1 July 2008

By email: financialservicesgreenpaper@treasury.gov.au

Financial Services and Credit Reform Green Paper
Corporations and Financial Services Division
Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Financial Services and Credit Reform Green Paper

Consumer Action Law Centre welcomes the opportunity to provide comment on the Financial Services and Credit Reform Green Paper (the **Green Paper**), released by the Australian Government Treasury on 3 June 2008.

Consumer Action strongly supports Option 2 proposed on page 12 of the Green Paper, where the Commonwealth Government would assume responsibility, not only for mortgage credit and advice, but also for other forms of consumer credit, such as credit cards, car finance, and other personal loans (including payday loans). As outlined below, we believe this approach would ensure comprehensive consumer protection, would minimise gaps and opportunity for regulatory gaming and be least costly for Governments and industy.

The remainder of this submission will outline:

- Trends in consumer credit markets over recent years;
- The proposed framework for national regulation of consumer credit, including licensing, enforcement and policy development;
- The coverage of consumer credit regulation; and
- The regulation of property spruikers (investment advice).

Trends with consumer credit

Consumer credit markets in Australia are growing and are complex. We are concerned that the Green Paper prefers an option which 'neatly' disaggregates the credit market between mortgage credit and other forms of personal credit, for the purposes of Commonwealth assumption of regulatory responsibility. We believe such a disaggregation is impractical and that Commonwealth responsibility must cover all areas of consumer credit.

In the past two decades a number of trends have emerged in relation to consumer credit and debt that are relevant to consideration of the appropriate forms of regulation. In our view,

Consumer Action Law Centre
Level 7, 459 Little Collins Street
Melbourne Victoria 3000
Telephone 03 9670 5088
Facsimile 03 9629 6898
info@consumeraction.org.au
www.consumeraction.org.au

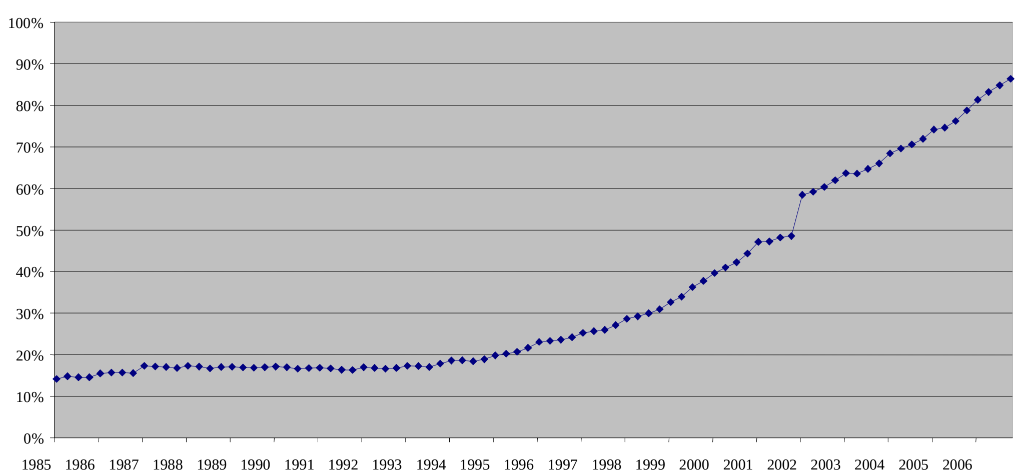
ABN 37 120 056 484 ACN 120 056 484

these trends have significantly weakened the position of consumers. Key trends include rising debt as a percentage of income; increases in personal bankruptcies; increases in foreclosures; an increase in access to credit (including low documentation loans and 100 per cent finance loans); and increases in credit card debt.

Household debt as a proportion of disposable income has increased dramatically in the past 20 years, from 12 per cent in December 1986 to 158.1 per cent in December 2006. This upward trend has also been mirrored by other measures of household debt. For example, households' debt to asset ratio increased from 8.1 per cent in December 1988 to 17.3 per cent in December 2006, and the ratio of housing debt to housing assets increased from 10.4 per cent to 26.1 per cent over the same period.[1]

Further, credit card debt as a percentage of annual average income has also increased markedly. The Green Paper suggests that the value of credit card debt is relatively small compared to mortgage credit. While this is true, it does not acknowledge that the number of credit cards and credit card transactions are far greater than mortgages and transactions. Also, credit card debt is unlikely to be used to purchase assets or to acquire wealth – and they have particular features that can "trap" borrowers. There are now over 14 million credit cards in Australia while there are only around 5 million home loans. Further, credit card debt is causing increasing problems for many households. To put credit card debt in perspective, the graph below illustrates very clearly an upward trend. The graph shows that in 1985 credit card balances were at 14.5 per cent of average annual income. In November 2006, despite increases in average annual income, credit card balances were at 86.39 per cent.

Graph 1. Credit Card Debt as Percentage of Annual Average Income



Source: ABS and RBA

Credit card debt is commonly understated because it is argued that consumers have increasingly used credit cards as a transaction tool. Much of the "debt" is said to be credit card balances that are paid off in credit cards' interest-free periods each billing cycle.

[1] Reserve Bank of Australia. Debt to disposable income ratio - Household Finances – Selected Ratios - B21.

However, RBA data clearly shows that 72 per cent of the $43.6 billion overall debt owing on credit cards is accruing interest.[2] Research also suggests that approximately two thirds of households do manage to pay off their monthly balance without accruing interest, and the third that do not pay their monthly balance owe a lot more debt relative to income.[3] The ABS reports that over two-thirds (69 per cent) of high wealth households had credit card debt compared to 59 per cent of middle wealth and 38 per cent of low wealth households. However, while fewer low wealth households had credit card debt, those who did on average had a similar amount owing ($3,200) to both middle ($3,400) and high wealth households ($3,700).[4] However these averages are somewhat misleading, in that they take into account those who pay off their debt each month as well as those with ongoing interest bearing debt. We believe that the average amount owed by those with interest bearing debt would be about double these amounts.

There also continues to be growth in other forms of small amount personal lending, such as payday lending. While there are no firm statistics on the size of this industry, payday lending has expanded significantly since the early 2000s. Industry data suggests that there are now over 800 payday lending stores and that there has been an increase in turnover for large payday lenders of over 200 percent in the last six months.[5] Payday lending is marked by exploitative pricing practices, with annualised interest rates (including fees and charges) reaching many hundreds, and in some cases, thousands of per cent.

These trends in consumer debt have been paralleled by an increase in bankruptcies and home repossessions in recent years. For example, data published by the Insolvency and Trustee Service Australia showed that there was a 12.1 per cent increase in personal insolvency activity in the March 2007 quarter compared to the March quarter 2006. The Insolvency and Trustee Service also reported that the excessive use of credit was responsible for 27 per cent of personal bankruptcies in 2007 (second only to unemployment as the leading cause of personal bankruptcy).[6] While there is some debate about whether high credit use or personal circumstances cause debt stress, we believe that high credit use can make consumers more vulnerable to life events such as unemployment – so that while unemployment may be identified as the key cause, the impact may have been much less had the individual had lower levels of consumer credit. Much of the credit causing personal bankruptcy involves personal credit rather than mortgage credit.

Consumer Action's experience of consumers' credit problems

Consumer Action runs a specialist telephone advice service that provides information and legal advice to Victorian consumers, as well as a litigation practice. The experience of our legal advice service is that more of consumers' reported problems relate to consumer credit other than mortgages. In fact, as the table below demonstrates, complaints about mortgages amounts to less than a third of all consumer inquiries about credit.

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[2] RBA. Credit and Charge Card Statistics - CO1.
[3] According to the 2002 report by Visa International, *The Credit Card Report: Credit card spending in perspective*, 64% of all households with credit cards in use did not pay credit card interest.
[4] Australian Bureau of Statistics. Household Wealth and Wealth Distribution, Australia, 2003-04.
[5] Connor Duffy, 'Payday loans on the rise', *Lateline*, 16 June 2008.
[6] Australian Government Inspector-General in Bankruptcy. 2006-20067 Annual Report on the Operation of the Bankruptcy Act.

Consumer credit inquiries (May 07 – May 08)	No.	%
Relates to mortgages	372	30
Relates to vehicle finance	292	25
Relates to credit cards	256	22
Relates to personal loans	123	10
Relates to payday loans	41	4
Other (credit purpose not stated)	102	9
TOTAL	1186	100

It is our view that the experience of consumer complaints from financial counsellors would demonstrate an even greater proportion of complaints relating to non-mortgage credit.

We also note that the market for consumer credit and consumers' use of credit products does not easily disaggregate the types of consumer credit as envisaged by the Green Paper. For example, many mortgages are now sold with a credit card attached to them as part of the same product. Consumers' use of types of consumer credit varies too – mortgages are commonly refinanced to pay out other non-mortgage credit and, especially for struggling consumers, credit cards and personal loans are used to meet mortgage payments and other recurrent day-to-day expenditure.

The process of regulating emerging areas such as payday lending has led to inconsistent outcomes of levels of effectiveness. For example, some jurisdictions have introduced caps on interest rates to limit the exploitative charging by payday lenders. However, in Victoria, lenders have evaded this regulation by loading costs into fees and charges, rather than interest. This has meant that the regimes adopted by some states to limit exploitative charging are ineffective.

Framework for national regulation of credit

Licensing and enforcement

The Green Paper states that the Commonwealth proposes to assume responsibility for mortgages as a financial product, including associated advice. This approach would ensure a level playing field between non-deposit taking institutions and banks. It is also stated that if the Commonwealth Government assumes responsibility for consumer credit, it would do so pursuant to the Commonwealth's regulation of other financial services and markets under Chapter 7 of the *Corporations Act 2001* (Cth).

We support the strong licensing framework under the Corporations Act, including the requirement for all licensees to be members of an EDR scheme and the requirement that licensees conduct themselves efficiently, honestly and fairly. We note, however, that the reporting and disclosure requirements of Australian financial licensees may not be appropriate for credit products. Considering this, we would welcome consideration of a more effective disclosure and reporting regime for credit providers. A potential alternative licensing framework is that proposed by the draft national finance broking legislation. Licence conditions proposed by that framework include qualification and ongoing training requirements, a requirement to act efficiently, honestly and fairly, membership of an EDR scheme and disclosure about costs and services.

The Green Paper also proposes that should the Commonwealth Government assume responsibility for consumer credit, the Australian Securities and Investments Commission (**ASIC**) would become the regulator. We strongly support ASIC as the regulator of consumer credit. ASIC is already responsible with the consumer protection provisions relating to consumer credit under the *Australian Securities Investments Commission Act 1999* (Cth) and has developed significant expertise in this area.

However, we also see a continued role for state regulators in the area of consumer credit, at least in the short to medium term. While ASIC does have regional offices in all capital cities, it is our view that there is significant expertise among state regulators of consumer credit. If responsibility for enforcement was transferred entirely to ASIC, this experience and the ability to respond sensitively and quickly to local issues may be lost. We therefore recommend a model of concurrent jurisdiction. We note that a dual regulator model is consistent with the Productivity Commission's recommendation relating to the generic consumer law in its recent Review of Australia's Consumer Policy Framework.[7]

Consumer redress

Consumers' access to redress, including the securing of just outcomes and the provision of financial compensation in some circumstances, is an integral feature of Australia's consumer credit framework. Consumer redress also serves an important enforcement role in its own right, through pushing up the cost of, and thereby deterring, 'bad' behaviour by business.[8]

As detailed further below, we strongly support the requirement that all credit providers be a member of an ASIC-approved EDR scheme. EDR schemes can deliver practical, responsive outcomes for consumers at no cost. However, we also believe that consumers should have access to low-cost tribunals to resolve consumer credit disputes – either for the long term, or until a thorough review (some years after the national regime has been in place) clearly indicates there is no need for these tribunals. Low-cost tribunals exist in Victoria (Victoria Civil and Administrative Tribunal), NSW (Consumer, Trader and Trader Tribunal), WA (State Administrative Tribunal) and ACT (Credit Tribunal).

Consumer Action has significant experience in conducting litigation in the Victorian Civil and Administrative Tribunal (**VCAT**). In our experience, VCAT can an accessible and low cost alternative to going to court. While Consumer Action would advise its clients to access an industry EDR scheme should one be available (see below for discussion about need for comprehensive access to EDR), there are reasons why access to a tribunal is also necessary.

Access to a tribunal cannot only provide a good discipline for the EDR schemes, it can also give a consumer an additional place for redress should they be dissatisfied with an EDR scheme outcome. In some circumstances, we have found that VCAT can actually be a

[7] Productivity Commission, *Review of Australia's Consumer Policy Framework – Final Report*, p 80.
[8] Productivity Commission, as above, p 193.

quicker process for consumers compared to EDR schemes. Nevertheless, the threat that the consumer can proceed directly to litigation encourages both the credit provider and any EDR scheme to resolve complaints quickly, cheaply and in accordance with the law.

Tribunals are also necessary when credit providers initiate proceedings against consumers in a court. In Victoria, should enforcement proceedings be issued against a mortgage in the Supreme Court, a consumer may be able to seek a stay and have a complaint heard at VCAT. This is because VCAT is vested with exclusive jurisdiction to deal with hardship variations and claims of unjust contracts or unconscionable fees and charges under the UCCC.[9] An EDR scheme cannot consider a complaint once legal proceedings have been initiated. In our experience, a consumer is often not aware that they have a right to apply for a hardship variation until mortgage enforcement proceedings have begun, when they seek assistance. If they were only to have the right to have any application for a hardship variation to be considered in a court, the costs involved in appearing before a court and the risk of expensive adverse cost orders would mean that a consumer might not initiate such a claim. This would severly limit such a consumer's access to a just outcome.

We also notes that some consumer complaints fall outside of the jurisdiction of EDR schemes. For example, the Banking and Financial Services Ombudsman (**BFSO**) has stated that it does not have jurisdiction to consider complaints relating to the imposition of bank penalty fees (which include dishonour fees, credit card late payment and over-the-limit fees). Should a consumer wish to challenge such a fee, they must initiate action at a court a tribunal. Considering the application fees and costs risks associated with courts in comparison with tribunals, the consumer might not be able to have a low-cost dispute resolution without access to a tribunal.

VCAT is significantly less formal than a court, yet we note that legal representation in the credit list is becoming more common. Despite this, consumers are able to access the tribunal without representation, particularly in relation to hardship applications. VCAT has lower fees and has a clear and easy-to-access fee waiver process for low-income consumers. In the Victorian Supreme Court, by comparison, a complainant must sign a 6 page affidavit and meet the prothonotary to discuss any application for a fee waiver. VCAT also has a presumption not to award costs unless it considers it fair to do so.[10]

We note that there may be constitutional limitations in vesting jurisdiction from a national law into a state tribunal. However, this may be overcome if states and territories vest their own tribunals with powers to hear consumer credit matters under a national consumer credit consumer law. We note that a similar suggestion was made by the Productivity Commission in relation to maintaining access to jurisdictional tribunals in the event that a national generic consumer law is established.[11]

Effective redress for consumers through either an EDR scheme or through a court or tribunal will often require the assistance of consumer credit legal services, legal aid and financial counselling services. Particularly for low-income and vulnerable clients, such assistance is

[9] Consumer Credit (Victoria) Act 1995, section 8.
[10] Section 109, *Victorian Civil and Administrative Tribunal Act 1998* (Vic).
[11] Productivity Commission, *Review of Australia's Consumer Policy Framework – Final Report*, p 67.

required to provide equitable access to judicial redress, as well as to deal with hardship arising form some consumer credit transactions. As detailed above, Consumer Action's legal service provided over 1,100 advices to consumers from May 2007 to May 2008. Fifty-six litigation files were opened during that period.

There are currently varying levels of assistance between the states and territories. While there are consumer credit legal services of legal aid in Victoria, NSW, ACT, Queensland and WA, there are not in SA, NT and Tasmania. The Productivity Commission has recently recommended that the Australian Government provide increased resourcing of consumer legal aid and financial counselling services.[12] We encourage the consideration of improved resourcing for legal aid and financial counselling to support consumers' credit problems, as part of the transition to Commonwealth regulation of consumer credit.

Policy development

We note that transferring responsibility for consumer credit law to the Commonwealth will involve the Commonwealth having an increased role in policy development. We also note that much of the policy development expertise that has developed to date around consumer credit lies with state and territory policy officers. Further, state and territory policy makers are generally colocated with complaint handling and enforcement functions, which provides useful input into areas requiring policy development. Considering this, we believe that states should retain a role in policy development.

A particular problem of reforming consumer credit legislation has been the difficulty in getting jurisdictions to agree to amendments. This has led to the consumer credit laws not keeping pace with market developments. Under the Uniform Credit Laws Agreement, amendments can only be passed by resolution of the Ministerial Council on Consumer Affairs (**MCCA**), with at least two thirds of jurisdictions support. We would support an amendment to this process, so that an expanded MCCA could determine policy with the agreement of the Commonwealth and three states or two states and a territory. This arrangement could be reviewed after a period of time.

Coverage of federal credit regulation

One of the primary reasons we support Commonwealth assumption of responsibility for consumer redit regulation is the well-documented weaknesses of the Uniform Consumer Credit Code and, in particular, the fact that it has not kept up with changes in the lending industry. Further, there are various aspects of the regulatory framework that are not covered by the UCCC, and in which the states and territories have developed uneven regulatory resopnses. Despite this, the UCCC involves important consumer protections, and any transfer of regulatory responsibility for credit should ensure the protections of the UCCC are maintained.

There are a number of major proposed amendments to the UCCC that we believe should be fast-tracked and included in any Commonwealth assumption of consumer credit. We also

[12] Productivity Commission, as above, rec 9.6.

believe that many of the innovative regulatory interventions of the state governments (outside the UCCC) must be maintained, where they result in substantial consumer benefit.

Current proposed amendments to UCCC

We strongly support the draft amendments to the UCCC that are aimed to respond to the problems of fringe lending (the *Fringe Lending consultation package*). In particular, we believe that the following amendments are broadly supported and should be implemented in the context of the national framework, or before:

- The prohibition of taking security over essential household goods (blackmail securities);
- Amendments to the business purpose declaration that ensure that credit providers ascertain the purpose of a loan;
- Amendments to the basis of challenging of fees and charges.

We note that the Green Paper states that it does not intend to regulate bank fees and charges. We strongly contest the Green Paper's statement that regulation of bank fees and charges discourages new investment and innovation and may actually lead to an increase in prices for consumers. We agree, however, that where competition is effective for fees and charges, that it is the best mechanism to ensure that fees and charges are kept to a minimum. However, it must be recognised that many fees and charges imposed by banks and other credit providers are not able to be kept in check by competition.

In our view, there are a range of fees that have not been kept in check by the operation of the market. These include mortgage exit fees, default fees on transaction accounts, credit card late-payment and over-the-limit fees and exploitative fees charged by payday and other fringe lenders. Competition cannot work effectively to keep contingent fees such as exit fees and default fees in check, and the nature of the payday lending market is that payday loan borrowers do not have access to credit products with fairer terms. In such an environment, we see a clear role for government regulation to ensure fees are kept in check.

Another amendment to the UCCC is currently before the Queensland parliament.[13] This amendment would make it clear that the UCCC regulated vendor terms arrangements, and extends the UCCC to "tiny-terms", where the cost of credit is incorporated into the cash price and the transaction is represented as a sale of goods by instalment (without any credit charges or interest). Vendor terms agreements and "tiny-terms" agreements are used to sell to vulnerable consumers, with the latter particularly relating to motor vehicles. We strongly support these amendments.

Other current processes of the Ministerial Council of Consumer Affairs (**MCCA**) to amend the UCCC should also be included in the national regulation of credit. These include:

- Proposals to improve pre-contractual disclosure;
- Credit card overcommitment; and
- Improving the operation and use of comparison rates.

[13] Justice Legislation Amendment Bill 2008.

Jurisdiction specific regulation

In a number of areas, individual jurisdictions have amended their consumer credit regulatory frameworks outside the operation of the UCCC. For example, the NSW and ACT governments have introduced comprehensive interest rate caps on the cost of credit, inclusive of fees and charges. The interest rate cap is 48%. A similar cap will come into operation in Queensland later this year. These interest rate caps operate to ensure consumers are not subject to the exploitative pricing of payday lenders.

Victoria has also introduced an interest rate cap, which is exclusive of fees and charges. Lenders use this as a loophole to charge a high cost of credit, loading the costs into fees and charges and the Victorian Government is presently reviewing its approach to this issue. We strongly support comprehensive interest rate cap and believe that it is a simple regulatory tool which can eliminate unfair and predatory payday lenders. When factoring in the social cost of payday lending, we also believe this regulatory solution would be least costly overall.

Victoria has recently amended its consumer credit laws so as to require all credit providers to be a member of an external dispute resolution (**EDR**) scheme. No other jurisdiction requires all credit providers to be a member of an EDR scheme. Although banks and financial service providers are required to be members of EDR schemes, credit providers that are not also financial services providers or authorised deposit taking institutions, are not required to be members. Most of those credit providers are small or 'non-conforming' credit providers. As EDR can deliver practical, responsive outcomes for consumers at no cost, we strongly support the Victorian requirement to be included in the national regulation of consumer credit.

Finance broking

We have provided our support and comments on the draft national finance broking legislation that was released for comment by MCCA. We note that the CoAG decision is that the Commonwealth would assume responsibility for mortgage credit and *advice*. It is our understanding that this would include mortgage brokers. We support the uniform regulation of credit and finance brokers and we refer you to our joint submission on the draft national finance broking legislation. A copy is attached.

Marketing

Lending practices now include extensive marketing of consumer credit. It is our view that further consideration should be given to Governments about the appropriateness of some forms of marketing of consumer credit, and whether there is a need for further regulation. For example, many lenders now regularly send existing credit card customers unsolicited offers to increase their credit card limit. Most offers are not accompanied by a full credit assessment. Problems arise not only because some recipients have had a change in circumstances reducing their capacity to pay, but because credit limits are sometimes progressively increased to a level that is unaffordable.[14]

[14] Consumer Credit Legal Service and Consumer Law Centre Victoria, *Submission to Victorian Consumer Credit Review*, August 2005.

There is also little doubt that consumer credit marketing often aims to get consumers “hooked” into credit products, focusing on the “benefits” associated with it, rather than the fact that it involves debt. Further, the offer of credit that is already “pre-approved” can be used to influence consumer behaviour so that consumers accept a higher level of debt.[15] Recent marketing campaigns, for example, have portrayed credit cards as, variously, a way to earn rewards;[16] a status symbol;[17] and even a fashion statement.[18] Given the significant danger that access to credit can result in unsustainable debt for many consumers, we do not believe that such marketing is appropriate.

Reckless lending

In recent years, we have noted that increasing debt levels among consumers expose disadvantaged and vulnerable consumers to predatory practices that are offered to them as a “debt solution”, but which actually increase their level of indebtedness or reduce their equity in assets.

An example of these predatory practices is “equity stripping”.[19] This most commonly takes the form of consumers entering into expensive home loan refinancing arrangements in an (often and understandably emotional) attempt to save the family home from foreclosure. These refinancing efforts often do not prevent the loss of the home, however, as due to the additional costs of refinancing, the consumers lose more of the equity than they would otherwise have retained. It is stripped by the refinancing costs and extra interest.

The UCCC allows a court to reopen a consumer credit contract if it is satisfied it was unjust. However, the UCCC provision has not succeeded in eliminating predatory lending because it is not an up-front obligation, and it relies on the consumer to take individual action in a court or tribunal. Regulators cannot enforce this obligation, which means it cannot be tackled as an industry-wide problem.

A relatively simple change to the regulation should provide an up-front obligation on lenders to ensure that a consumer has capacity to repay a loan without substantial hardship. This would ensure that the protection was unambiguous and would allow regulators to act on systemic problems. This would not need to be prescriptive about how lenders should determine a consumer’s capacity to repay a loan. We believe the obligation alone could greatly improve protection, as the market would develop appropriate standards in making these assessments and lenders that did not meet such standards would be pressured to improve due to comparisons with competitors.

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[15] Consumer Action research on unsolicited credit card limit increase offers, forthcoming.
[16] For example, ANZ’s 2007 campaign to “convert bills into rewards”; Westpac’s new “Earth” credit card.
[17] For example, American Express campaigns; cf Virgin credit card campaigns targeting a younger market segment.
[18] For example, the NAB Visa Mini campaign in 2006.
[19] See ASIC, *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress*, March 2008.

Property spruikers

We welcome the Green Paper's consideration of the regulation of property investment and advice. Although property investment advisers are currently regulated by the consumer protections provisions of the *Trade Practices Act* 1974 (Cth) and state *Fair Trading Acts*, these laws do not compel property advisers to disclose either the potential financial risks to investors or any conflicts of interest, such as receiving commissions. Providers of property investment advice are not licensed, and we believe that the law should be changed to impose mandatory conduct requirements on such providers.

Consumer Action has experience with complaints from consumers who owed money as a result of attending National Investment Institute (**NII**) schemes (run by the infamous Henry Kaye). NII and similar schemes[20] generally charge a high upfront fee for participation and evade the Australian financial services licensing regime by purportedly providing 'education' rather than financial advice. 'Education' is commonly also advice about property investment. Consumers regularly reported high-pressure sales tactics, difficulties in getting a refund, as well as speakers' unwillingness to assist or respond to requests for assistance.

Such advisers are often commonly tied to a range of other entities, including lenders, brokers, estate agents and conveyancers. For example, consumers who attend an investment advice seminar are often referred to other parties directly, without the chance to shop around. There are often high fees paid to all those involved. Such complex arrangements add additional consumer detriment, particularly where there are fees and charges passing between the different parties. Inappropriate management of conflicts of interest can lead to poor advice from advisors.

In line with recommendations of the Parliamentary Joint Committee on Corporations and Financial Services and the Victorian Parliament's Law Reform Committee, we support the national regulation licensing of providers of property investment advice should be federally regulated through a regime similar to the Australian financial services licensing scheme in the Corporations Act. Attached is a copy of our submission to the Victorian Law Reform Committee for your information.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Gerard Brody

Gerard Brody
Director – Policy & Campaigns

[20] For example, the Today Not Tomorrow Institute, marketed by former NII employee, George Mihos.