

- mainstream products, where the lack of regulation may be the result of innovations in product design (such as peer-to-peer lending); and
- avoidance activity on the fringes, where lenders and brokers deliberately change their business models and structures to fall outside the law or aspects of the law.[37]

6.31 ASIC informed the committee that the government had recently taken steps to address some avoidance practices. It had done so 'by circulating draft regulations to close some gaps in the law being exploited by payday lenders and signalling a review of the exemption for indefinite and short-term leases in the National Credit Act'. ASIC observed, however, that:

> …given that the possible structures for avoiding the cap on costs are limited only by the ingenuity of those advising possible avoiders, the Government could consider a general anti-avoidance provision that sought to deter entities making repeated changes in business models to continue avoiding their obligations under the National Credit Act (rather than addressing each model as it emerges after the event).[38]

6.32 In December 2012, Treasury consulted on proposals for changes relating to investment lending, peer-to-peer lending, small business lending, short-term and indefinite-term leasing, and a number of anti-avoidance mechanisms. ASIC stated that to the extent 'the Government identifies gaps or problems in relation to these topics they have not been addressed'.[39]

6.33 The increase in the number of businesses that charge consumers fees to repair their credit records, or to pursue claims through the EDR schemes, was the second source of concern for ASIC. It explained:

> These companies often charge high fees for services that would otherwise be provided free of charge by the dispute resolution services, and may exacerbate the consumer's financial difficulties where they pursue unmeritorious claims that delay or impede the resolution of their position.

36 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 1.

37 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

38 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

39 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 1.

6.34 ASIC considered that the implementation of the responsible lending obligations would continue to be an area of review as the obligations are expressed in general terms, which allows for significant divergence in practices across the industry.[40]

Committee view

6.35 Since 2002, and undoubtedly well before, some unscrupulous people in the financial services industry exploited the inadequate regulation of consumer credit. Early indications suggest that the new credit laws have been effective in stamping out the predatory lending practices that existed between 2002 and 2010, though most submitters agreed that the laws need time to settle down before a definitive assessment of their effectiveness can be made.

Conclusion

6.36 The inescapable message coming out of the 2002–2010 period when irresponsible, even predatory, lending went largely unregulated and unchecked is that early indications of a problem must be attended to promptly and, where possible, stamped out before it takes root. This may mean simply enforcing existing laws or campaigning for new ones.

6.37 New credit laws are now in place and appear to be working effectively, although there are suggestions that some people are operating on the margins of the legislation in an endeavour to circumvent the law. Indeed, a number of witnesses, well-positioned to comment, identified areas on the fringes of mainstream lending that still expose consumers to risks, such as the 'for-profit financial difficulty' businesses. It is important for ASIC to match the ingenuity of these operators. Additionally, ASIC needs to be ready to take on the challenge created by a constantly changing industry with the creation of new products and business models—some deliberately designed to exploit legal loopholes. It is also important for ASIC to remain alert and receptive to any signs of poor or irresponsible lending practices, and when they emerge, it must educate consumers of the dangers; act quickly where it has the power to do so; and actively lobby for changes if the laws are deficient.

6.38 In the previous chapter, the committee recommended that ASIC consider adopting a multi-pronged campaign to educate retail customers. The campaign should focus on the care consumers need to take when entering into a financial transaction and where they can find assistance and affordable and independent advice when they find themselves in difficulties because of that transaction. In light of this chapter's discussion on the new credit laws, the committee builds on this recommendation.

40 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

Recommendation 2

6.39 As part of the multi-pronged campaign (see Recommendation 1), the committee recommends that ASIC actively encourage consumers to report any suspected unscrupulous conduct related to consumer credit.

Recommendation 3

6.40 The committee recommends that as the national credit reforms introduced in 2010 bed down, ASIC should:

- **carefully monitor the implementation of the new laws giving particular attention to activities that may fall outside the legislation but which pose risks to consumer interests;**
- **ensure that it acts quickly to alert consumers to likely dangers and the government to any problems that need to be addressed; and**
- **build capacity to monitor and research lending practices and to be prepared to launch marketing and education strategies should poor practices begin to creep back into the industry.**