SUBMISSION TO THE SENATE ECONOMICS COMMITTEE IN RELATION TO HOUSEHOLD DEBT

By

CONSUMER CREDIT LEGAL CENTRE (NSW) INC.

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The Consumer Credit Legal Centre (NSW) Inc ('CCLC') is a community legal centre specialising in financial services, particularly matters and policy issues related to consumer credit, banking and debt recovery. It has been operating for 17 years and is the only such Centre in NSW. It has a particular focus on issues that affect low income and disadvantaged consumers.

CCLC provides free legal advice and assistance to consumers concerning banking, credit, debt and related matters. We also educate consumers about their rights and obligations in the field, and seek to identify and recommend changes to areas of law that require improvement.

Service activities include legal information and legal advice given in a variety of situations and formats:

- By mail
- Over the telephone
- Face-to-face
- Via our website (information only)
- Via educational publications such as the CCLC Flyer (information only)
- Via general media (information only)
- Via workshops/seminars for community lawyers, financial counsellors, community/welfare workers and the public (information only).

The CCLC is also uniquely placed to undertake detailed policy projects, and to interact with regulators and policy makers on complex legal issues affecting consumers, especially disadvantaged consumers. Examples of recent major policy projects include:

Submission to the Review of the Code of Banking Practice on behalf of six consumer organisations across Australia
Research Report in relation to Finance and Mortgage Brokers
- Debt Collection Research Report

1. Current levels of household debt and whether these are historically high (as a proportion of household income or otherwise):

A day in the life of CCLC

A caller rings the legal advice line in a distressed state. He is a returned serviceman on a pension. He has several debts, largely credit cards and a small home loan. He has been trying to pay them off but is fighting a losing battle on his income. Every payment he makes is absorbed in interest and fees, including over limit fees. He wants to pay his debts and has asked the bank to consolidate his debt but they refuse because they do not think he can afford to pay the consolidated loan. He says he can pay even though it will absorb more than half his pension. He and his wife are beside themselves and have contemplated a suicide pact.

A financial counsellor ring to complain about a referral made to her service. In dealing with the issue it becomes apparent that her service is being stretched to absolute capacity. She has taken 21 messages off her phone that morning. She works in the mortgage belt in outer Sydney and has more work than she can keep up with. She bemoans the size of her client's home loans. "They [lenders] take all sorts of things into account that never would have been considered previously: overtime, casual work, child support……The clients can't keep up with the payments. Some of the men have taken to their beds in despair - they are already suicidal. The women might be on anti-depressants to, but they're struggling on with children and part-time jobs."

Consumer borrowing has been increasing at historically unprecedented levels for a number of years. The level of Australian indebtedness is rising and is rising faster than ever before. Reserve Bank of Australia figures show that in February 2004 personal lending, including credit cards, reached $ 98.75 billion.[1] Credit card debt alone reached $25.94 billion (in January 2004), up from $17.4 billion in December 2001.[2] Housing debt was $448.4 billion (up from $286.3 billion in December 2001).[3] This brought consumer debt to a total of $ 547 billion in February 2004. The recently released Financial Stability Review March 2004 published by the Reserve Bank of Australia[4] notes that the level of outstanding household credit has risen at an annual rate of 15 per cent since 1996 and at an even faster rate of 22 per cent over the 12 months preceding January 2004. Household debt represented over 140 per cent of disposable income in 2003 compared with 105 per cent in early 2001, taking Australia from having a relatively low debt-to-income ratio by international standards a decade ago to having a relatively high level of household debt when measured against income.
The rise of household debt is one of the reasons the Reserve Bank cited for increasing interest rates in late 2003.

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1 Reserve Bank of Australia Bulletin Statistics published at www.rba.gov.au/ Statistics/Bulletin, Statistical Table D.2 Lending and Credit Aggregates.

2 Reserve Bank of Australia Bulletin Statistics published at www.rba.gov.au/ Statistics/Bulletin, Statistical Table C.1 Credit & Charge Card Statistics.

3 Reserve Bank of Australia Bulletin Statistics published at www.rba.gov.au/ Statistics/Bulletin, Statistical Table D.2 Lending and Credit Aggregates.

4 Financial Stability Review published at www.rba.gov.au on 25 March 2004.

It appears that much of the increased personal spending has been financed by rapidly rising real estate values. It is commonly stated that while we owe more than ever, our net worth has grown proportionately. This may be true. At the same time, much of this wealth is illusory. Dwellings may be worth significantly more than they were 10 years ago but, in many cases, they are not necessarily better. Indeed, while some have taken the opportunity to use their increased equity to renovate, many have deteriorated. Further, unless you are vacating a capital city permanently, or moving from a thriving coastal town to a less vibrant rural location, you need every cent you receive upon the sale of your property (and then some usually) to purchase another.

People who entered the property market prior to the marked rise in real estate values have had the opportunity to amass significant equity in their homes. The financial services market has adapted very effectively to this by inventing numerous ingenious ways to divest people of their equity. Very few home loans do not offer redraw to encourage people not to pay off their loans too fast (and most of us would no longer want to live without it). Many lenders offer interest-only loans or periods, margin lending facilities so people can borrow to invest, and line-of-credit or equity loans secured by your residential property. These all amount to debts which must eventually be repaid or the property lost.

For people who were not already property owners, there have been two options in recent years, either stay out of the market or borrow large amounts of money. The need for larger deposits alone has spawned a market in 100% loan to value ratio loan products and vehicles such as deposit bonds. For many young people home ownership is completely impossible, while others are in significant debt.

People are also working longer hours, are often tied to their jobs to service their significant debts, and have less time to enjoy the dwelling in which their entire wealth is invested.

In September 2003 CCLC took over the operation of a telephone assistance service from Wesley Mission. This service, formerly called the Credit Helpline, and now known as the Credit and Debt Hotline, has taken 2512 calls from the public and financial counsellors in its first 5 months of operation at CCLC. A large number of these callers were in financial difficulty as a result of debt. Some of these callers gave some detail about the type and size of the debt(s) they were experiencing difficulty with. Many had multiple debts. 636 gave details of one or more credit card debts, 227 gave similar details in relation to secured motor vehicle loans and 85 gave details in relation to their home loans. Home loan amounts ranged up to $630,000 (although the legal centre legal casework service has assisted clients with higher loans including one client on social security with a loan in excess of $800,000), but were more commonly for $50,000-350,000. Many other callers identified they were facing financial difficulties but did not give specific details in relation to their debts.

Credit Cards

The Credit and Debt Hotline took over 750 calls in its first month of operation at CCLC. Most callers to the service have at least one credit card debt. 146 callers have identified their credit card(s) as their major debt problem or a significant part of their problem. Of those 146 callers, 50% self assessed as being on a low income (largely in receipt of govt benefits). 139 callers gave details regarding the amounts outstanding on their cards. These were made up of:

- 48 calls (35%) owed less than $5,000 (but were nevertheless struggling to pay;
- 28 calls (20%) owed over $5000 but no more than $10,000;
- 52 calls (37%) owed over $10,000 but no more than $40,000.
- The remaining 11 calls involved amounts above $40,000. (Extremes included $90,000 and $200,000 in total credit card debt.)

Recent CCLC Client
An elderly pensioner, Mrs. F, accumulated over $70,000 in credit card debt. The debts were accumulated via a series of credit card limit increase with no assessment of the client's ability to pay. Mrs F in fact had two cards with each of two major banks and had been surviving by using one card to pay off another in addition to whatever payments she could make.

In 03/04 CCLC acted for 17 clients like Mrs F who had been granted credit card limits that far exceeded their ability to pay in he 2003/2004 year alone and gave advice to many more. Contrary to popular images in the press, almost none of these clients were not irresponsible young people and a significant number were over 55 years old. "Credit card overcommitment", as we refer to it, has been one of the key issues dealt with by our legal practice since the late 1990's. Further this has also been the experience of financial counsellors in NSW and of services similar to ours in other states.

On 21 November 2002, Visa released research which purported to demonstrate that there was no problem with credit card debt. The publication "The Credit Card Report: Credit card spending in perspective" [5] drew data from a number of independent sources and the press release emphasised the following points (among others):

- 6 out of 10 card holders do not incur interest each and every month
- only 35% of households are paying interest on their credit card accounts
- 25% of the total card outstandings as reported by the Reserve Bank is non-interest bearing and is repaid by the due date
- Low-income earners ($15,000 pa or less) represent only 5% of cardholders and account for only 4% of interest bearing card debt. This group pays off their card bills in full by the due date in the same proportion as do many higher income groups (59% do not pay interest)
- While credit card limits have been increasing, around 56% of accounts have limits less then $5000
- Defaults (past 90 days due) and write-offs reduced 40% between 1998 and 2002.

Turning some of these statistics on their heads however reveals quite a different picture:

[5] Visa "The Credit Card Report: Credit card spending in perspective" Volume 1, Nov 2002g

- 4 out of 10 credit card accounts (approximately 3.84 million accounts) do attract interest
- 35% of households are carrying 65% of the interest bearing debt
- 75% of the total outstandings reported by the Reserve Bank is interest-bearing (75% of $21,502 million as at August 2002 = $16,126.5 million)
- $5000 is an unmanageable limit for people on very limited incomes. The minimum payment on a $5000 outstanding debt is usually more than more than the available income of most people on Centrelink payments.
- An increasing number of consumers use their credit card purely as a payment mechanism as other payment mechanisms become more expensive. These consumers who pay the balance off at the end of each month improve the overall figures for the rate at which cards are paid, and the default rate. This doesn't mean that consumers who were paying credit cards off slowly 5 years ago are now paying them off faster.

And credit card balances have continued to grow since the release of the above research.

Banks defend their credit assessment practices, claiming they have reduced default rates by half in the last seven years[6]. Consumer advocates remain sceptical. The Australian Bankers Association concedes that three out of ten cardholders have not paid their account out completely in last twelve months[7]. That is roughly 2.9 million accounts[8] on which interest is being paid, presumably because people have insufficient funds available to pay their cards out (it being highly unlikely they are choosing not to pay this amount because they can invest the money more productively elsewhere).

The Australian Bankers Association also notes that seven out of ten credit card account holders pay out their balance at least once per year[9]. The question must be asked – how do they do this? Is it their tax return, the sale of property, a sudden influx of income? Or perhaps they have simply transferred their debt to another card or consolidated it into their home loan.

The KMPG report points out that 91% of the disturbing $357 billion in household debt (as at December 2000 – now $590 billion) is actually housing debt, supported by increased wealth in the form of property ownership and not related to credit card debt at all[10]. The question must be asked, however, how much credit card debt has been disguised by or absorbed into this figure?

Fierce competition in the home lending market means that it is relatively easy for overcommitted borrowers who are struggling to find $200-300 per month to pay the interest and fees on their credits cards to top up their existing home loan to consolidate their debts. If their existing credit provider won't come to the party, there is always a friendly broker or an

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[6] Australian Bankers Association media release: *Credit Card Data Sheds New Light On Credit Usage* 10 July 2001

[7] ibid

[8] 30% the 9,578,701 bank issued credit card accounts as at March 2001 as identified in the KPMG Consulting report, op cit pg 6

[9] Australian Bankers Association media release: *Credit Card Data Sheds New Light On Credit Usage* 10 July 2001

[10] KMPG Consulting, op cit pg 6

alternative lender who will gladly consolidate your debts to win your business. And if you didn't learn your lesson and cut up the cards the first time you do this, you can probably do it again next year - at least until the bubble bursts in the property market and people discover they are out of equity and options.

Home loans

CCLC also receives regular calls from borrowers who are experiencing difficulties paying their home loans. While not as frequent as calls in relation to credit card debt, unmanageable home loan debt is particularly distressing for the borrower who faces the immediate risk of losing their home. Quite often we are called very late in the possession process because the borrower has been completely frozen by depression and/or denial and failed to seek advice and assistance until it is too late. While some banks have improved their response to financial hardship in recent years and most follow a moderately paced process before taking legal action, non-bank lenders and at least one regional bank tend to apply to the Supreme Court very quickly following any default.

Mr. A approached CCLC in need of urgent representation for a hearing in 7 days time in the Commercial Division of the Consumer Trader & Tenancy Tribunal (the "CTTT"). Mr. A stated that a major lender had taken possession of his home and his home was due to be auctioned on the day after the hearing in the CTTT. Mr. A stated that the lender had entered into possession of his home before the required default notices had expired. No action had been taken in Supreme Court, the lender had simply changed the locks.

On closer examination of the loan documents it was revealed that Mr. A had signed a business/investment purpose declaration. This meant he had arguably lost the protection of the Consumer Credit Code. If the CTTT found that the business purposes declaration had been validly executed it would not have had jurisdiction to hear the matter. In that case Mr. A's loan would not have been covered by the Consumer Credit Code and he would have lost his home.

Debt Consolidation

Another useful statistic contained in the Visa report is that 56% of interest-bearing debt is held by cardholders in households earning more than $60,000. Conversely, of course, 44% is therefore borne by those earning less than $60,000. In many households, particularly those with dependants and a sizeable (Sydney) mortgage to pay, $60,000 is a very modest income.

It is our experience that consumers in this category are getting into difficulty with credit card accounts but are resolving this difficulty, at least in the short term, with alternative forms of consumer credit. Consider the following case studies:

Our clients, Mr and Mrs T were having financial difficulties because of Mr T's reduced working hours. They had fallen behind in their credit card and home loan payments. They were being harassed by a collection agency that was threatening (quite inappropriately) to repossess their house. Desperate to consolidate their debts they approached their current mortgagor – a non-bank lender - but were rejected because of defaults on their existing home loan. They received the same response from a bank. At this point, they responded to an advertisement for a company that sounded like a home lender.

The company turned out to be a finance broker. The advertisement attracted our clients because it said that they would re-finance any borrower regardless of their credit rating. They were asked to sign a document called a *Mandate to Act.* They noticed that the proposed terms of the loan said that the loan was only for two years. After being assured they would be able to roll the loan over at the end of that period they signed the document. Some weeks later they received a loan offer. They paid $1135 in application and valuation fees.

They then sought the advice of a solicitor who said that they should not proceed. He said that they were being asked to a sign an investment purposes declaration that would effectively remove any protection they would otherwise receive under the UCCC. He also strongly advised against entering a loan with a two-year term with no practical plan for repayment at the conclusion of that period. On the basis of this sound advice our clients withdrew from the transaction but are being pursued in the Local Court for $4730.00 in brokerage fees. They were eventually able to solve their credit card problem with a refinance with a major bank. The dispute with the broker continues.

Mr and Mrs M wanted to consolidate their home mortgage, personal loan and visa card under one loan with the lowest possible interest rate so that they would have money left over to carry out home renovation. They saw advertised in the local newspaper a non-bank lender whom they decided to approach for refinancing.

All the promises made by the finance broker turned out to be untrue, plunging Mr and Mrs M into more debt. The firm failed to get the couple the full loan amount they required and failed to consolidate their debt. Instead, the firm offered the couple a loan and a credit card, therefore effectively adding to the credit card debt of the family. Mr and Mrs M were then forced to refinance yet again.

In these cases the refinancing was not the solution the clients were after and the key factor motivating their complaints was the actions of the relevant finance brokers. However, a quick glance at the classifieds page of a daily newspaper suggests that many others may be turning to alternative forms of credit to solve their problems with credit card debts:

"Loan rejection a thing of the past…." Property secured funding only.

"Need cash – Do you have a home as security?"

"Refinance you loans – Low doc, No Financials, Bad Credit Loans"

In fact Sherman Ma, of non-conforming lender Liberty Financial, was recently quoted in a Melbourne newspaper indicating that Liberty Financial had “rescued” 40 Melbourne families from the loss of their home due to credit card debt in the past 12 months. No credit card debt that was refinanced in this way would show up as a credit card default. Indeed the marketing of major, reputable broking firms now includes examples of how much you can save on your credit card payments by refinancing them into your home loan.

2. The factors, including lending policies of banks and other financial institutions, that contribute to household debt levels:

Credit Card Assessment

a) Failure to assess income and liabilities

In all cases of credit card overcommitment dealt with by CCLC our clients have disclosed their financial situation fully and honestly to the extent that inquiries were made by the bank. While it is not unusual for lenders to ask about people’s income and liabilities when granting an initial credit card facility, it is by no means uniform. Further these questions are often posed in a very abbreviated fashion and no documentary evidence or other corroboration is usually sought.

Credit limit increases, on the other hand, are almost universally granted without any current income and liability information being sought. Borrowers circumstances may have changed since the initial facility was sought and this may not be picked up by the lender. In other words a credit facility may be granted on the basis of one financial situation and then increased when the borrowers financial situation may have changed for the worse in the interim period. More disturbingly, however, borrowers are offered credit limit increases regardless of the income stated on their original application. In the many of these cases CCLC as been involved in the lender had sufficient information already available on the clients’ original application form to be aware that the borrower did not have sufficient income to meet their new contractual obligations. In some cases clients who had clearly disclosed that they were in receipt of the aged or disability pension on their original application form have been offered a series of limit increases until their credit limit in $5-10,000 over their original limit.

In the above situations, a fairly cursory review of the clients’ account would have sounded alarm bells in relation to possible financial difficulty. In most cases the clients have paid the minimum payment or less for many months and sometimes many years. Contrary to be interpreted as a sign of financial difficulty, the consistent meeting of minimum payments is usually a precursor to an offer of a credit limit increase. In one case a client had been granted a limit increase when he had failed to meet the minimum monthly payment in 6 out of 12 months immediately prior to the increase. In most of these cases the clients have eventually found themselves in situations where repayment of the minimum payment alone was impossible or caused them financial hardship. Some clients survive for lengthy period by paying most of their income onto the credit card account to meet their minimum monthly payment and then using the card to pay for essential living expenses. Repayment of the principal debt was not possible without the sale of assets. Most of these clients had no assets to sell.

b) Assessment of capacity to pay based on the minimum monthly payment rather than the fully drawn limit.

Another key factor contributing to problematic credit card debt is that many lenders assess a client's capacity to pay on whether they can afford the minimum monthly payment. This means that even where some form of credit assessment is carried out it, borrowers may face financial difficulty if they fully draw their account. The result of this is that there is a gap between financial difficulty as measured by default rates and real levels of debt related stress in the community.

Home lending

Home lending has been characterised in recent years by increased flexibility and competition. Both the diversity and complexity of credit and related products has never been greater – increasing product diversification is seen, indeed, as one of the successes of a more deregulated market. Moreover, there are many more credit providers in the market than ever before, including a large number new "fringe" players and an increasing use of intermediaries such as finance/mortgage brokers. Even in the mainstream market, the increased competition in the marketplace has had the effect that some very poor lending practices have accompanied the massive increase in the volume of consumer lending referred to above.

Lenders have become more relaxed about the types of income accepted for the purposes of home loan applications and about the types of documentation required to support any income attested to. New products such as "low doc" and "no doc" products do way with the pretext that the lender has any obligation to confirm the borrower's income at all. High loan to value ratios, up to 100% of LVR also mean that borrowers can obtain loans with little or no deposit.

In our experience increasing use of intermediaries to execute home lending transactions are a frequent cause of concern for consumers and feature strongly in our client casework practice.

> Mr. & Mrs. D are illiterate. Mr. D earns an average wage as a labourer. Mr. & Mrs. D had a home loan with a major bank. A door-to-door salesperson called at their home without notice stating he could save them thousands of dollars and several years off the term of their home loan. Mr. & Mrs. D did not understand how this would work but very much wanted to repay their home loan as soon as possible. Mr. & Mrs. D were asked to sign a contract but the contract was not explained. It turned out Mr. & Mrs. D had agreed to refinance to a more expensive interest only line of credit loan which was totally inappropriate in their circumstances. The salesperson charged them $5000 for the plan to save thousands of dollars. Mr. & Mrs. D ended up owing a lot more money on their loan and owing Over $10,000 on a credit card linked to the loan. Mr. & Mrs. D could not afford the repayments on the loan or the credit card and faced losing their home.

In 2003, CCLC undertook a research and policy project in relation to the mortgage/finance broking industry. The report surveyed both brokers and consumer casework agencies such as financial counselors, community legal centers and legal aid. The report was commissioned by the Australian Securities and Investments Commission ("ASIC"). The report was released by ASIC in March 2003.

The report identified a number of structural features of the finance/mortgage broking industry and regulatory gaps that placed consumers at risk. It also identified a serious problems experienced by consumers in practice, including:

- Problems in relation to fees, including excessive fees, non-disclosure of fees; charging the full amount of fees where the broker has been unable to arrange suitable finance and securing payment of fees through lodging caveats over the client's property.

- Problems in relation to the arranged finance, including failing to arrange the finance on time for property settlement deadlines, failing to arrange the finance for the amount requested by the consumer, arranging the finance at high interest rates, maximising the amount borrowed in circumstances where this is not in the consumer's interest and arranging finance for borrowers, particularly pensioners, which they are unable to afford.

Sub-prime lending is also an area of increasing concern. The non-conforming loan market in Australia is estimated to be worth approproximately $6 billion[11]. It represents 4% of total lending commitments[12]. It is a newly emerged market sector that has seen exponential growth in the last 2 years. The BRW Magazine in 2004 ranks Bluestone, a Sydney mortgage provider focussing on the sub-prime market, as the number one fasting-growing small to medium size enterprise[13]. In just over 12 months, its turnover increased by 886% to $41.5 million, and its net profit surged to $9 million in the 12 months from $2.7 million the previous year. Another main player in the sub-prime lending market, Liberty Financial, had a net profit of $13.5 million, up from just over 1 million in 2002[14].

There are signs that the sector will continue to grow as the slowing market and decreasing housing prices will force traditional lenders to be more conservative with its lending criteria, further expanding the size of the non-conforming market. Liberty Financial estimates that the non-conforming market grows at about twice the rate of the wider industry. A report released by research group Datamonitor predicts the market will more than double to $20 billion in the next three years[15].

Increasing along with the rapid growth of the sub-prime market are concerns about the regulation of this sector. The Standing Committee on Economics, Finance and Public Administration Review of the Reserve Bank of Australia Annual Report 2003, noted the Committee's concerns about lending policies of banks and other institutions, and the Governor of RBA Mr Ian Macfarlane's concerns about the lack of regulation of non-bank lenders. CCL has our own concerns about the possible drivers behind the rise of this sector.

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[11] 'Low-doc lender triples profit', Lisa Murray, *Sydney Morning Herald,* Tuesday 5 October 2004, Business, p.23.

[12] 'Non-conforming lending to double to $20bn', Lisa Murray, Sydney Morning Herald, Thursday 25 November 2004.

[13] 'What goes around …', Max Walsh, *Money Magazine,* November 2004, p. 34.

[14] Murray, 'Low-doc lender triples profit'.

[15] Murray, 'Non-conforming lending to double to $20bn'.

Recent CCLC case - Mr & Mrs S

CCLC represented Mr and Mrs S in a hearing in the General Division of the CTTT to recover finance broker fees paid. Mr and Mrs S approached a broker to arrange a personal loan. They ended up with a business/investment loan with a 2nd mortgage over their home to a fringe lender with high costs. The costs of arranging the loan were so significant that of the $30,000 they borrowed, they only received $17,000. The broker's costs alone were over $7,000. Our clients were successful in getting an order in the CTTT for a refund of most of the broker's fees. The lender and solicitor involved had also profited considerably from high fees and a high interest rate but it was not possible to mount a successful case against them. In this case our clients were able to refinance back to the mainstream. In other cases clients have approached us having already lost their homes as a result of similar transactions.

Other examples we have come across include borrowers who have refinanced to avoid enforcement action in relation to other debts such as credit cards, or foreclosure on their current mortgage, to find that they are now in very expensive loans and face considerable break costs (up to tens of thousands of dollars) to refinance back into the mainstream if their financial situation improves. Often these transactions have also included hefty set-up costs (such as multi-thousand dollar establishment and brokerage fees), which were included in the loan balance, significantly increasing their level of overall indebtedness. CCLC is also aware of borrowers who have been forced into the sub-prime home lending market because of a fairly modest, old and completely disputed phone bill.

Our greatest concern of all is the marketing of short-term interest-only loans suitable for investors or property developers to people on low incomes who own residential property. Often these loans are taken out by people with a desperate need for short term funds but no ability to repay. The interest rate is expensive and the fees sometimes extortionate. At the end of the loan period, the house is sold to cover the principal debt or the borrower is offered a refinance along similar terms with another set of similarly high fees. Usually these transactions involve a chain of intermediaries including brokers and solicitors, and as a result of creative and well-informed business planning they are extremely difficult to challenge under consumer protection laws.

(e) risks for households and the economy of high debt households

Concern was expressed by card industry analyst, Michael Ebstein of MWE Consulting, in the Australian Financial Review in August 2002 about a 'high risk category of consumer who had "used up" the credit available to them and paid monthly interest, and so was especially vulnerable to interest rate rises and other shocks'[16]. Consumer advocates are well acquainted with these borrowers. The increasing trend of allowing interest-only payments or minimum payments on a range of credit facilities from credit cards to home loans means that people are spending longer period of their lives exposed to significant debt. This increases the

[16] Andrew Cornell, *Focus on consumers looms as threat to bank earnings,* The Australian Financial Review, 12 August 2002

probability that sooner or later the vicissitudes of life will impact adversely on borrowers' ability to repay their credit commitments.

In the case of credit cards where a lack of capacity to pay the principal debt is far from unusual, there is an inevitability that if nothing else intervenes, some borrowers will eventually retire and face serious financial hardship or the loss of their principal residence, or will be forced to work indefinitely into their old age to meet their credit commitments.

This joint research project between the University of NSW and the Financial Counselling Association of NSW has been analysing data taken by financial counsellors in relation to their clients in NSW for several years. The analysis of the 2001 data was releases on 15 November 2002. The analysis was based on 2682 clients, 82% of whom had incomes of less than $30,000. 85% of these clients presented with consumer credit debts and they owed a total of $77 million between them. The median consumer credit debt owed by these clients was $15,000. The 2001 clients presented with 24% more consumer credit debt overall than the 2000 client group, with a 25% increase in the median amount owed. At the same time there was very little change in the level of other debt (non-credit) between 2000 and 2001 years.

Excessive use of credit was the second most frequently self assessed primary and secondary cause of financial difficulties after unemployment (higher than domestic discord, ill health and gambling). Clients 65 and older reported excessive use of credit most frequently (28%) as the primary cause of their difficulties (in 2000 it had been ill-health as the most often reported cause in this age-group). Credit card debt was the most frequently reported type of consumer credit across each household group studied (couple, single, couple with children, single with children). Over each selected age, household and income grouping, the proportion of clients presenting with credit card debt was higher in 2001 than in the 2000 study.

The study also noted the fact that many of the clients were using credit for essential expenses to supplement inadequate income, serving only to exacerbate their situation as repaying borrowings and interest further ate into their available weekly income. For instance 69% of clients paid rent and credit repayments- of these 50% had only $127.38 or less per week left after credit repayments and rent to pay for food, utilities, transport, clothing etc).

While easy access to credit has been favoured by governments in recent years as essential to buoyant consumer spending and economic growth, allowing and indeed encouraging borrower to borrow beyond their means is counter-productive. Overcommitted consumers cannot spend as their income is largely absorbed by interest and debt repayment. Further, stress and depression levels increase, adversely impacting on work participation levels and productivity.

(f) whether there is a case for addressing the lending policies of banks and other credit providers, and if so, what practical options are available

There is clearly a case for addressing some of the worrying practices described above. Credit industry representatives have maintained that decreasing default rates are indicative of the fact that there is no systemic maladministration in relation to lending. While falling default rates are clearly positive, consumer advocates do not believe they reveal the whole story. Over-reliance on minimum payment obligations is masking current and potential problematic debt. Further, in relation to credit card debt in particular, the wide use of cards as a payment mechanism rather than a loan facility distorts default figures when they are expressed in

percentage terms. Finally, the unprecedented availability of credit limit increases, refinancing and debt consolidation are factors which enable people to delay a crisis in their financial situation for up to several years, with no guarantee that they won't eventually (and in some cases, inevitably) default.

CCLC submits that proper credit assessment practices should be mandated by legislation. Currently there are remedies for borrowers under the common law for maladministration in lending and in the case of consumer lending, under the unjust contract provisions of the Uniform Consumer Credit Code ("UCCC"). While often allowing consumers to negotiate a solution with the assistance of a legal service like to CCLC or by applying to a dispute resolution service such as the Banking and Financial Services Ombudsman, these laws are not providing a sufficient disincentive to curb problematic lending practices. Further, each and every case must be argued on its merits and relief for the consumer is arbitrary at best. Prevention in this case is clearly a better option for both consumers and lenders.

CCLC submits that the following principles should be enshrined in the UCCC or other appropriate legislation:

- That lenders should undertake a proper credit assessment in relation to each credit contract, or variation of credit contract, they enter to ensure that the borrower(s) has the capacity to meet their contractual obligations;
- That the above credit assessment should be based on the borrowers ability to repay the facility if it is fully drawn within a reasonable period (say under 30 years for home loans and under 5 years for all other forms of consumer lending)
- That the above ability to repay is not conditional upon the borrower having to sell their principal residence or other primary asset;
- That there are automatic penalties for the lender for failure to comply with the above provisions including financial penalties for the lender in addition to relief from the relevant debt for the affected borrower;
- That the ability to market using credit limit increase offers be curtailed in situations where the borrower's repayment patterns indicate a predefined level of financial difficulty.

Further we submit that business purposes declarations should be removed from the UCCC and the onus should be on the credit provider to prove that loans are for business/investment purposes. Further consideration should be given to extending the protection provided by the UCCC to other forms of lending, particularly small business and private investors.

The regulation of brokers currently under discussion by the State governments should be expedited and must specifically deal with the issue of reckless lending practices involving intermediaries.

Consideration should also be given to moving credit from the State to the Commonwealth jurisdiction and licensing all credit providers in a similar (yet not necessarily identical) model to other financial service providers. This would give consumer's better access to dispute resolution and provide a vehicle for maintaining tighter control of lenders that are not currently subject to prudential regulation. In the UK the regulation of credit that involves a first mortgage has recently become the jurisdiction of the Financial Services Authority in contrast to other forms of credit. Further all credit providers are required to be licensed (whether offering first mortgages or not) and are warned that the actions of all intermediaries

marketing their products, whether formalised arrangements or not, can jeopardise the credit provider's license.

Currently in Australia, lenders are not required to be licensed or to be members of an external dispute resolution scheme (in contract to insurance agents, financial planner etc) unless they are authorised deposit-taking institutions such as banks and building societies. Far from being responsible from the intermediaries who market their products, most credit providers are at great pains to distance themselves from responsibility for their actions. Major credit providers train and accredit their 3rd party channels but it is often a case of "all care taken but no responsibility. With fringe lenders then one or more credit providers are used to distance the credit provider from all knowledge of the transaction beyond the strict confines of the application form, which is cleverly tailored by intermediaries to meet their approval criteria. In our experience these arrangement are legally impenetrable, effectively providing the credit provider with immunity in the worst cases of consumer detriment.

Finally, financial literacy is NOT the answer to consumer debt. As a general rule consumers do not enter unmanageable debt because of ignorance. They may have an unrealistic appreciation of their capacity to repay, or an overly optimistic view of their employment prospects. These tendencies have perhaps more to do with personality types than financial sophistication. In the majority of our experience, however, people fall into two main categories:

1. Those who have suffered an unforeseen change of circumstances impacting on their ability to meet their financial obligations, such as unemployment, accident, illness or family breakdown; and
2. Those who have restricted choices because of their personal situation. These people are not eligible for mainstream credit and will not make "wiser" choices as a result of education because these choices are not available to them.

In the first example, no amount of education will make any difference. Reducing the amount of debt people are exposed to and/or the period for which they are exposed, however, will make an impact on the number of casualties and the size of the damage.

The second example includes clients of CCLC who used their credit cards to cover standard bills and everyday expenses. Faced with the decision of whether to pay the car registration on a credit card or not at all, for example, most people will opt to make the payment and figure out how to pay it back later. After all, driving unregistered or not driving at all, are often less "rational" options. The same applies to paying an electricity bill. Similarly, it is not uncommon for people faced with the loss of their home to refinance on less favourable terms in an attempt to save an asset in which they have invest considerable financial and emotional resources. For a number of people, this serves only to exacerbate a precarious financial situation, adding interest and fees to an amount they were already unable to pay. Financial literacy is unlikely to change this.

In our experience most people have the desire and the motivation to repay their debts. Unfortunately, once they have borrowed more than they can possibly repay, no amount of responsibility and motivation can assist. In short, while financial literacy is not a worthless goal in itself, it is unlikely to impact greatly on unmanageable debt. The credit industry on the other hand can be compelled to make responsible lending decisions and stop the problem at

source. After all, the aim is not to put an end to readily available, flexible credit options, only to curb the excess.