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# HOT TOPICS

LEGAL ISSUES IN PLAIN LANGUAGE

# Consumer credit



NSW GOVERNMENT | Communi i

This is the seventy second issue in the series *Hot Topics: legal issues in plain language*, published by the Legal Information Access Centre (LIAC). *Hot Topics* aims to give an accessible introduction to an area of law that is the subject of change or public debate.

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# Introduction

**There has been a significant change to the credit law landscape in Australia with the commencement of the *National Consumer Credit Protection Act 2009* (Cth) (NCCP) on 1 July 2010.**[1] **The Act will mean that the Commonwealth now regulates consumer credit in Australia and not the states and territories, as had previously been the case.**

The new credit law consists of:

1. The *National Consumer Credit Protection Act 2009* (NCCP);
2. The *National Credit Code* (at Schedule 1 of the NCCP) (NCC). This is the transfer of the *Consumer Credit Code 1996* with some significant amendments; and
3. *National Consumer Protection (Transitional and Consequential Provisions) Act 2009.*

The new credit law's objectives are:

> to create a single, uniform national credit law;

> to regulate credit industry participants in addition to credit contracts and transactions; and

> to protect consumers and the economy by encouraging responsible lending and some flexibility in response to financial hardship.

## AUSTRALIAN CREDIT REGULATION

### From patchy state-based regulation to a national uniform approach.

Prior to 1996, the states and territories of Australia approached the regulation of credit independently of one another. In NSW for example, the *Credit Act 1984* applied, which focused largely on disclosure (essential information for the borrower) as the key regulatory tool and was limited in scope to consumer credit contracts up to $20,000.[2] In the early to mid-1990s the states worked together to produce uniform template legislation which was enacted in Queensland and then brought into the law in every other state and territory in a variety of ways.

**HOT TIP**

**National scheme legislation can be uniform, consistent or template legislation. Uniform or consistent legislation is copy legislation, where a jurisdiction may copy legislation from another jurisdiction in the interests of having uniformity across the states. However, uniform or consistent legislation is not dependent on the legislation from another jurisdiction, nor is there a total commitment to total uniformity.**

**Template legislation is where a jurisdiction enacts legislation which is dependent upon legislation from another jurisdiction. It may say, for example, such and such an activity is governed by the provisions in such and such an Act from such and such a State. This means that, when changes are made in the original jurisdiction's legislation through amendments passed in its parliament, those changes are automatically binding in other jurisdictions.**

[Taken from the Legislative Assembly for the ACT: 2000 Week 4 Hansard (29 March) p 1056.]

It was the *Consumer Credit (NSW) Act 1995* which made the uniform *Consumer Credit Code* (often referred to as the Code or the UCCC) law in NSW. The Code applied to credit for predominantly personal, domestic or household purposes without a monetary limit. This meant that the main regulatory instrument for the protection of consumer borrowers applied to most home loans for the very first time.

The Code applied uniformly across Australia, although some states and territories enacted additional complementary legislation which varied from one jurisdiction to another, including setting interest rate caps, or imposing licensing or registration regimes on credit providers. Finance brokers were covered under related legislation[3] in some states, but not covered at all in many jurisdictions and were licensed only in Western Australia.

1. ***Note:*** Not all the provisions of the Act commenced on that date.
2. Interestingly the Credit Act 1984 also covered commercial vehicles and farm machinery, an inclusion that has not been repeated since in any of the subsequent credit legislation.
3. For example, the *Consumer Credit Administration Act 1995* (NSW), the *Consumer Credit (Victoria) Act 1995* and the *Finance Brokers Control Act 1975* (WA).

The Code contained many detailed provisions, but in summary it covered:

> information that must be provided to the borrower[4] prior to entering the loan and upon entering the contract (*disclosure*);

> information that must be provided to the borrower throughout the life of the contract (*disclosure*);

> the right to apply for a hardship variation to the loan in the event of a change in circumstances due to unemployment, illness or other reasonable cause;

> procedures which must be followed by the credit provider in order to enforce a loan in a court or take action to repossess the security goods or property; and

> rights for the borrower to challenge unjust contracts, unconscionable fees and charges and misleading and deceptive conduct.

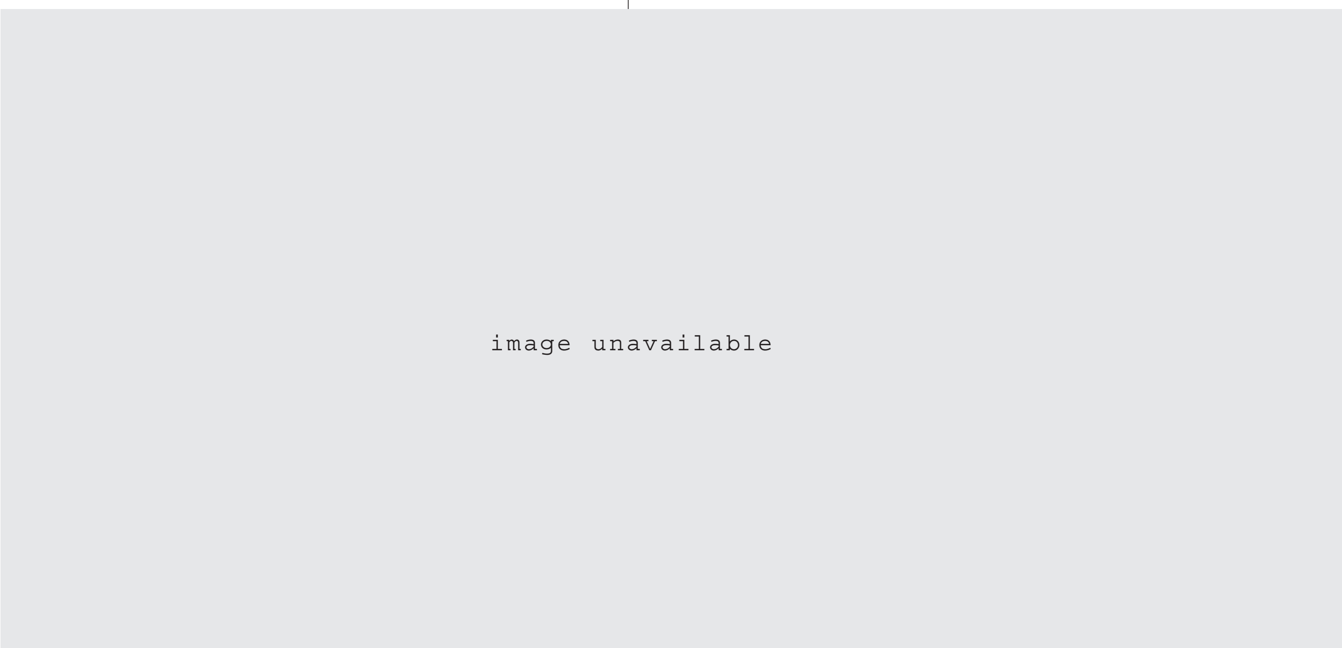
## THE RISE OF FINANCE BROKERS

In 2003, the Australian Securities and Investments Commission (ASIC) published a report prepared by the Consumer Credit Legal Centre[5] in relation to finance and mortgage brokers. Although finance brokers had been active in the business credit market for years, they were a relatively new phenomenon in the consumer credit market. Their numbers were growing rapidly and mainstream credit providers found that to remain competitive they had to offer their products through brokers, as well as directly to the public. New market players began to offer their products exclusively through brokers, allowing them to operate with no shopfront presence at all.

The ASIC report highlighted the consumer harm resulting from a complete lack of regulation of intermediaries such as brokers. Worse, the existing consumer protections contained in the Code were being diluted as credit providers hid behind the actions of brokers to escape responsibility for poor lending decisions.

The Ministerial Council for Consumer Affairs set up a working party to develop national uniform broker legislation in 2003 and later released draft legislation for consultation, the *Finance Broking Bill 2007*. Some parts of the Bill were controversial, but large parts were supported by industry and consumer groups alike. Considerable progress was made on the more controversial issues through further consultation. Setting up a national licensing regime, however, remained a major practical stumbling block for the eight independent jurisdictions.

This and many other issues relating to consumer credit, such as the inconsistent availability of effective dispute resolution, also came to prominence in the Productivity Commission Review of Consumer Protection Framework in Australia in 2007. The review proposed the transfer of responsibility for the regulation of credit to the Commonwealth Government with the Australian Securities and Investments Commission (ASIC) as the regulator (Draft Recommendation 5.2). The recommendation also included specifically that an enhanced version of the Code should be developed and enacted nationally; that there should be a compulsory licensing system for brokers, and that credit providers and brokers should be required to be members of an ASIC approved External Dispute Resolution scheme.




Tanya Lake, *Australian Financial Review.*

4. References to the borrower include references to co-borrowers, and in some cases also to guarantors.
5. *A report to ASIC on the finance and mortgage broker industry*, Consumer Credit Legal Centre, March 2003, available online at http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Reports#2003 scroll down to Report 19.

In June 2008 the Federal Treasury released the *Green Paper on Financial Services and Credit Reform – Improving, Simplifying and Standardising Financial Services and Credit Regulation* which asked among other things whether the Commonwealth Government should take responsibility for all forms of consumer credit including credit cards and small personal loans, or just home loans and mortgage brokers.

## A FEDERAL ANNOUNCEMENT

On 3 July 2008, barely two days after submissions on the Green Paper closed, Senator the Hon Nick Sherry, the then Minister for Superannuation and Corporate Law announced agreement had been reached with the state and territory governments for the transfer of all credit regulation to the Commonwealth including 'personal loans, credit cards, pay day lending and micro loans'.[6]

### HOT TIP

**A Green Paper is a parliamentary or non-parliamentary paper which includes discussion of policy and tentative government proposals.**
**A White Paper is a statement of proposed government policy available for public comment.**

The reform process had two phases:

### Phase One – key elements

> enacting the existing state legislation, the Uniform Consumer Credit Code (UCCC), into Commonwealth legislation;

> establishing a national licensing regime to require providers of consumer credit and credit-related brokering services and advice to obtain a licence from ASIC;

> extending the powers of the Australian Securities and Investment Commission (ASIC) to be the sole regulator of the new national credit framework with enhanced enforcement powers;

> requiring licensees to observe a number of general conduct requirements including responsible lending practices;

> requiring mandatory membership of an external dispute resolution (EDR) body by all providers of consumer credit and credit-related brokering services and advice;

> extending the scope of credit products covered by the UCCC to regulate the provision of consumer mortgages over residential investment properties;

> extending the operation of the *Corporations Act* to regulate margin lending;

> regulation of trustee corporations; and

> Phase One legislation to be in place by mid-2009.

### Phase Two – key elements

> enhancements to specific conduct obligations to stem unfavourable lending practices, such as a review of credit card limit extension offers, an examination of state approaches to interest rate caps (see page 21); and other fringe lending issues as they arise;

> regulation of the provision of credit for small businesses;

> regulation of investment loans other than margin loans and mortgages for residential investment properties;

> reform of mandatory comparison rates and default notices;

> enhancements to the regulation and tailored disclosure of reverse mortgages;

> examination of remaining existing state and territory reform projects; and

> Phase Two legislation to be in place by mid-2010.

In the event, the new legislation passed the Federal Parliament on 23 November 2009. Consultation commenced in relation to Phase 2 in 2010, with any additional amending legislation to be rolled out over 2010-2012.

### KEY CHANGES

> **Consumer credit is now regulated by Commonwealth laws not state and territory laws.**

> **The Australian Securities and Investments Commission (ASIC) is now the regulatory body for consumer credit (NSW Fair Trading no longer has responsibility).**

> **The law now regulates both credit contracts AND credit activities. The latter is new.**

> **Entities undertaking credit activities must:**
> – **be licensed;**
> – **be a member of an external dispute resolution (EDR) scheme approved by ASIC; and**
> – **comply with Responsible Lending Conduct provisions which aim to better inform consumers and prevent them from entering unsuitable credit contracts.**

> **Consumer Trader and Tenancy Tribunal will no longer hear credit cases.**

> **EDR is the main form of dispute resolution under the new regime, but both the State and Federal Courts have jurisdiction under the legislation. There is an opt-in small claims procedure in the Local Court and Federal Magistrates Court for some types of disputes.**

6. Treasury Press Release No. 42 *COAG agree to transfer responsibility for all consumer credit to the Commonwealth*, 3 July 2008.

# The new law in a nutshell

The new law from 1 July 2010 consists of:

> the *National Consumer Credit Protection Act 2009 (and Regulations) (NCCP Act)*; and

> the *National Credit Code* (at Schedule 1 of the NCCP) (*NCC*). This is the transfer of the *Consumer Credit Code 1996* with some significant amendments.

The *NCCP Act* requires all entities undertaking credit activities to be licensed, to be members of an approved External Dispute Resolution scheme, and to comply with Responsible Lending Conduct provisions. Credit activities are defined very broadly and will in effect capture all credit providers, brokers and other intermediaries in the consumer credit market.

## NATIONAL REGULATOR

The Australian Securities and Investments Commission (ASIC) is the regulator under the new law and will administer the licensing regime in addition to being responsible for enforcement of the law. ASIC also releases Regulatory Guides which can provide some insight into how they will approach their role in enforcing the law and how to interpret the legislation.

Consumers can complain to ASIC and in serious or systemic matters (problems that potentially affect many consumers) ASIC may investigate and/or take enforcement action. ASIC also has some specific powers eg, to commence class actions on behalf of consumers in the case of unjust contracts and unconscionable fees.

## LICENSING

The new license now required by brokers, credit providers, mortgage managers and other industry players is an Australian Credit License (ACL). Licensees can also appoint credit representatives. You can check whether a particular person or organisation is registered, licensed or has been duly appointed as a credit representative at www.fido.gov.au/credit.

There are some exemptions. For example, debt collectors who act as an agent for a licensee and are already licensed under applicable state legislation, such as the *Commercial Agents and Private Inquiry Agents Act NSW,* are exempt for the first 12 months. However, debt collectors who purchase debts will however be required to be licensed as credit providers. Retail staff who arrange credit on the shop floor or at the car yard are also exempt, but the credit provider granting the loan still needs to be licensed and to comply with all the requirements under the NCCP Act.

### HOT TIP

**Jurisdiction can refer to a geographical area where a set of laws apply. For example, each state and territory of Australia is a separate jurisdiction because they each have laws which only apply within their boundaries.**

**Jurisdiction can also refer to whether or not a court has the power to make a decision on a particular matter, eg specialist courts such as the Children's Court have a jurisdiction which is limited to their particular area of the law.**

**Jurisdiction can also be limited by the amount of money related to a case or by the severity of the sentence that can be imposed.**

ASIC has fairly broad powers to place conditions on licenses and to suspend or revoke a license in appropriate circumstances. There are penalties for unlicensed conduct and consumers can seek compensation for any loss caused, including against any licensee who deals with an unlicensed lender, broker or other intermediary. However, a loan will not be void or unenforceable simply because the credit provider, or broker, was unlicensed.

## EXTERNAL DISPUTE RESOLUTION

All licensees and credit representatives must be members of an external dispute resolution scheme (EDR or EDR scheme). This is arguably the most important aspect of the new law for consumers.

EDR is a service for resolving disputes between consumers and members of the EDR scheme. EDR is funded by the members of the EDR scheme (for example credit providers, brokers, debt collectors). The funding comes from a combination of membership fees and complaint handling fees. EDR schemes are independent and are governed by a board with equal numbers of consumer and industry representatives.

Some important benefits are:

> EDR is free for consumers;
> EDR is independent (although industry funded);
> all enforcement (including court proceedings in some cases) stops while EDR considers your dispute;
> negotiation between the parties is encouraged;
> a decision will (usually) be made by the EDR if the parties cannot negotiate a solution; and
> the consumer does not have to accept the decision of EDR on a dispute; the consumer can still go to court (as long as the time limits have not expired).

EDR will form an integral part of resolving consumer credit disputes in Australia. It is likely that court action will be very rare and used only in those cases where:

> there is a serious systemic public interest issue to be determined or;
> EDR is not available (eg. credit providers who have ceased lending) or; and
> EDR is available but the EDR will not consider the matter (for example, because there is complex and conflicting evidence that needs to be analysed under cross-examination or where the amount claimed is above the relevant monetary limit for the EDR scheme).

More information on the relevant EDR schemes is provided in ***Help for consumers*** on page 22.

## RESPONSIBLE LENDING

The NCCP Act includes a Chapter requiring licensees and credit representatives to comply with responsible lending conduct provisions. These obligations are aimed at better informing consumers and, most importantly, preventing them from entering into unsuitable credit contracts. These provisions are covered in more detail in ***Responsible lending conduct*** on page 7.

## THE NATIONAL CREDIT CODE

The *National Credit Code* (NCC) forms a schedule to the NCCP Act and replaces the *Consumer Credit Code 1996* (see page 1). The provisions of the Code have largely been carried over to the *NCC* with a few important amendments:

> the NCC covers credit obtained for the purpose of investment in residential property (or the refinance of such loans);
> some provisions have been tightened in an attempt to reduce opportunities for lenders and brokers to avoid the law;
> ASIC has been given the power to take action on behalf of a class of consumers in relation to hardship, unjust contracts, and unconscionable changes of interest rate, establishment fees and prepayment or early termination fees;
> the NCC, like the Code, gives borrowers the right to apply for a variation of the loan contract because of financial hardship in certain circumstances. The *NCC* amended those provisions. Details of these rights, including the amendments, are given in ***Financial hardship*** on page 16; and
> the NCC amended the information required in default notices and many other required forms to include information about the borrowers' rights to apply for hardship and to take any dispute to EDR.

Business credit and credit taken out for the purpose of investment other than in residential property (eg shares) are not covered by the new credit law, although whether these types of lending should be regulated, and to what extent, is being considered in Phase Two of the reform process.

## GOING TO COURT

As EDR is free of risks and cost, it is likely to become the main way to access justice for credit disputes in Australia. However, there will be some circumstances in which matters will still need to go to court.

The Consumer Trader and Tenancy Tribunal in NSW no longer has any jurisdiction in relation to credit matters (from 1 July 2010). Instead, all the state courts, the Federal Magistrates Court,[7] and the Federal Court will have jurisdiction. There is an 'opt-in', small claims procedure available in the Local Court and the Federal Magistrates Court, with limited costs and risks for some types of matter. For example, the following matters could be taken to court using this procedure:

> an application for a hardship variation;
> an order for the return of a vehicle (that has been illegally repossessed);
> an application for compensation for a breach of the responsible lending obligations where the amount sought is under $40,000; and
> an unjust contract application where the contract value (loan amount) is under $40,000.

All of the state and territory courts have also been vested with jurisdiction under the new law so that it can be pleaded in a defence and cross-claim in any enforcement proceedings for a contract covered by the law.

In the vast majority of cases, consumers should take their dispute to EDR in preference to court. There are narrow circumstances where this may not be possible. In those cases, consumers should seek legal advice – see ***Help for consumers*** on page 22.

Some matters under the credit law can only be dealt with by a court. Specifically, an application for a civil or criminal penalty under the law could only be dealt with by a court. However, these applications can only be taken by ASIC.

7. Including any other court, or division of the Federal Court, which may take its place.

# Disclosure

**Disclosure rules dictate minimum levels of information that must be given to consumers about the contracts they might enter so that they can make an informed decision about whether to enter the contract or not.**

It also covers information that must be given to the borrower throughout the contractual relationship (the term of the loan). These rules have not changed under the new law. The following are examples of the disclosures required in the National Credit Code (NCC) about the contract (the actual list is very long):

> the amount of credit to be provided or credit limit and who it is to be paid to (section 17(3)(a) and (b));

> the annual percentage rate or rates and how they apply. If there is a reference rate, it must include the name of the rate, any margin on top of the rate, and where the rate is published. (section 17(4));

> the method of calculation of the interest charges and the frequency of when the interest is charged (section 17(5));

> the total amount of interest charges and repayments payable if the loan term is less than seven years (section 17(6) *and (7)(iii));

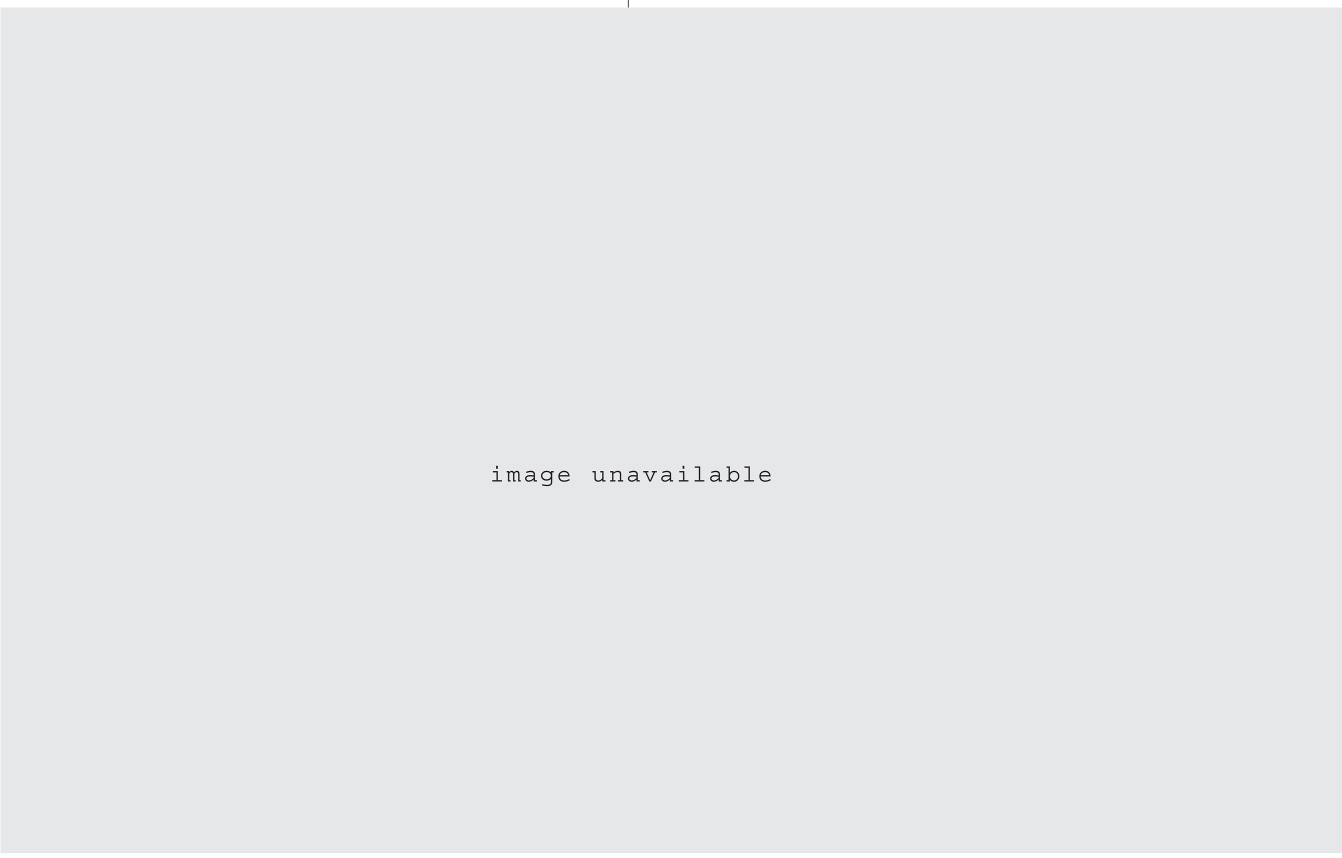
> the amount of the repayments and how this amount is calculated (section 17(7) (a) (i));

> the number of repayments (if known) (section 17(7) (ii); and

> when the first repayment is due and the frequency of repayments (section 17(7) (a) (iv).

A penalty of forfeiting all or some of the interest charges under the contract may be applied if the credit provider fails to disclose the required information. Consumers can also apply to be compensated for any loss.

The new credit law has also added a requirement for licensees, credit assistants (usually brokers), credit representatives, and debt collectors to give consumers a Credit Guide, which will give them information about the entity they are dealing with, including their license number and what EDR they belong to.




***Picture of sign outside a development, Perth, 2008.***

Erin Jonasson, *Australian Financial Review.*

# Responsible Lending Conduct

**Responsible lending conduct is a new addition to credit law in Australia. While the reform process was already in motion by the time the global financial crisis hit the headlines, and consumer groups had been pressuring the government for responsible lending laws for years, it cannot be doubted that events overseas, particularly the spectacular losses reported from the sub-prime lending sector in the USA, provided added impetus to the insertion of the responsible lending conduct chapter in the new law.**

Responsible lending obligations are imposed on five different groups:

1. credit assistance providers (brokers)
2. credit providers
3. lessors under consumer leases
4. credit representatives of any of the above
5. debt collectors (disclosure only).

All licensees and credit representatives are required to be give consumers a Credit Guide. The Credit Guide must:

> be in writing;

> specify the licensee or credit representative's name, contact details and license number or representative number;

> include details of the entity's
  – internal dispute resolution procedures
  – the EDR of which it is a member; and

> inform the consumer of the prohibition on credit providers entering contracts which are unsuitable for the consumer and of the consumer's rights in relation to requesting a copy of the assessment.

All credit providers (and lessors under consumer leases) must assess whether a loan or lease is 'not unsuitable' before entering the contract, or increasing the limit on an existing contract. Brokers must make a similar assessment before recommending or assisting a consumer to enter into a lease or loan, or increase their limit on an existing contract. In making the assessment the licensee must:

> make reasonable inquiries of the consumer's requirements and objectives;

> make reasonable inquiries about the consumer's financial situation; and

> take reasonable steps to verify the consumer's financial situation.

The loan or increased credit limit must be assessed as unsuitable if:

> the consumer could not comply with the consumer's financial obligations under the contract, or could only with substantial hardship; or

> the loan will not meet the consumer's requirements and objectives.

There is a prohibition on entering unsuitable contracts. It is yet to be seen how 'not unsuitable' will be interpreted in court and EDR decisions.

The change that will have the most significant impact on lending practices will be the requirement to verify the consumer's financial situation. There are two common current lending practices which are likely to change when the responsible lending laws (which come into effect on 1 January 2011 for banks and finance companies):

> ***unsolicited limit increases on credit cards***. These are the offers which arrive in the mail and if you sign your credit card limit goes up.

> ***low-doc and no-doc home loans***. This is where you simply declare your income as a certain amount and the credit provider just relies on this without making any further enquiries.

In both of these types of lending credit providers may have to change current practices to meet the new requirement under the law to verify the financial situation of the consumer.

ASIC has produced a Regulatory Guide in relation to Responsible Lending Conduct that provides more information.[8]

## SUB-PRIME LENDING IN AUSTRALIA

Beginning in 2007, an economic shockwave emanating from the USA impacted on economies all around the world in what has come to be referred to as the 'global financial crisis' (or GFC). The major acknowledged cause of the crisis was a practice of bundling and selling very high risk mortgage debt on the international market. These debts originated from home loans extended in significant numbers to marginal borrowers across various parts of the USA. There were several features which contributed to the eventual melt down:

1. Failure to properly assess the credit risk. Many borrowers had no real capacity to repay the loan (leading to the colloquial description 'NINJA' loans – no income, no job).
2. In some cases there were low initial repayments ('honeymoon periods') for significant periods which were lower than the amount required to pay the accruing interest on the loan, resulting in negative amortisation (a growing loan balance). A few years into the loan many borrowers owed both more than they had borrowed and more than the house was worth. Further, among those borrowers who could afford the initial repayments, many could not afford the higher repayments when the 'honeymoon period' ended.
3. High costs – sub-prime mortgages are often priced for risk meaning that the most marginal borrowers were required to pay the highest amounts in interest and other charges, decreasing the probability that these loans would be repaid.
4. No liability for the shortfall after the sale of the property. When a borrower surrendered a property, or it was repossessed, the lender had no recourse to the borrower for any of the shortfall (difference between the amount paid for the property upon resale and the amount owed under the loan contract). The net result of negative amortisation and a bursting property price bubble left investors bearing significant losses when the loans almost inevitably failed.
5. Unsustainable increases in property prices.

It was a commonly-held view that there was no equivalent market in Australia and that we were therefore immune to a similar phenomena occurring closer to home (although clearly not entirely immune to the contagious effects of a global economic meltdown).

It is true that negative amortisation has not been a feature of the recent Australian loan market,[9] and lenders in Australia can pursue the debtor for any shortfall upon the sale of a mortgaged property. However, there have been a number of ways in which sub-prime lending has taken place in the Australian market, to the detriment of borrowers and potentially the broader economy.

### Low-doc loans

A range of lenders (including major banks) offered 'low-doc' loans which allowed borrowers to self-certify their capacity to repay a loan. These products were designed to accommodate the needs of self-employed borrowers and investors without regular proof of income (such as pay-slips), but were sold to a wide range of borrowers including low-salaried workers and social security recipients. While lending guidelines and actual lending practice varied significantly between lenders, in some cases a property valuation and a signed statement saying 'I verify that I can meet my obligations under this loan' was sufficient.

### Non-conforming loans

A small number of non-bank lenders offered 'non-conforming loans' to borrowers who did not meet the lending criteria of more mainstream institutions such as banks. These loans, often also 'low-doc', were subject to *risk-based pricing,* meaning that the interest rate was adjusted according to the a perceived risk associated with any particular borrower and ranged from about one percentage point above the standard variable rate for major banks to four or five percentage points above the standard.

Borrowers commonly had impaired credit reports (a default from a previous loan or bill, such as a telephone bill), insecure income or were seeking to consolidate debt. In some cases, borrowers may have qualified for mainstream loan products but were influenced by brokers chasing the higher commissions available on these alternatives. Set-up costs were often comparatively high, and borrowers faced significant break costs if they later sought to refinance to more competitive interest rates with other lenders.

8. See *Regulatory Guide 209 – Credit Licensing: Responsible Lending Conduct* copy of which can be download from the ASIC Website (www.asic.gov.au; select Credit and then Guidance).
9. The ill-fated state government sponsored Homefund Scheme in the late 1980s and early 1990s did, however, include some loans where negative amortisation was a feature.

## CASE STUDY: *Kent v Rebfin Pty Ltd* [2008] NSWCTTT 1168 (10 July 2008)

**Mr and Mrs Kent resided in country NSW and were behind on their mortgage payments due to erratic employment (as a result of drought, bushfires and inclement weather). They had received a default notice from their mortgage lender, the first step in taking enforcement action against their home. They saw an advertisement for 'urgent cash advances' and 'bad credit mortgages'. They made enquiries and were offered a short term business loan of just over $15,000 arranged by Artex Mortgages with a lender, Rebfin, to pay their home loan arrears and land rates. The cost of the loan was 10% *per month* (increasing to 15% per month upon default). Rebfin put a caveat on the Kents' home. The Kents received $10,000 after payment of brokerage, one month's interest and various fees and charges associated with setting up the loan. The Kents were asked to sign a declaration that the loan was for business, in circumstances where the broker had been clearly told the real purpose of the loan. They were told this was 'merely a formality'.**

**The Kents were told this was a temporary solution and that a full refinance of their mortgage and this loan at a more reasonable rate would be arranged subsequently. The full refinance never eventuated and their debt ballooned.**

**The Kents, represented by Consumer Credit Legal Centre (NSW), applied to the Consumer Trader and Tenancy Tribunal on the basis that the loan was covered by the Code (despite the inaccurate declaration) because the broker had been told the actual purpose of the loan. Further, it was argued that the loan was unjust under section 70 of the Code (now section 76 of the NCC), that the interest rate of 10% per month exceeded the interest rate cap applicable in NSW of 48% per annum and other technical arguments. Orders were also sought against the broker under the *Consumer Credit Administration Act 1995*.**

**Evidence was also supplied by an elderly couple who had almost gone ahead with a loan on similar terms involving the same broker and lender, including their being strongly encouraged to sign a misleading business purpose declaration.**

**The evidence of Mr and Mrs Kent was accepted by the Tribunal.[10] They were successful and were released from all liability for the Rebfin loan:**

> **The steps taken by the respondents to avoid the regulation of the loan by the Consumer Credit Code show a disregard of the rights the applicants had for the consumer protection offered by the Code. The knowledge that the applicants would be unable to meet the repayments under the caveat loan shows a disregard for their position at the time the loan was granted, and it must have been known that the entry into the caveat loan together with the failure to take prompt steps to arrange for a complete refinance meant that the applicants financial position was likely to rapidly deteriorate. Further the lodging of the caveat limited their capacity to seek refinancing elsewhere and to make arrangements with Members Equity for refinancing or for changes on the grounds of hardship under s 66 of the Consumer Credit Code. The evidence is that the risk to Rebfin was minimal having regard to the level of equity the applicants held in their home.**
>
> **In my view the circumstances of this case lead to a determination that the applicants be relieved from any liability to Rebfin for any amount. This means that the caveat loan and the mortgage should be wholly set aside pursuant to section 71(1)(c), and orders made for Rebfin to take all necessary steps to have the caveat lodged on the title of the applicants' home lifted pursuant to section 71(g) of the Consumer Credit Code.**

**In the meantime, CCLC had negotiated a hardship variation with their original mortgage lender to prevent enforcement action on the home loan.**

### Unregulated lending

This occurred when borrowers were encouraged to sign inaccurate business or investment purpose declarations, depriving them of any access to the protections afforded by the law to consumer borrowers. In this market, interest rates could be very high, as much as 10% ***per month*** on loans (effective annual rate of 120% per annum) secured by a caveat over the consumer's home, increasing to 15% upon default. These loans were also 'low-doc' or 'no-doc', with the lender concerned with the value of the asset only. Referred to as 'equity stripping',[11] these loans were often set up to fail with the lenders exacting tens of thousands of dollars in interest and enforcement costs from the borrower upon the sale of the borrower property upon default.

The loans previously described (see page 8) were highly detrimental to the borrowers concerned. Some tried desperately to pursue home ownership, only to be ultimately forced back out of the market after a considerable amount of expense and heartache. Others had owned, or had been paying off, their homes for many years and then lost both their house and

10. The respondents in this case did not appear on any occasion before the Tribunal, nor did they lead any evidence.
11. For more information see ASIC *Report 119 Protecting wealth in the family home,* 13 March 2008, available for download at http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Reports

## CASE STUDY: *Permanent Mortgages v Michael and Karen Cook [2006] NSWSC 1104 (24 October 2006)*

**Michael and Karen Cook were paying off their home and raising a family. In 1998 they had taken out a home loan of $110,000 for a term of 25 years with the Commonwealth Bank to refinance a previous loan. They were of limited education and had already suffered a serious financial setback when Michael had to undergo lengthy treatment for cancer. In 2000, Michael was made redundant and they went into default.**

**They then took out a two successive interest-only, 12-month loans with different lenders, both of which they defaulted on resulting in a judgment for possession. The loan grew with each refinance, slowly eating away the equity in their home. Michael worked intermittently as a truck driver throughout. By 2002 they were on their third loan since the Commonwealth Bank loan, when they borrowed $22,000 at very high interest to meet arrears on this most recent loan. Unable to repay either loan (the home loan or the $22,000 loan) they then sought to refinance again. This transaction (in effect the fourth home loan in 3 years) was the subject of the Supreme Court proceedings.**

**The case involved two loans, one with Permanent Mortgages for $200,000 and another to private investors for $45,000. The first of these loans was the subject of the proceedings. It was a 12-month, interest only loan at 13.8%, reducing to 8.8% if each payment was made within 7 days of the due date. Both loans were managed by La Trobe, who had also been involved in the first two loans in the series of refinances.**

**The Cooks were unable to make a single payment on the loans and the plaintiffs sought orders for possession in the Supreme Court. In obtaining the loans the Cooks had signed a business/investment purposes declaration under Section 11 of the Uniform Consumer Credit Code (the Code). Permanent Mortgages (the plaintiff) maintained that the Code did not therefore apply. The Cooks (the defendants), represented by Legal Aid NSW, maintained that not only did the Code apply, but that the loan contract was unjust under section 70 of the Code and should be re-opened and relief granted.**

**Permanent Mortgages had extended the loan despite the fact that the Cooks had failed to meet their lending criteria in that:**

- **They could not supply 6 months of statements on the previous loan demonstrating satisfactory conduct because they were constantly in default;**
- **They originally stated that the loan was not for a business or investment purpose and changed this when queried by the lender's representatives; and**
- **They had, with the assistance of a broker, supplied certificates by two different accountants (the second being supplied when the first was rejected) who had not actually met the defendants let alone reviewed their financial information. These did not comply with the lender's requirements. They provided no other evidence of their ability to service the loan.**

**Section 11.3 of the Code says that a business/investment purpose declaration will be ineffective if the credit provider knew or had reason to believe that the loan was in fact for a personal, household domestic purpose. The judge at the initial hearing noted that that plaintiff's representatives knew that the defendants 'were refinancing a mortgage in default over their home; that they had furnished no statement of assets and liabilities; that they had provided no evidence of any business or investment; that they had failed to complete the questions in the mortgage application form as to the purpose of the loan (at 64)' and found that the Code applied to the credit provided by the plaintiff to the defendant because:**

> **... the Plaintiff , or 'relevant person' within s11(3), knew or had abundant reason to believe that the credit was to be applied wholly or predominantly for personal domestic or household purposes (at 65).**

**On the point of whether the contract was unjust under section 70 of the Act the judge noted that:**

> **88. Whether I should hold the mortgage unjust in this case involves a balancing exercise. On the one hand are the circumstances that the Defendants speak English as their first language; were experienced borrowers; had the services of a solicitor; were extremely anxious to obtain the loan; and were prepared to sign false statements and procure false certificates. On the other hand, the beneficial nature of the Code indicates that it was intended to protect the unsophisticated and meagrely educated, such as the Defendants, from their own foolishness. Given the means of the Defendants and their credit history, the Plaintiff, in my view, was aware, or would have been aware, had it made the most perfunctory of enquiries, that the Defendants were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgage property for a sum sufficient to cover the principal and interest. It was likely that they would thus become obligated to pay interest on the amount of the credit, not at 8.8% p.a., but at the much higher rate of 13.8%.**

**The Cooks were successful and were obliged to pay only the principle sum applied to pay out their previous loans and interest at the lower rate of 8.8%. All the costs of setting up the loan, the default fees and enforcement costs and the extra interest were deducted from the amount claimed. Of course this still resulted in the sale of their home because this was the last in a series of loans, most of which they could not afford to pay. This outcome, and specifically the requirement to pay interest on the amount borrowed, was the subject of an appeal by the defendants but the trial judge's decision was essentially upheld by the Court of Appeal (*Cook v Permanent Mortgages Pty Ltd* [2007] NSWCA 219 (9 August 2007).[12] It is arguable that several of the previous loans were also unjust but the time limit in the Code meant that only the most recent loan was able to be challenged at the point where the Cooks sought legal assistance. The Code sets the time limit for unjust contracts applications as two years from when the contract comes to an end (section 73).**

**NOTE: The business/investment purpose declaration has been a common mechanism for avoiding the application of the Code. While there are a number of cases where these declarations have been declared ineffective, others have been unsuccessful and presumably there are many other contracts where the borrowers did not have the means or the knowledge to challenge the effectiveness of a declaration. Under the new Credit Law the provisions have been tightened. For example, for loans entered from 1 July credit providers must make reasonable enquiries about the purpose of the loan – it is not sufficient to simply argue that the credit provider did not know and had no reason to suspect the true purpose.**

12. There were actually two sets of proceedings commenced by Permanent Mortgages. The first proceedings were issued before any default notice complying with section 80 of the Code has been served on the defendants because the plaintiffs maintained the loan was not covered by the Code. They then served a section 80 notice and issued fresh proceedings after the default notice had expired. The first proceedings were ultimately dismissed with costs payable by the plaintiffs because the Code was found to apply.

thousands of dollars in equity after entering a new loan or debt consolidation. Arguably these loans both contributed to upward pressure on property prices as they enticed more borrowers into the market and then to a drop in prices in some areas when loans began to fail in significant numbers.

In March 2009 *The Australian* reported that low-documentation loans that were 30 days past due then stood at a new record high of 19.73 per cent compared to standard loans at 1.75 per cent.[13] This figure was not entirely due to poor lending practices, with the credit crunch also playing a role in keeping non-bank loan rates high while other borrowers were feeling the relief of Reserve Bank interest rate cuts. The Reserve Bank Financial Stability Review September 2009[14] also revealed there were more applications for housing repossession as a percentage of dwelling stock in 2006-2009 than in any previous year, that 12 of the top 15 suburbs for mortgage 90 days past due in Australia were in NSW at that time, and that arrears on non-conforming home loans far outstripped both standard and other low-doc loans.

The new responsible lending laws are intended to prevent these loans. Whether this objective is attained remains to be seen. While the courts have taken a dim view of these loans in some recent cases (see below), these have been confined to their circumstances and have had little preventative effect.

## CREDIT CARDS

Credit cards are revolving credit accounts. This means that instead of borrowing a set amount for a specific purpose (such as the purchase of a home or car), the borrower is given access to credit up to a specified credit limit. The money can be spent on many things, ranging from expensive holidays and home renovations, to petrol and groceries. The amount required to be repaid is very small, based on a minimum repayment of two to three per cent of the account balance, and the contract period is indefinite. There are other types of revolving credit, including substantial lines of credit secured over the borrower's home, but credit cards are the most common.

In May 1994 there were 6.5 million credit and charge[15] card accounts in Australia, with $5166 million outstanding, and a maximum limit available across all cards of $17,099 million. By March 2010 this had grown to 14.5 million accounts with $47,177 million outstanding, $34,729 million of which is accruing interest. Total available limits if fully drawn now total $128,961 million.[16] The average card balance in March 2010 was $3243. However, calls to the Credit and Debt Hotline operated by Consumer Credit Legal Centre (NSW) (CCLC) suggest that this average is misleading, with a significant number of consumers paying off their balance each month, and so the debt which is accruing interest is spread among a much smaller number.

The majority of credit card borrowers manage their accounts very well. There are a significant minority, however, who encounter difficulties, sometimes serious difficulties. Credit cards, including store cards offered by major retail chains, are the most common loan type to feature in calls to the Credit and Debt Hotline. Solicitors and financial counsellors at CCLC regularly advise callers who report difficulty paying off their card debts, with some consumers owing tens of thousands of dollars across several card accounts, and others struggling with one card and less than five thousand dollars in debt.

There are a number of factors about the way credit cards are marketed and applications granted which consumer advocates argue contribute to the widespread problems in this market.

## CREDIT LIMITS ARE TOO BIG

Credit card limits are set by reference to the potential borrower's capacity to meet the minimum required repayment only. This means that many borrowers will struggle to repay the debt within a reasonable period if they 'max out'[17] their card. For example, if a borrower has $100 per month to put towards paying off his or her credit card debt, then at a minimum repayment of 2% he or she may be offered a credit limit of up to $5000. Paying off this amount at $100 per month at an interest rate of 14.3% would take over six years, and at 20.7% over nine years. Further, any further use of the card in this period would extend this period, as would any application of fees, such as annual account fees, and over-limit or overdue fees.

This is a very long time to be paying off a debt that may have been used for nothing more than everyday living expenses, and borrowers are often demoralised: 'I pay and I pay and never seem to get anywhere', is a common refrain from callers seeking assistance. A change in the borrower's circumstances (such as illness, unemployment or even retirement) which affects their ability to repay a debt is more likely to happen the longer the debt endures. The new responsible lending laws do not

13. 'Mortgage Delinquencies Rise', http://www.theaustralian.news.com.au/business/story/0,28124,25268991-36418,00.html *March 31, 2009.*
14. Available at http://www.rba.gov.au/publications/fsr/2009/sep/html/contents.html pages 48-49.
15. Unlike credit cards, charge cards are required to be paid off in full at the end of each statement cycle, usually one month.
16. Reserve Bank of Australia, Statistical Tables, Payment System, Credit and Charge Card Statistics C1, viewed at http://www.rba.gov.au/statistics/tables/index.html#money_credit on 16 May 2010.
17. Spend the full amount available under the credit limit.

## CONGRATULATIONS, YOU'RE PRE-APPROVED

**In August 2008, Consumer Action Law Centre in Victoria released a report on unsolicited credit limit increase offers.[18] The report was based on research conducted by Deakin Business School, Deakin University, Melbourne and the School of Marketing and Communication, Lumsa University, Rome. The researchers examined 21 Australian limit increase offers from a behavioural economics perspective and concluded that consumers were likely to accept such offers on the basis of a number of factors that had little to do with rational engagement with the transaction and its implications. Specifically, they cast doubts on the effectiveness of either financial literacy or disclosure to effectively counter the psychological processes likely to be undergone by consumers when faced with such offers. One of the many observations of the researchers was the manner in which such offers frame the prospect of increasing the customer's potential debt as an increase in security:**

> **[*Referring to a particular offer among those analysed*] the offer is described as a solution against the unpredictability of life, 'you never quite know when you may want access to extra credit', and as a unique opportunity, 'a higher credit limit can give you greater financial freedom'. This implies that a missed acceptance of the offer will result in the customer not having the appropriate tools to face the unpredictability of life, and without the safety or freedom to control any additional expenses. In addition, this framing invokes a potent psychological expectation of potential regret if the offer is not accepted and the customer is faced with a future emergency or opportunity.**

directly address this problem, although ASIC has made some helpful comments in regulatory guidance.[19]

### CREDIT LIMIT INCREASE OFFERS ARE TOO TEMPTING

Credit card customers are often offered credit limit increases on the basis of their repayment history. This means that existing customers, who regularly meet their minimum repayment may be offered further credit on that basis alone. In this way, customers are offered additional credit regardless of whether they can afford the additional amount, or indeed whether they are making any headway in paying off the amount they already owe. The new responsible lending laws do not address this form of marketing, but will arguably discourage credit providers from approving credit limit increases without making enquiries as to the borrower's current financial circumstances.

Both these issues are being considered further by the Government as part of *Phase Two* of the national credit reform process. Also under consideration are:

> the way interest and interest free periods are calculated;

> the way repayments are applied;

> the impact of low minimum repayments; and

> improved disclosure.

18. *Congratulations, You're Pre-approved – An analysis of credit limit upselling letters* available online at http://www.consumeraction.org.au/downloads/CongratulationsYourePreApprovedfullandfinalreport150808.pdf
19. Regulatory Guide 209 – Responsible Lending Conduct (check).

# Unjust contracts, misleading, deceptive & unconscionable conduct

The NCC provides for borrower and guarantors to apply to have a contract *re-opened* because it is unjust. When considering an application to re-open a contract, the court (or in practice EDR) *must* consider the public interest and to all the circumstances of the case (section 76, NCC). They may have regard to the following:

(a) the consequences of compliance or non-compliance with the contract;

(b) the relative bargaining positions of the parties;

(c) whether the contract was subject to negotiation;

(d) whether the borrower was realistically able to reject or renegotiate any of the contract provisions;

(e) if the contract imposes conditions that are unreasonably difficult to comply with or not reasonably necessary to protect the legitimate interests of a party to the contract;

(f) whether the consumer (or their representative) was reasonably able to protect their own interests because of their age, physical or mental condition;

(g) the form of the contract and how it is expressed;

(h) whether the consumer received independent legal advice or other expert advice;

(i) whether the contract was explained to the consumer and whether they understood that explanation;

(j) whether undue influence or unfair tactics or pressure were used on your client;

(k) whether the credit provider took measures to make sure the borrower understood the nature and implications of the transaction;

(l) whether the credit provider knew or could have reasonably ascertained by reasonable inquiry at that time that the consumer could not repay the loan, or could not pay it without substantial hardship;

(m) whether the terms of the transaction or the conduct of the credit provider is justified in light of the risks undertaken by the credit provider;

(n) whether any part of a mortgage is void other another section of the NCC;

(o) whether in comparison with other similar loans the interest and fees are excessive; and

(p) any other relevant factor.

For a contract to be considered unjust, it would usually need to be found to be inadequate in relation to a number of the factors above. For example, the fact that a consumer did not receive legal or expert advice about their credit contract would not of itself mean that the contract was unjust. This would be the case for almost every credit contract in the country!

Under the Code, the unjust contract provision (then section 70) was the only way of dealing with loan contracts where it was obvious that the borrower could never afford the loan. The responsible lending provisions of the NCCP Act now attack this problem more directly, but given those provisions are new, and there is considerable room for interpretation, consumers should refer to both the responsible lending provisions of the NCCP Act and the unjust contracts provisions of the NCC in the event of a dispute. This is particularly true if there are factors in the unjust contracts list which apply (such as unfair pressure or tactics, or characteristics of the borrower – their age, physical or mental condition – that affect their ability to protect their own interests) which are not strictly relevant under the responsible lending provisions.

Section 76 of the NCC also differs slightly from section 70 of the Code. Sub-section 70(l) of the Code confined the credit provider's obligations to investigate affordability to 'reasonable enquiry *of the debtor*'. This phrase has been removed in section 76 of the NCC, meaning that credit providers should make reasonable enquiries more generally, including of third parties, in line with the responsible lending provisions.

The unjust contracts provisions have also been used to re-open contracts where a co-borrower has been unfairly signed up to a loan for which they did not receive a benefit (the 18-year-old girlfriend at the car yard when the boyfriend buys a car, for example), or where a guarantor has been induced to sign a guarantee, usually placing their home at risk, with inadequate information or understanding of the risks.

It is important to note that the unjust contracts provisions only take into account circumstances that are known, or reasonably foreseeable, at the time the contract was entered. The fact that a borrower subsequently became mentally ill or physically disabled for example, or a relationship ended and one spouse departed with the security property, is not relevant to whether a contract was unjust at the time it was entered.

## CASE STUDY: A GUARANTEE THAT WAS NOT A GUARANTEE

**Mrs R, an elderly pensioner, owned her own home. Her son told her he wanted to borrow $170,000 for his own use and persuaded her to be guarantor for his loan. The son conducted all the negotiations with the Bank. The Bank demanded that Mrs R transfer half of her home to her son before they would agree to the loan. Mrs R consented to this and incurred significant expense in terms of legal costs, stamp duty and other associated costs. She also placed her home at risk if any of her son's other creditors took enforcement action against her son's interest in her home.**

**After the transfer occurred, Mrs R was not put on the loan as a guarantor as she intended, but was documented as a joint debtor without her knowledge or consent. The Bank knew from the loan application form that Mrs R was on the pension and could never afford to make repayments on the loan. The Bank had also previously been told that Mrs R was a guarantor to the transaction. Mrs R did not get any benefit from the proceeds of the loan. CCLC took the case on and lodged a complaint with the Banking and Financial Ombudsman now part of the Financial Ombudsman Service) after discussions with the Bank had been unsuccessful.**

**The Ombudsman came to a finding that Mrs R should not be liable as a co-debtor because the Bank had breached clause 26.1 of the Code of Banking Practice by accepting Mrs R as a co-debtor where the Bank knew she would not receive any benefit from the transaction. Mrs R could also not be liable as a guarantor to the loan, as the Bank failed to comply with guarantor disclosure requirements under sections 50-57 of the Uniform Consumer Credit Code and section 28.4 of the Code of Banking Practice. Mrs R got her title deeds back and commenced the process of transferring the house back into her name.**

## RE-OPENING THE CONTRACT

If it is decided that a contract is unjust the court has wide powers to vary the contract including:

> relieving a debtor or guarantor from the payment of any amount;

> setting aside, or varying a contract, in whole or in part;

> ordering a mortgagee to take steps to discharge a mortgage;

> ordering goods to be delivered to a person; and

> making an order that an amount be paid.

In practice, borrowers are usually required to repay any amount for which they received a benefit. In the case of unsecured debt, this can mean that a borrower may be relieved of interest and charges, and some of the principal and given an arrangement to pay off the remainder over time. In some circumstances the credit provider will release the client from the entire debt, but this will rarely be required at law. Where there the loan is secured, especially if it is a housing loan, some account will be taken of the borrower having had use of the property for a period also. This means that in many cases a loan may be found to be unjust and yet the borrower will still be forced to forfeit the security property (see the *Cook* case on page 10).

If the borrower (or guarantor) has had no benefit from the loan at all, then it is possible that they will be relieved of the entire debt.

A contract may be found to be unjust, but the court may still decide that it is not appropriate to grant relief. In making a decision whether to grant relief, the court can take into account the conduct of all parties at the time the contract was entered or since.

## MISLEADING, DECEPTIVE & UNCONSCIONABLE CONDUCT

The NCC prohibits false and misleading representations (section 154) about a matter that is material to a person's decision to enter a credit contract. A breach of this section carries a criminal penalty and the affected consumer can seek compensation for any loss. The ASIC Act also contains provisions in relation to misleading and deceptive conduct and representations (ASIC Act, sections 12DA and 12DB) and unconscionable conduct (ASIC Act, section 12CD).

## CHALLENGING FEES, CHARGES AND CHANGES OF INTEREST RATE

As a general rule, the interest rate under a contract is considered part of the essential bargain made by the parties when the contract was entered and not subject to a challenge in a court or EDR. There are two exceptions to this rule:

1. In NSW there is currently a cap of 48% on interest and all up-front fees and charges. Default fees and other fees paid upon a contingency are not included. Charging interest above this amount is prohibited. This legislation is due to cease to have force on 1 July 2011.
2. The interest rate compared to other similar contracts may be relevant as part of an overall unjust contract case. While price alone will rarely be enough, several court decisions have made reference to *injurious* or *usurious* interest rates.

## HOT TIP

**The term 'usury' dates back many centuries and originally referred to any charge for lending money. As charging interest became more widely accepted it came to mean the charging of excessively high interest rates on loans. Taking interest is still prohibited under Islamic law.**

Iain Ramsay 'usury' *The New Oxford Companion to Law*, by Peter Cane and Joanne Conaghan. Oxford University Press Inc, accessed 7 June 2010.

The NCC does enable consumers to apply to have other charges reduced or annulled as unconscionable (section 78):

> a change in the annual percentage rate or rates;

> an establishment fee or charge;

> a fee or charge payable on early termination of the loan contract; and

> fee or charge for the prepayment of an amount under the credit contract.

There was a sudden surge in exit fee cases both in the EDRs (and to a lesser extent in the specialist credit tribunals in NSW and Victoria) when the Reserve Bank lowered interest rates several times in rapid succession in response to the global financial crisis. These complaints were largely made up of:

> borrowers in fixed interest rate contracts who wanted to refinance to the lower rates then available in the market; and

> borrowers in variable interest rate contracts with non-bank lenders[20] that did not lower rates in line with the Reserve Bank reductions in the cash rate, and who faced very high exit fees and deferred establishment fees for leaving the contract early (usually in the first 3-5 years of the loan).

These cases are very difficult to win. The test of unconscionability is a very high hurdle to get over. In most cases you have to prove matters which involve complex calculations of the credit provider's costs and/or loss, and all the relevant information is held by the credit provider. Arguing these matters in EDR is no easier. However, as EDR schemes can consider not only the law, but good industry practice and fairness in all the circumstances, you can bolster your case with arguments such as that:

> the fee is not clearly disclosed in the contract; and

> the fee has been unfairly applied in all the circumstances.

## CASE STUDY – MISLEADING AND DECEPTIVE CONDUCT

**In May 2007 ASIC obtained consent orders in the Federal Court against mortgage-broking firm Sample and Partners following allegations that the firm's sales techniques had been misleading and deceptive.**

**Consumer Credit Legal Centre (CCLC) later assisted many borrowers who were claiming compensation. While the exact experience of borrowers varied from case to case, the following factors were present in the majority of cases:**

**> borrowers were cold-called about a special mortgage deal.**

**> borrowers were told by representatives who visited their homes that they would save significant amounts of money and pay off their homes sooner by refinancing.**

**> borrowers were told that their loan was specially chosen for them from a large range of products and credit providers when in fact very few were considered.**

**> promised savings did not eventuate or were outweighed by the $3500 fee paid to the mortgage broker.**

**> in many cases the interest rate was higher than the borrowers' previous loan.**

**Many borrowers owed significantly more at the time of seeking assistance than they did before they refinanced. Their financial position had clearly deteriorated. Despite the consent orders obtained by ASIC, very few of the cases CCLC advised on settled directly with the broker. Most were lodged with the Credit Ombudsman Service and significant evidence exchanged before any compensation was paid.**

20. While banks get some of their money from overseas markets, they raise a large amount of the money they lend from other customer's deposits. Non-bank lenders, on the other hand, are usually entirely dependent on international credit markets for their funds. As international costs were very high in the wake of the economic crisis in the US and Europe, these lenders could not afford to lower their interest rates.

# Financial hardship

**Financial hardship is having difficulty in paying your loans and debts when repayment is due, usually due to a change in circumstances.**

Financial hardship is arguably the most common problem affecting consumers, so the provisions relating to financial hardship in the NCCP Act are an important right for consumers. The NCCP Act provides the following rights to consumers in financial hardship:

> giving consumers the right to apply for financial hardship (subject to certain requirements – see below);

> requiring the credit provider to respond to the application in writing within 21 days, stating whether or not they agree to the change;

(If they do not agree to the change they must provide reasons for refusing the hardship application; notify the consumer of their right to go to EDR and provide contact details of the relevant EDR.)

> if the credit provider agrees to the repayment arrangement it must give the consumer a notice in writing within 30 days after the agreement is made stating the particulars of the change;

> if the credit provider does not agree to the application for change then the consumer can apply to EDR for the requested change; and

> if the consumer is unsuccessful in EDR then the request for hardship can be enforced in court.

The NCC specifically gives consumers the right to apply for and enforce an application to vary the contract on the grounds of financial hardship, subject to meeting certain requirements.

Section 72 of the NCC covers the circumstances where a consumer can request a repayment arrangement on the grounds of financial hardship.

1. The amount of the loan must be under the relevant hardship threshold (a moving threshold, $357,830 from 9 June, for loans entered into prior to 1 July 2010[21] and $500,000 for loans entered into after 1 July 2010).
2. The consumer must be having (or will have) trouble making their loan repayments because of 'illness, unemployment or other reasonable cause'
3. There are three options for the contract to be varied:
   – extend the term of the loan and reduce the amount of each payment;
   – postpone a repayment till a future date;
   – extend the term of the loan and postpone certain repayments; and
   – in all of the above options, there is no change to the interest rate.
4. If the variation was made as requested the consumer must 'reasonably expect' to be able to discharge their obligations

If the requirements set out in section 72 are met then even if the credit provider refuses the request to vary the contract, the consumer can enforce the request in court (section 74 of the NCC).

EDR can also make determinations to vary a credit contract (regulated by the NCCP/NCC) on the grounds of financial hardship. This is a recent change. Most consumers will go to EDR if the credit provider refuses to vary the credit contract after the financial hardship application is made (or the credit provider failed to respond). As stated above there are four requirements to be met in requesting a change on the grounds of financial hardship under the NCC. If the consumer is seeking to have the matter determined in EDR, two of the above requirements are slightly different:

> The threshold for court does not apply to EDR. EDR set their compensation limits in their terms of reference (for the two existing industry-based EDR schemes, FOS and COSL[21] they are $280,000 and $250,000 respectively). EDR also interprets the request for change as being the amount in dispute (eg, repayments reduced by $2000 for three months = $6000). This means that consumers have far greater access to EDR for financial hardship than court.

> EDR is not as strict in the interpretations of the three options required in point 3 above.

21. The threshold was available at http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/Hardship-threshold?openDocument#2010-2011 at the time of publication, but ASIC are launching a new consumer-oriented money website in September 2010.

EDR can also review (but cannot determine) financial hardship applications that are not regulated under the *NCC*, particularly if the loan is covered by an industry code of practice such as the Banking Code of Practice, the Mutual Code of Practice or the Mortgage Finance Industry of Australia Code of Practice. Some small business and investment debts for example may be covered by these Codes but not the NCC.

EDR is a very useful process for consumers seeking changes to their contract on the grounds of financial hardship as there is ample opportunity to conciliate and negotiate an outcome.

## DEBTOR HARASSMENT

Debtor harassment is a breach of section 12DJ of the ASIC Act, which prohibits the use of physical force or undue harassment or coercion in connection with the supply of, or payment for, a financial service. ASIC and the Australian Competition and Consumer Commission have jointly produced a guideline detailing the types of conduct that might constitute a breach of the law. *The Debt collection guideline: for collectors and creditors*, October 2005 ('the Guideline') is available at: www.fido.gov.au.

Examples of conduct that might breach the Guideline include:

> contact for the purpose of frightening, intimidating, exhausting, or embarrassing the debtor;

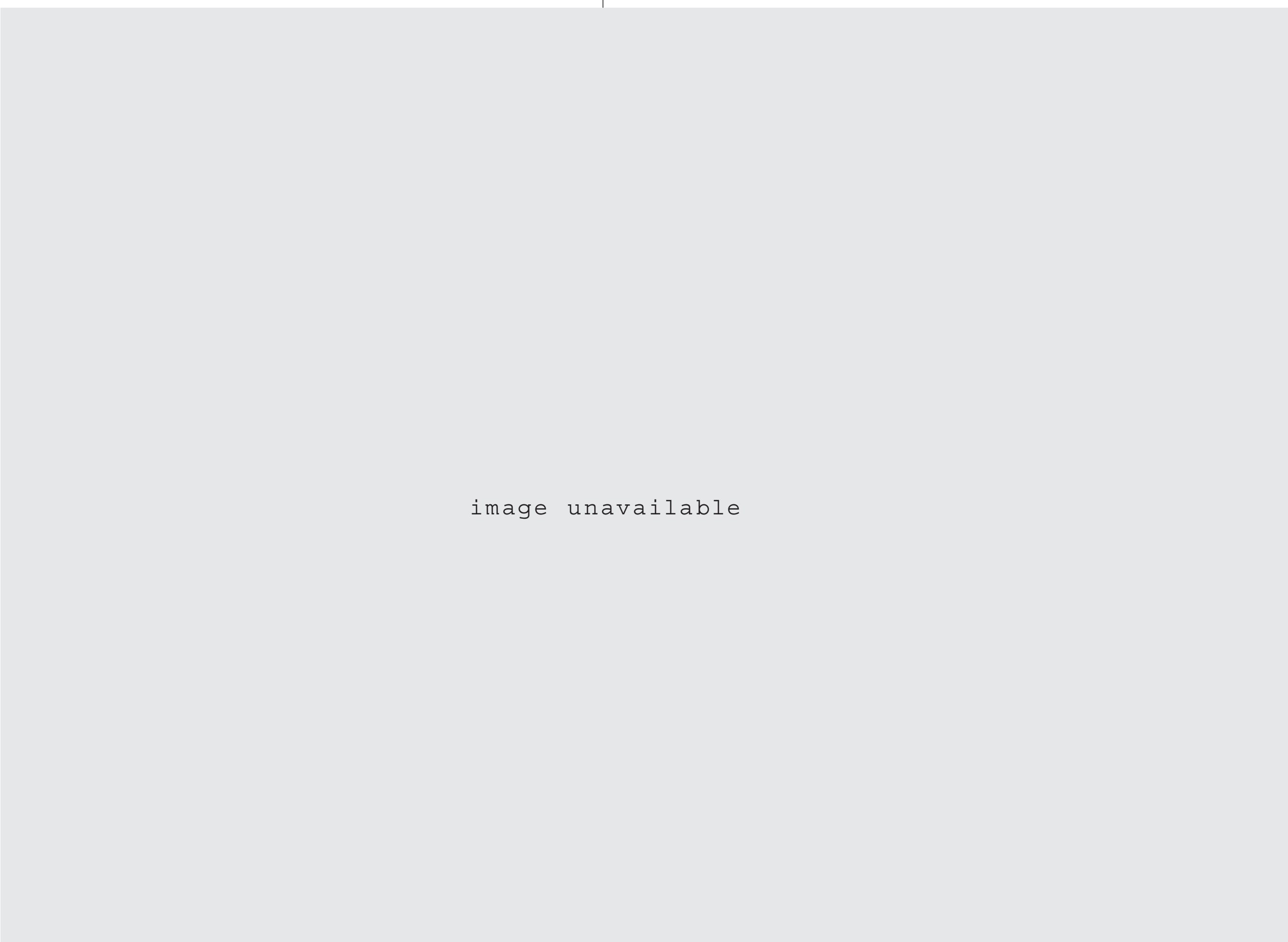
> contacting a debtor after 9:00pm or before 7:30am on weekdays or before 9:00am on weekends;

> contacting a debtor by telephone more than three times per week or 10 times per month;

> misrepresenting the credit providers rights at law – such as indicating an intention to seize property over which there is no mortgage without an appropriate court order; or

> revealing details of the debtor's indebtedness to third parties, such as colleagues and neighbours.

The Guideline is not law and the courts would ultimately decide whether a particular course of action constituted undue harassment or coercion. However, the Guideline is a good indicator of the types of conduct that should be reported to ASIC, and will no doubt be highly persuasive in an EDR complaint.




Gregory Byerline, *Design Pics Inc.*

# Enforcement

**The new credit laws provide certain rights to consumers in the event of enforcement action. Enforcement action is when the credit provider starts to pursue payment of the debt in full (including taking action in a court) and/or take possession of any security for the loan.**

## GENERAL ENFORCEMENT PROCESS

**This process applies to all contracts regulated by the NCCP:**

Default

↓

Notice under Section 88 of the NCC

↓

30 days to pay the amount of the default and the usual repayment

↓

If the default and usual repayment are paid then the contract goes back to normal

↓

If not, the credit provider can make the whole loan repayable

AND

Commence court proceedings to recover the whole debt

AND/OR

Repossess security property (if the loan is secured)

The default notice requirement in the NCC is a key consumer right. In contracts not regulated by credit laws, such as small business loans, it is possible for the credit provider to make the debt immediately owing on default. In the NCC it is a requirement (section 88 NCC) that before enforcement proceedings can be commenced:

> the consumer must be in default;

> the credit provider must have given the consumer at least 30 days written notice to fix the default (see Form 12 in Section 3.); and

> those 30 days have expired and the consumer has not fixed the default.

The default notice must have a prominent heading stating that it is a default notice and must contain information including:

> What needs to be done to fix the default;

> The date when enforcement proceedings may begin in relation to the default and possession of the mortgaged property (the security for the loan) if the default is not fixed;

> That the repossession and sale of the mortgaged property may not extinguish the consumer's liability. That is, there may be a shortfall and the consumer will be liable for that shortfall;

> The consumer's right to:
  – apply for financial hardship under section 72
  – negotiate a postponement of enforcement under section 94[22]
  – make an application to the court under sections 74 and 96 to enforce an application for hardship or postponement of enforcement;

> The right to apply to EDR;

> That, if a further default occurs during the period of the default notice period, **no further notice is required.**

***A common mistake consumers make is to pay the arrears in the default notice but forget to make the usual repayment!***

> That the debt may be listed on a consumer's credit report if the debt remains overdue for more than 60 days and the credit provider has taken steps to recover all or part of the debt; and

> That the whole debt is payable if the default is not fixed. This is called an acceleration clause (sections 92 & 93 NCC).

There are additional requirements to be met by the credit provider when taking possession of goods (for example a car) used as security for the loan.

22. Section 94 gives the consumer the right to apply for a postponement of enforcement provided the application is made within the period of the default notice. This will rarely be necessary as lodging in EDR effectively provides a postponement of enforcement in any case. In any event the can apply for a stay of enforcement under section 74 if they are applying for a hardship variation.

The credit provider cannot repossess goods used as security without a court order unless:

> the amount outstanding is less than 25% of the original amount borrowed (or under $10,000 whichever is lesser); and
> (if from a residential property) the occupier of the premises has consented in writing after being informed of their rights.

## REPOSSESSION PROCESS

**General enforcement process** (see page 18)

↓

Failure to comply with a default notice

↓

Security property repossessed by credit provider

↓

Credit provider must give a written notice within 14 days of repossession of goods

↓

Written notice gives the option of either paying the arrears and enforcement expenses or paying the credit contract in full to get the goods back

↓

Have 21 days to respond to notice

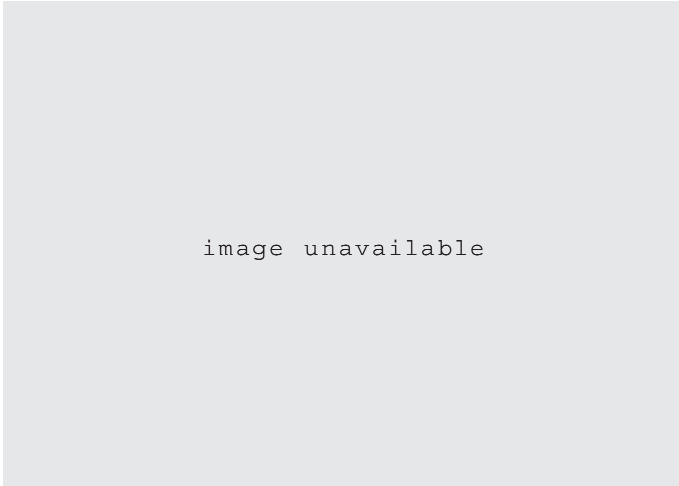
↓

If unable to pay the arrears or the whole loan (including enforcement expenses) then goods may be sold

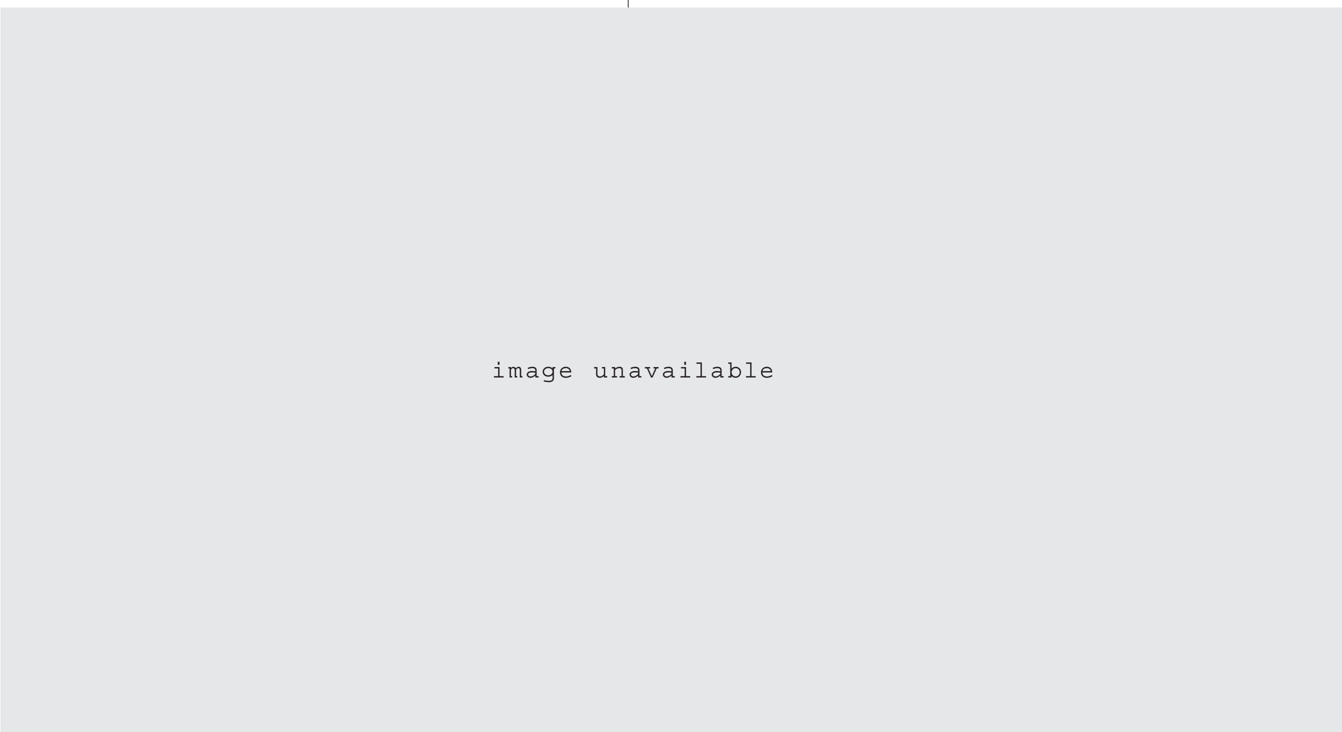
↓

After sale of goods, a notice is given setting out the amount realised from the sale and the amount left to pay.

A dispute can be lodged in EDR if the lenders fails to comply with any of the these requirements. Consumers may also be able to apply for hardship depending on what stage in the process has been reached – consumers should see ***Help for Consumers*** on page 22 for information on where to get advice or how to contact EDR.




Greg Newington, *Australian Financial Review.*




***'For Sale' signs outside units in Fairfield as rising interest rates lead to forced sales.***

Peter Morris, *Sydney Morning Herald.*

# Other protections

**There are some protections in the credit law that are rarely applicable in mainstream lending, but are very important to protect disadvantaged and vulnerable consumers.**

## INTEREST RATE CAPS

New South Wales, Queensland and the Australian Capital Territory all have comprehensive caps on the price of consumer credit where it is regulated under the relevant legislation (the *Uniform Consumer Credit Code* until 20 June 2010 and then the *National Consumer Credit Protection Code 2009*). This means that the price of a loan cannot exceed 48% per annum, including any up-front fees and charges. In Victoria, there is a dual interest rate cap, 48% for unsecured lending and 30% for secured lending, but fees and charges are not included in the calculation, allowing lenders to recoup whatever they cannot charge as interest as fees.

The Commonwealth Government undertook to examine the state and territory approach to interest-rate caps as part of Phase Two of the reform process. In the meantime the caps will remain in place for a limited period in those states and territories that currently have them. Credit providers argue that the high cost of some loans, particularly small loans like 'payday loans', can be justified by higher comparative cost of lending and the higher risk. There is some research to support that very small loans cannot be made profitably for less than 48%.[23]

There are several reasons, however, for imposing a cap:

> the impact of high cost loans on consumers is to entrench disadvantage and create a debt trap – high cost loans don't solve financial problems they delay and exacerbate them;

> without any cap, there is no effective competition in the fringe market and prices will not stop at what can be justified;

> high-cost loans are not confined to the small, personal loan market – they are also prevalent in equity stripping scenarios - see ***Sub-prime lending*** on page 8;

> as cost increases, so does the likelihood of unjust/unconscionable conduct and/or fraud – where a borrower is desperate for money, and an unscrupulous credit provider or broker sees a chance to make an unusually large profit, there are incentives on both sides to attempt to avoid the intent of the law;

> price is the one thing that it is hard to fabricate – if you want to charge it, it needs to be written into the contract.

This makes enforcement of a cap much easier than more nebulous concepts such as unjust or unconscionable conduct, or responsible lending. Further, it can be easily enforced across a range of contracts rather than on a case-by-case basis.

Consumer groups support interest-rate caps and the sector of the lending industry most likely to be affected are vehemently opposed because it threatens their livelihood. This will be a hotly debated issue in Phase Two, with vulnerable consumers in NSW at serious risk of losing a protection that has been part of NSW law since 1996.

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***Loan signs in Bankstown. The Reserve Bank raising its official cash rate placed pressure on mortgage rates, 4 March 2008.***

Tracey Nearmy, *AAP Image*.

23. NAB report, *Do you really want to hurt me?* page 13, available online at www.nab.com.au

## PROHIBITED SECURITIES

It has been a common practice for fringe lenders to take security over household goods that have no real resale value, but have significant value to the borrower. Borrowers seeking to borrow small amounts for day-to-day living expenses would usually encounter extreme difficulty raising sufficient funds replace their essential household goods. This practice has been referred to as taking 'blackmail securities' because the credit provider has no real interest or intention in taking the goods, but relies instead on the borrower's fear of losing them to ensure repaying the loan takes precedence over any other expense. This threat endures even if the borrower became a bankrupt, because the loan is technically secured and the creditor retains the right to enforce against the security.

As of 1 July 2010, 'essential household property' will not be permitted to be taken as security for a loan except in very limited circumstances. The property subject to the prohibition is the same as is protected from creditors for a person who is bankrupt under the *Bankruptcy Act 1966*. As a guide this would be:

> basic kitchen equipment;

> sufficient household furniture;

> sufficient beds for the members of the household;

> educational, sporting and recreational equipment for use of children and students in the household (as computers are used for education, this should be covered);

> equipment for the safe transport, sustenance, and containment of babies (eg, car seats, prams and strollers, playpens, bottles, sterilisers);

> television;

> stereo;

> radio;

> washing machine and a dryer;

> fridge and freezer;

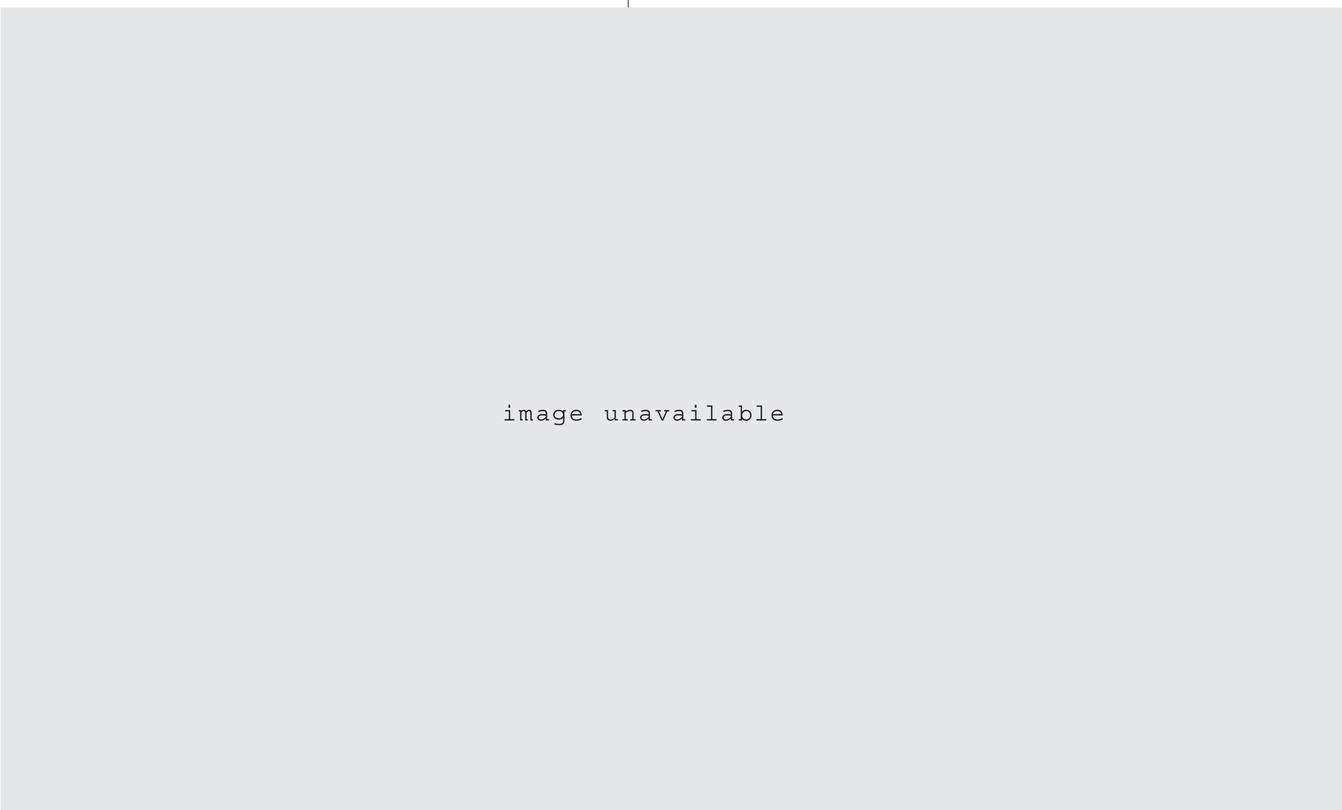
> a generator;

> telephone; and

> video recorder.

Property used by the mortgagor in earning income by personal exertion (tools of trade) is also unable to be used as security if they are valued below the limit in the bankruptcy regulations. This amount can be found at www.itsa.gov.au.

The only exception is property that secures a loan that was taken out for the purpose of buying the property. For example, where a consumer purchases a bed using a loan and the credit provider takes a goods mortgage over the bed and can repossess it in the event of default.




A. Hampton, © DWSPL.

# Help for consumers

**This section explains the types of assistance available to consumers who have problems with loans, particularly consumer loans. Contact details for these agencies, including free legal assistance, are included on page 24.**

## EDR

External dispute resolution is a free, independent dispute resolution service. Brokers, credit providers and other participants in the consumer credit industry must be members of an EDR. There are two EDR services relevant to consumer credit contracts. They are the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service Ltd (COSL). The contact details for both are given on page 24. Consumers can apply to an EDR service for a range of disputes including but not limited to:

> if they cannot reach agreement with their credit provider about a hardship variation;

> if their contract may be unjust; and

> if the lender and/or broker has breached the responsible lending provisions of the law (for contracts entered from 1 July 2010 for brokers and non-bank lenders, and from 1 January 2011 for banks, credit unions, building societies and registered finance companies).

The process is usually conducted entirely by written submissions and statements and documentary evidence and the consumer is rarely required to be present in person. The EDR will try to encourage the parties to resolve the dispute, including conducting conciliation, but will make a finding or determination if necessary. The consumer preserves all rights to take the matter to court provided no relevant time limit has expired.

Importantly, an EDR member cannot take a consumer to court to enforce a debt while the matter is in EDR. If legal proceedings have commenced, the consumer can still go to EDR provided he or she has not taken a step in the legal proceedings beyond lodging a defence (and/or cross claim).

For more information, how to lodge a complaint, or to view the complete terms of reference and operational guidelines/rules see the contact details on page 24.

## FINANCIAL COUNSELLING

Financial counsellors assist people with a wide range of financial problems. They work with their clients to help them get out of the cycle of debt and take control of their finances. A financial counsellor will:

> help you get a clear picture of your overall financial situation;

> explain what options you have in relation to your debts and the advantages and disadvantages of them;

> may advocate or negotiate with creditors, government agencies and others; and

> will listen and provide support.

Financial counsellors have strong links with other service providers and may also provide referrals to other agencies that can assist, such as community legal services, housing bodies and so on.[24]

To find a financial counsellor in NSW call the Credit and Debt Hotline see page 24 for contact details.

## COMPLAINING TO ASIC

The Australian Securities and Investments Commission (ASIC) has the power under the law to investigate alleged breaches of the law and prosecute if appropriate, impose conditions on licences, revoke licences and ban particular individuals from undertaking credit activities. If your complaint is serious, or possibly systemic (affecting many other consumers also), you should consider making a complaint to ASIC. Unlicensed conduct should particularly be reported, but also breaches of the responsible lending laws, inappropriate debt collection conduct and failure to respond appropriately to financial hardship. You can complain to ASIC online, in writing or by phone. You should also get advice about how to resolve your dispute, including possibly lodging a complaint in an EDR scheme. While it is important

24. Information about financial counselling adapted from the Australian Financial Counselling and Credit Reform Association website: www.afccra.org

that serious matters are reported to ASIC, the regulator can only take action in a limited number of cases and will not usually be able to intervene to resolve your individual dispute.

### FREE LEGAL ADVICE

There are a number of legal services which can give free initial advice to consumers either over the phone or in person, depending on the service in relation to credit and debt matters. Further assistance, including representation in EDR or at court is usually subject to conditions. Legal Aid applies an income and asset test and a merit test. Other services have slightly more flexible approaches but will generally consider the following:

> the level of vulnerability or disadvantage of the consumer;
> the consumer's ability to access other legal assistance; and
> the public interest in pursuing the matter.

For contact details see page 24.

### HOT TIP – WHAT IS AN OMBUDSMAN?

**An Ombudsman is a body that deals with complaints. There are two types of Ombudsmen in Australia and New Zealand:**

***Parliamentary ombudsmen*** **– for complaints relating to government agencies.**

***Industry-based ombudsmen*** **– for complaints from customers of particular services eg telecommunications, banking, investments, energy, water and public transport. The essential features of an ombudsman are independence, clearly defined jurisdiction, powers to investigate and deal with complaints, accessibility, procedural fairness and accountability. For more information visit www.anzoa.com.au**

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***Colin Neave, the Financial Services Ombudsman at the launch of the service in Melbourne, 2008.***

# Contacts and further information

## LEGAL INFORMATION ACCESS CENTRE

The **Legal Information Access Centre (LIAC)** in the State Library of NSW can help you if you need more information about the law, including legislation and cases. The service is free and confidential. Contact details on the back cover or at **www.legalanswers.sl.nsw.gov.au**

### SPECIALIST CREDIT LAW ADVICE (COMMUNITY LEGAL CENTRES)

**ACT – Consumer Law Centre ACT**
Tel: 6257 1788

**NSW – Consumer Credit Legal Centre (NSW)**
Tel: 1800 808 488 www.cclcnsw.org.au

## LawAccess NSW

LawAccess NSW is a free government telephone service that provides legal information, advice and referrals for people who have a legal problem in NSW. Contact LawAccess for enquiries regarding **Legal Aid**.

Tel: 1300 888 529
Telephone typewriter access: 1300 889 529
Translator and Interpreter Service: 131 450

**www.lawaccess.nsw.gov.au**

## COMMUNITY LEGAL CENTRES

The Community Legal Centres NSW directory lists the contact details of New South Wales Community Legal Centres.

**www.clcnsw.org.au/clc_directory.php**

To find your nearest community legal centre across Australia go to www.naclc.org.au

## CREDIT AND DEBT HOTLINE

Contact for financial counselling services in NSW.
Tel: 1800 808 488

**www.fcan.com.au**

## FINANCIAL OMBUDSMAN SERVICE

Tel: 1300 78 08 08

**www.fos.org.au**

GPO Box 3
Melbourne VIC 3001

## CREDIT OMBUDSMAN SERVICE

Tel: 1300 138 422
Fax: 02 92738440

**www.cosl.com.au**

PO Box A252
Sydney South NSW 1235

## CONSUMER CREDIT

**www.treasury.gov.au/consumercredit**

The Federal Treasury's website for the latest information on the new consumer credit laws.

## AUSTRALIAN SECURITIES COMMISSION (ASIC)

**www.asic.gov.au or www.fido.asic.gov.au.**

The ASIC website has practical information on the new consumer credit laws, including guidelines and factsheets on licensing and registration for those involved in credit activities.

You can complain to ASIC online, in writing or by phone.

ASIC Complaints
Australian Securities and Investments Commission
PO Box 9149
Traralgon VIC 3844

Fax: Australia (03) 5177 3749
International + 61 3 5177 3749
Email: **infoline@asic.gov.au**
Tel: Australia 1300 300 630
International +61 3 5177 3777