



Submission to:

**Senate Economics Reference  
Committee**

**Inquiry into possible links between  
household debt, demand for  
imported goods and Australia's  
current account deficit**

**Centre for Credit and  
Consumer Law, Griffith University**

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## About the Centre for Credit and Consumer Law

The Centre for Credit and Consumer Law is an academic centre, hosted by Griffith University Law School.

The Centre for Credit and Consumer Law was established in March 2004 to be a source of expertise, and a centre of excellence, on credit and consumer law issues, and it has the overall objective of promoting the attainment of a fairer, safer, and more efficient marketplace, particularly for low income and vulnerable consumers.

The Centre will produce high quality research, relevant to current policy issues, and advocate for reforms to law, policies and practices from a consumer perspective. It will also form linkages with consumer, community, government and industry groups to further its overall objective.

The Centre for Credit and Consumer Law is funded by the Queensland Government's Consumer Credit Fund (administered by the Office of Fair Trading) and Griffith University.

## Response to the Inquiry Terms of Reference

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

Current levels of household debt are historically high and continuing to rise.

In November 2004, the total personal debt owed to banks by Australian households was \$543.2 billion, up from \$478.6 billion in November 2003, and \$160.6 billion in November 1994.<sup>1</sup> Total personal debt has increased almost every month for at least the last 10 years.<sup>2</sup>

Similarly, credit and charge card debt continues to grow each year, rising from \$5.3 billion in November 1994 to \$28.6 billion in November 2004.<sup>3</sup>

At the same time, household savings are decreasing, and, while incomes are rising, the increases in household debt are increasing at a much faster rate.<sup>4</sup> On average, households spend 2.3% more than the amount that is coming into the household each week.<sup>5</sup> The borrowing gap (the difference between household expenditure and household

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<sup>1</sup> Reserve Bank of Australia, Table D05 Bank Lending Classified by Sector, <http://www.rba.gov.au/Statistics/Bulletin/D05hist.xls>.

<sup>2</sup> Reserve Bank of Australia *D05 Bank Lending Classified by Sector* at <http://www.rba.gov.au/Statistics/Bulletin/D05hist.xls>.

<sup>3</sup> Reserve Bank of Australia, Table C01 Credit and Charge Card Statistics, <http://www.rba.gov.au/Statistics/Bulletin/C01hist.xls>.

<sup>4</sup> Reserve Bank of Australia (2003) 'Household debt: what the data show' *Reserve Bank of Australia Bulletin*, March, 1 p 1.

<sup>5</sup> AMP.NATSEM (2004) *Household debt in Australia: walking the tightrope* AMP.NATSEM Income and Wealth Report Issue 9, November, p 2.

discretionary income) has been increasing since 1992, and in 2003, this gap was estimated at \$50.3 billion.<sup>6</sup>

The Reserve Bank figures quoted above represent aggregate levels of household debt. Recent studies from the University of Newcastle have examined debt levels of individual clients presenting to financial counselling services in NSW, and these also show an increase in household debt levels. Of this client group, in 2001:

- 85% presented with consumer credit debts,<sup>7</sup> and the group presented with 24% more consumer credit debt than the 2000 client group;<sup>8</sup>
- the median consumer debt was \$15,000<sup>9</sup> (an increase of 25% from the median consumer debt for the 2000 client group).<sup>10</sup>

For many households, these increased levels of debt are not currently causing them any financial or other difficulties.

However, for other households, their current credit and debt commitments have become simply unsustainable. Some of these borrowers seek assistance from financial counsellors and similar agencies:

- In 2002/2003, financial counsellors under the Commonwealth Financial Counselling Program assisted approximately 16,000 clients.<sup>11</sup>
- During 2003/2004, one financial counsellor in Brisbane assisted 679 new clients and 399 existing clients.<sup>12</sup> The most common presenting problem for new clients was bankruptcy (44%); with general debt (19%); and debt recovery (15%) also common.<sup>13</sup>
- In the University of Newcastle research referred to above, 22 financial counselling services conducted 3,439 full initial financial counselling sessions in 2001.<sup>14</sup> Excessive use of credit was the second most frequently noted cause of credit and debt problems (after unemployment).<sup>15</sup>

In Queensland, demand for financial counselling services is increasing, waiting periods to see a financial counsellor can be a few weeks, and geographical coverage across the State is inadequate.

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<sup>6</sup> Ian Manning (2004) *Are we heading for a fall?* Presentation to the 2<sup>nd</sup> National Consumer Credit Conference, Melbourne, September, p 6.

<sup>7</sup> Margaret Griffiths and Bill Renwick (2002) *Consumer Debt: a Profile of Consumers in Financial Crisis*, p 12.

<sup>8</sup> Griffiths and Renwick (2002), p 16.

<sup>9</sup> Griffiths and Renwick (2002), p 12

<sup>10</sup> Griffiths and Renwick (2002), p 16.

<sup>11</sup> See [http://www.facs.gov.au/annreport\\_2002-03/volume02/part1/outcome1/11\\_family\\_assistance.htm](http://www.facs.gov.au/annreport_2002-03/volume02/part1/outcome1/11_family_assistance.htm), viewed 15/10/04.

<sup>12</sup> Personal communication, December 2004.

<sup>13</sup> Personal communication, December 2004.

<sup>14</sup> Griffiths and Renwick (2002), p 48.

<sup>15</sup> Griffiths and Renwick (2002), p 17.

Many consumers resort to bankruptcy or other insolvency arrangements. For example, in 2003/2004, there were 16,441 non-business bankruptcies across Australia, and 5,482 Debt Agreements under Part IX of the Bankruptcy Act;<sup>16</sup> and in 2003, excessive use of credit was the second most common cause of non-business bankruptcies, after unemployment.<sup>17</sup>

Other households, who are currently managing their credit commitments, may be at risk of default or financial hardship if their financial circumstances or other factors change. Unemployment, family breakdown, and ill health all feature as significant causes of financial difficulty.<sup>18</sup>

In a speech to the Sydney Institute in 2003, the Governor of the Reserve Bank expressed the view that:

‘a significant number of households have chosen a debt level which makes sense in good times, but does not take into account the fact that bad times inevitably will occur at some time or other’.<sup>19</sup>

Current levels of household debt should therefore be a significant issue for Australian governments and policy makers.

(b) *The factors, including the lending policies of banks and other financial institutions, that contribute to household debt levels.*

There are a range of factors that have contributed to high household debt levels, including the deregulation of the finance sector, the economic conditions of relatively low interest rates, low inflation, and low levels of unemployment, and rapidly increasing property values.

However, the lending policies and practices of banks and other credit providers have also played a significant role in a number of areas.

In the housing loan market, credit providers have increasingly been providing credit to consumers who may not have been successful applicants in the past:

- Consumers with little or no savings can seek out loans with higher loan to valuation ratios (95-100%). The creditor’s interests are protected with mortgage insurance<sup>20</sup> and/or other restrictions,<sup>21</sup> but the borrower is left with a limited

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<sup>16</sup> Insolvency and Trustee Service Australia, *Release No. 88: Administrations under the Bankruptcy Act 1966, Statistics Provisional, Financial Year ended 30 June 2004*, available at [http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Statistics->Annual%20Statistics->Annual%20Stats%20Documents/\\$FILE/Jun%2003-04%20stats.pdf?OpenElement](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Statistics->Annual%20Statistics->Annual%20Stats%20Documents/$FILE/Jun%2003-04%20stats.pdf?OpenElement).

<sup>17</sup> Insolvency and Trustee Service Australia (2004) *Profile of Debtors 2003* p 10.

<sup>18</sup> See for example, Insolvency and Trustee Service Australia (2004) *Profile of Debtors 2003* p 10; Griffiths and Renwick (2002), p 17.

<sup>19</sup> IJ Macfarlane (2003) “Do households borrow too much?” *Reserve Bank of Australia Bulletin*, April 2003, p 14.

<sup>20</sup> Productivity Commission (2004) *First Home Ownership: Productivity Commission Inquiry Report*, No 28, March 2004, p 46.

<sup>21</sup> Reserve Bank of Australia (2003) “Recent developments in low deposit loans” *Reserve Bank of Australia Bulletin*, October p 2-3.

buffer if their financial circumstances change and/or the property value decreases.

- Low-doc and no-doc loans enable loans to be provided on the basis of a self-certification of the borrower's capacity to pay the loan, with the creditor making little or no independent enquiries.
- Other forms of non-conforming loans have become available or promoted to consumers<sup>22</sup>, including vendor finance and interest only loans.
- Some lenders appear to engage in asset-based lending for consumer purposes, where little assessment is made of the borrower's capacity to pay the loan; instead, the credit provider relies on its ability to force a sale of the security property at the end of the loan term.<sup>23</sup>
- Home equity and reverse equity loans have become increasingly available. These loans can be used to fund renovations or non-housing expenses, and they add to the size of the mortgage over time.<sup>24</sup>
- Greater promotion of refinancing of home loans and debt consolidation. Often this involves an additional borrowing on top of the refinanced or consolidated loans.
- Lower standards of credit assessment. For example, the Reserve Bank Governor recently raised concerns about a decrease in standards of credit assessment, with the result that credit commitments involving up to 50% of gross income were common.<sup>25</sup>

In terms of credit cards and personal loans,

- Credit card issuers offer increases in credit limits without making any assessment of the borrower's current capacity to manage the increased limit. In some extreme case studies, this practice has resulted in aged pensioners with credit card debts of thousands of dollars.<sup>26</sup> Legislative amendments in the ACT have addressed this practice, but other jurisdictions have not yet followed suit.
- There has been an emergence of a range of fringe and payday lenders offering short-term, high cost loans to consumers excluded from the mainstream credit

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<sup>22</sup> Productivity Commission (2004) p 48.

<sup>23</sup> For example, see Nicola Howell (2004) *Solicitor lending to consumers: a study of asset-based lending and interest only loans in Victoria* for Consumer Credit Legal Service (Vic).

<sup>24</sup> Reserve Bank of Australia (2003) 'Household debt: what the data show' *Reserve Bank of Australia Bulletin*, March, p 3.

<sup>25</sup> IJ Macfarlane (2004) *Monetary Policy and Financial Stability*, presentation to the CEDA Annual Dinner, 16 November 2004.

<sup>26</sup> See for example, the case study on p 41 of the Banking and Financial Services Ombudsman's Annual Report 2004.

market. Often, borrowers using this form of credit end up revolving the loans a number of times, paying additional (high) fees on each occasion.<sup>27</sup>

Many of these examples illustrate the fact that there is currently no positive obligation, imposed on all credit providers, to assess a borrower's capacity to repay a loan within its terms before providing a loan. Instead, in some cases, lenders choose to protect themselves through mechanisms other than assessing capacity to pay, including ensuring the sale of the asset will cover the outstanding debt and enforcement costs; higher interest rates; requiring mortgage insurance; limiting loan-valuation ratios; and/or relying on credit scoring or repayment patterns (particularly in the case of credit cards).

However, these mechanisms rarely provide any protection for a borrower who has taken out a loan in circumstances where he or she simply had no capacity to repay in accordance with the terms of the contract.

The *Consumer Credit Code* includes a provision that could have been expected to the effect of requiring credit providers to assess capacity to pay. Section 70(1) gives the Court a power to re-open an unjust transaction, and section 70(2)(l) provides that one of the factors that can be taken into account in determining whether a transaction is unjust is:

“whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with the terms or not without substantial hardship”.

This is only one of a range of factors that a Court can take into account, and the legislation does not provide any guidance as to the weighting to be given to the different factors.

When introduced, s 70(2)(l) appeared to represent a fundamental change in the law. Prior to the introduction of the *Consumer Credit Code*, the courts had held that the lender was not responsible for ensuring that a prospective debtor could afford repayments, and even where it was clear that a debtor would not be able to do so, a loan would not be considered unjust.<sup>28</sup>

However, cases applying s 70(2)(l) are few and far between. We have not found any reported or unreported cases in which s 70(2)(l) was relied upon to provide relief to overcommitted borrowers.

It is therefore difficult to assess the extent to which this clause has had an impact on lending practices.

It is likely that s 70(2)(1) is relied upon in negotiations on behalf of consumers, and in decisions of industry dispute schemes, such as the Banking and Financial Services Ombudsman. However, in the absence of an interpretation of the effect of this section by the Court of the scope and application of the provision, it is difficult to know whether the provision in practice provides a constraint on lending behaviour at the outset, or is

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<sup>27</sup> For example, Dean Wilson (2002) *Payday Lending in Victoria – a research report*, Consumer Law Centre Victoria Ltd, p 65-66.

<sup>28</sup> For example: *Custom Credit Corporation Limited v Lynch* [1993] 2 VR 469.

simply responded to by way of settlement offers if a complaint is raised with the credit provider.

Even if a Court were to consider the application of s 70(2)(l), and finds that a transaction is unjust because the borrower did not have the capacity to pay, a Court may require the borrower to repay at least the principal sum borrowed. This was certainly the experience under previous credit legislation. In *Esanda v Murphy*, the Court suggested that “it is difficult to imagine the circumstances in which the debtor should not be required to repay at least the principal sum ... lent.”<sup>29</sup>

Another limitation of s 70 is that fact that some credit providers structure a consumer transaction so as to avoid coverage by the *Consumer Credit Code*.<sup>30</sup> In these cases, the rights to challenge an unjust transaction under s 70 are simply not available to the borrower.

Interestingly, the courts (at least in NSW) have considered the question of whether a contract is unjust or unconscionable in the context of applications for relief under the *Contracts Review Act NSW* (1980) (“CRA”) and/or general principles of unconscionability. Again, conventional understanding of provisions providing relief for unjust contracts or unjust transactions, is that these provisions are unlikely to be unjust merely because the borrower cannot meet the contract obligations or because the borrower might lose their home. “Something more” is required,<sup>31</sup> normally in terms of a procedural injustice.

However, in two recent cases, the Court found that loans that were highly improvident to the borrower, and that were provided without the lender making any enquiries as to the borrower’s capacity to pay, were unjust contracts. The Court also found that the lender’s conduct was unconscionable.<sup>32</sup> Again, the question of whether a Court can or will grant relief from the obligation to pay the principal sum borrowed is a very real one, and will impact on the effectiveness of decisions decided under the CRA and unconscionability principles.

In any case, it is clear that current legislation does not impose a direct and positive obligation on credit providers to assess capacity to pay.

Section 70 provides a right that *may* be available after the event, and its availability is dependent on individual consumers pursuing individual actions. Section 70 does not provide a clear standard for assessing the conduct of credit providers at the outset of a credit transaction. While the provisions of s 70(2)(l), and the availability of action under the CRA and/or unconscionability principles might act to temper the practices of some credit providers, for some products, consumer advocates regularly see instances of clear overcommitment at the outset of a loan or credit facility, or at the time that the amount of credit available is increased.

A further complicating factor is the role of finance and mortgage brokers in the consumer credit market. A report by Consumer Credit Legal Centre (NSW) in 2003

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<sup>29</sup> For example: *Esanda Finance Corporation Ltd v Murphy* (1989) ASC 55-703.

<sup>30</sup> David Niven & Tim Gough (2004) *The Operation of the Consumer Credit Code*, Consumer Credit Legal Service (Vic) p 4.

<sup>31</sup> *Mah v Esanda Limited (Commercial)* [2004] NSWCTTT 448 (25 August 2004), para 23, citing *Australian Society Group Financial Services (NSW) Ltd v Bogen & Ors* (1989) ASC 55-938.

<sup>32</sup> *Elkofairi v Permanent Trustee Co Ltd* [2002] NSWCA 413 (18 December 2002); *Small & Ors v Gray & Ors* [2004] NSWSC 97 (5 March 2004).

highlighted concerns that credit providers are abrogating their credit assessment responsibilities to brokers, but that some brokers are not making any assessments of capacity to pay, and instead, are directing consumers to loans that are simply unaffordable.<sup>33</sup>

Recently, there have been some inroads into requiring a positive obligation to assess capacity to pay.

The ACT's *Fair Trading Act 1992* now includes, in s 28A, a requirement that 'a satisfactory assessment process' be undertaken when a credit provider offers a credit card, or an increase in a credit card limit. However, it has no application where personal loans, mortgages, or other forms of consumer credit are involved.

On the self-regulatory front, the revised *Code of Banking Practice* provides:

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>34</sup>

And the Banking and Financial Services Ombudsman has played an important role in providing relief in cases where there has been 'maladministration in the decision to lend' because the bank did not properly assess the borrower's ability to repay.<sup>35</sup>

However, these initiatives are limited in their scope and applicability, and do not replace the need for a broadly applicable obligation on credit providers to assess the borrower's capacity to repay.

(c) *The extent to which demand for imported goods contributes to household debt levels.*

We do not have any information about the extent to which demand for imported goods contributes to household debt levels. However, we do note that most of the increases in household debt can be attributed to increases in borrowing for housing, both owner-occupied and investment housing.<sup>36</sup> We also suspect that for those consumers seeking assistance from financial counsellors and other advice services, their credit and debt issues would rarely be linked to the purchase of expensive or significant imported goods

(d) *The extent to which demand for imported goods by Australian households contributes to the current account deficit.*

We refer to our comments above.

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<sup>33</sup> Consumer Credit Legal Centre (NSW) Inc. (2003) *A report to ASIC on the finance and mortgage broker industry* p 29.

<sup>34</sup> Code of Banking Practice: Clause 25.1.

<sup>35</sup> See Banking and Financial Services Ombudsman (undated) *Policies and Procedures Manual* p 24 – 27, which describes the BFSO's approach to maladministration claims. Available at [www.bfso.org.au](http://www.bfso.org.au).

<sup>36</sup> Reserve Bank of Australia (2003) 'Household debt: what the data show' *Reserve Bank of Australia Bulletin*, March, p 8.



(e) *Risks for households and the economy of high household debt levels.*

High household debt levels pose significant risks for many households and individuals. As noted above, many households are likely to be 'only just' managing their consumer credit obligations, and are vulnerable to changes in individual financial circumstances and/or economic conditions.

At the extreme end, household debt that becomes unmanageable can result in bankruptcy (whether debtor or creditor-petitioned). The consequences of bankruptcy are serious and wide-reaching. A bankrupt's assets (including their family home, and any car worth more than \$5,900<sup>37</sup>) can be sold to repay creditors; a bankrupt cannot travel overseas without permission from the trustee; a bankrupt's ability to obtain credit will be limited; and bankrupts are prohibited from managing a corporation.<sup>38</sup>

However, even where bankruptcy is not the ultimate outcome, overcommitment and consumer indebtedness can have a significant and long-lasting impact on individuals and households.

For example, in a survey of 900 clients using the services of Citizens Advice Bureaux in the UK, nearly 40% said that they felt unable to cope with their debt problem, and a further 27% said that they could no longer cope.<sup>39</sup> Overcommitment and debt problems had significant impacts on clients' mental health, with 62% mentioning they were suffering from stress, anxiety or depression; personal relationships; inability to pay for children's needs; and feelings of isolation and exclusion.<sup>40</sup> Other research in the UK has also made similar findings.<sup>41</sup>

We understand that the Committee has received a submission from the Consumer Credit Legal Centre (NSW), and we note that the case studies included in that submission also illustrate the significant impact of overcommitment on individuals and households.

Overcommitment and indebtedness can also become an ever increasing cycle. Defaults on mainstream credit products result in the imposition of default fees and enforcement costs, increasing the amount owed. Attempts to refinance a loan from a mainstream provider may be unsuccessful, with the result that the consumer is forced to the fringe lending market, where the interest rates and fees are likely to be significantly higher. Again, the higher cost of credit increases the likelihood of default. In these circumstances, and absent a significant increase in income, it becomes more and more difficult for the consumer to find a way out of their financial difficulties.

As well as the personal costs on debtors, overcommitment also imposes costs on:

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<sup>37</sup> *Current amounts*, at <http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us->Publications->Current%20Amounts?OpenDocument> (viewed 10 February 2005).

<sup>38</sup> *Bankruptcy overview* at <http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/bankruptcy->bankruptcy+overview?opendocument> (viewed 2 February 2005).

<sup>39</sup> Sue Edwards (2003) *In too deep: CAB's clients' experience of debt* for Citizens Advice Bureau, UK and Citizens Advice Scotland p 65.

<sup>40</sup> Edwards (2003) p 72 – 75.

<sup>41</sup> For example, Elaine Kempson (2002) *Over-indebtedness in Britain: a report to the Department of Trade and Industry*.

- financial institutions and other credit providers (through costs of bad debts);
- financial counsellors, as greater numbers of consumers seek their services;
- community and welfare organisations, who provide emergency financial relief and other support to individuals and households in financial difficulty; and
- Government agencies that provide income support and other services.

(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.*

The risks of overcommitment and indebtedness for individual consumers and households are significant and require action.

As noted above, there is currently no positive obligation imposed on credit providers to assess a borrower's capacity to pay. Instead, unless the ACT legislation applies, borrowers are largely reliant on the indirect influence of s 70(2)(1) of the *Consumer Credit Code*, and/or self-regulatory mechanisms such as the revised *Code of Banking Practice*.

This situation is not sufficient to protect consumers from unnecessary hardship and distress. A preventative approach would place greater obligations on credit providers at the outset of a loan, given that credit providers are best able to manage the risks of lending. It would also ensure that the focus of responsible lending is placed on the credit provider and its actions, rather than on the borrower, as tends to occur when relief is sought from an unjust transaction.

Accordingly, the *Consumer Credit Code* should be amended to include a requirement for credit providers to undertake a proper credit assessment in relation to each credit contract that the borrower enters. This process should focus on ensuring that the borrower has the capacity to meet their contractual obligations.

A proper credit assessment should also be required when the borrower or credit provider seeks to increase the amount of credit available under the contract.

The 'satisfactory assessment process' defined in the ACT *Fair Trading Act* would be a useful place to start in formulating an appropriate obligation.

Introducing such an obligation is not a novel approach. It is already enshrined in limited scope in the ACT and, in a slightly different form, for subscribers to the *Code of Banking Practice*.

It is also an approach being taken in overseas jurisdictions. For example, in South Africa, levels of consumer credit have caused concern to governments and policy makers, and the new Consumer Credit Law will include measures to combat 'reckless lending' and

over-indebtedness.<sup>42</sup> The policy framework underpinning the new law also includes a commitment to monitoring, at regular intervals, levels of indebtedness.<sup>43</sup>

In the United Kingdom, the Banking Code provides:

“Before we lend you any money or increase your overdraft, credit card limit or other borrowing, we will assess whether we feel you will be able to repay it.”<sup>44</sup>

And the best practice guidelines of the Association for Payment Clearing Services in the United Kingdom include the following:

“Card issuers should take an active approach to ensuring responsible lending.

1. Issuers should take appropriate checks to assess a customer’s ability to repay before increasing a customer’s credit limit. Any increase should always be in proportion to the customer’s risk profile.”<sup>45</sup>

Other changes are also needed to reduce the incidence of asset-based lending in consumer transactions. In particular, we suggest that the obligation to undertake a proper credit assessment should *not* be able to be discharged simply by assessing the value of the security property, in circumstances where the loan is for consumer purposes, the security property is the family home or other major asset, and there is no intention on the part of the borrower that the property will be sold. The credit provider must be required to assess the borrower’s ability to meet the obligations under the contract without selling the security.

Penalties for failing to undertake a proper credit assessment should be sufficient to encourage compliance, and it should be made clear that relief from the relevant debt is an appropriate remedy for the affected borrower.

We cannot imagine that introducing a positive and direct obligation to undertake a proper credit assessment would be onerous for credit providers, and indeed we would suggest that it is good business practice in any case. Introducing an obligation would ensure, however, that credit assessments are carried out by *all* credit providers (including fringe and non-conforming lenders) and for *all* consumer credit products (including credit cards).

We also believe that further consideration needs to be given to the introduction of restrictions on the cost of credit. Currently, only the ACT, NSW and Victoria place any restrictions of the cost of consumer credit.<sup>46</sup> In other jurisdictions, effective interest rates on many fringe and non-conforming products greatly exceed 48% (the maximum rate in

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<sup>42</sup> Department of Trade and Industry (South Africa) (undated) *Making credit markets work: a policy framework for consumer credit*, p 25; Consumer Credit Bill 2004 s 70, <http://www.dti.gov.za/ccrdlawreview/consumercredit/gaz26678.pdf> (viewed 3 February 2004).

<sup>43</sup> Department of Trade and Industry (South Africa) (undated) *Making credit markets work: a policy framework for consumer credit*, p 27.

<sup>44</sup> Clause 13.1. The Banking Code is available from [www.bankingcode.org.uk](http://www.bankingcode.org.uk).

<sup>45</sup> Association for Payment Clearing Services *Best practice guidelines – credit card limit increases*, Version 1.0 (April 2004), available from [www.apacs.org.uk](http://www.apacs.org.uk).

<sup>46</sup> In all three jurisdictions, loans with interest rates of more than 48% are void; and in Victoria, mortgages are void in the loan interest rate exceeds 30%.

ACT, NSW and Victoria). When these are combined with high fees, the impact on levels of overcommitment are compounded.

(g) *Whether there are other measures that might be taken in place of possible restrictions on lending practices which would be as effective.*

Financial literacy is currently seen as a panacea to a range of consumer problems in the financial services sector. However, financial literacy initiatives will have limited, if any, impact where borrowers:

- have suffered an unforeseen change of circumstances, that impacts on their ability to meet their credit commitments;
- are ‘financially excluded’ from mainstream credit markets, and are only able to access the high cost credit provided in the fringe market;
- simply do not have enough income to meet their daily living expenses. In these cases, credit cards or fringe loans provide at least a short-term solution.<sup>47</sup>

Changes to legislation that require ‘responsible lending’ will stop the problem at the outset, and have a much more significant impact on levels of overcommitment than financial literacy initiatives.

(i) *Whether there is a need for any other form of regulatory intervention in relation to this issue.*

There is a range of other regulatory intervention required to address this issue and related issues.

- Given the increasing role of finance and mortgage brokers in the consumer credit market, appropriate regulation of finance and mortgage brokers is needed urgently. State and territory governments are currently considering national or uniform regulation of brokers; and this process should be given high priority.
- The *Consumer Credit Code* should be reformed to ensure that its coverage and application is not avoided by clever use of ‘business purpose declarations’ and other avoidance mechanisms.
- Consideration should be given to expanding the application of the *Consumer Credit Code* to cover investment and small business lending.
- Access to independent and accessible dispute resolution is a key to effective consumer protection regimes. Regulatory change is needed to ensure that all consumer credit providers and brokers belong to an ASIC-approved dispute resolution scheme.
- Consideration should also be given to introducing a licensing regime for both credit providers and brokers. Other players in the financial services sector are

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<sup>47</sup> In a survey of payday lending customers, the most frequently cited reasons for obtaining a loan were to pay bills (32%) and to cover day-day living expenses (26%): Wilson (2002) p 66.

licensed, and this gives the regulator greater capacity to monitor the practices of industry players, and exclude unscrupulous operators from the industry.

- Mainstream credit providers should be encouraged to provide credit products that meet the demand for small amount, short-term finance and to provide alternatives to the high-cost fringe lending products. Some developments are happening voluntarily,<sup>48</sup> however, much more could be done. Regulatory models to provide greater encouragement for this practice should to be explored.<sup>49</sup>

(j) *Any related matters.*

A whole of Government approach is needed: Consumer credit overcommitment is a complex issue, and is influenced by a range of legal, economic and personal factors and social policies. In order to effectively address overcommitment, the whole range of factors and policies would need to be examined in the context of a high level, ‘whole of government’ exercise. To date, this has not occurred in Australia.

In contrast, in the United Kingdom, concern about levels of consumer overcommitment and indebtedness lead to the establishment of a Task Force on Over-indebtedness in 2000.<sup>50</sup> A Ministerial Group and Officials Group have also been established, and the latter includes representatives from a range of departments and agencies, including the Departments for Education and Skills; Constitutional Affairs; Health; Trade and Industry; Work and Pensions; the Home Office and HM Treasury. An Action Plan for tackling over-indebtedness was released by the Department of Trade and Industry and Department for Work and Pensions in 2004.

A similar high level, and broadly based, process is needed if the issues of high household debt and overcommitment are to be adequately addressed in Australia.

Consumer policy and research: Responding to inquiries such as this one raises the continued, and unresolved, issue of the limited resources that are available for independent and consumer-focused research and policy work in Australia.

Effective consumer policy can only be developed when all stakeholders have a real opportunity to have input, and with the assistance of high quality research about the actual experiences of consumers. The demand for input from consumer organisations is very high, and capacity to meet that demand is very stretched. Enhancing current capacity would only benefit decision making on consumer policy issues.

One model that is worth exploring is that of the National Consumer Council in the United Kingdom. The NCC is independent, and funded largely by government, with a remit:

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<sup>48</sup> For example, the ‘Step-up loan’ provided by the National Australia Bank.

<sup>49</sup> See discussion in Therese Wilson (2004) “The inadequacy of the current regulatory response to payday lending” 32 *Australian Business Law Review* 193, at 203-206.

<sup>50</sup> Taskforce on tackling overindebtedness (2003) *Second report*, p 6, available at <http://www.dti.gov.uk/ccp/topics1/overindebtedness.htm>.

“to safeguard the interests of consumers and to ensure that these interests are represented to, and are taken account of, by decision-makers”.<sup>51</sup>

The NCC carries out a range of research to find the consumer issues of the future, and, where change is needed, develops policy solutions and campaigns, and works with providers of goods and services to ensure that these policy solutions work. The benefits to the community of the NCC’s work are recognised by Government and other stakeholders.

In our view, establishing an independent National Consumer Council in Australia would enhance the level and detail of information available to Parliamentary inquiries and government and industry consultation processes, and would result in more effective and efficient consumer protection initiatives.

### **Contact for further information**

For further information in relation to this submission, please contact:

Nicola Howell  
Director  
Centre for Credit and Consumer Law  
Griffith University South Bank campus  
PO Box 3370  
South Brisbane Qld 4101

Tel: (07) 3875 3243  
Fax: (07) 3875 3273  
Email: [N.Howell@griffith.edu.au](mailto:N.Howell@griffith.edu.au)

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<sup>51</sup> See <http://www.ncc.org.uk/about/index.htm>, viewed 30 January 2005.