Consumer Credit
Legal Centre NSW

October 2011

Submission to the

Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011

by the

Consumer Credit Legal Centre (NSW) Inc

Consumer Credit Legal Centre (NSW) Inc ("CCLC") is a community-based consumer advice, advocacy and education service specialising in personal credit, debt, banking and insurance law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. We provide legal advice and representation, financial counselling, information and strategies, and referral to face-to-face financial counselling services, and limited direct financial counselling. CCLC took over 16,000 calls for advice or assistance during the 2010/2011 financial year.

A significant part of CCLC's work is in advocating for improvements to advance the interests of consumers, by influencing developments in law, industry practice, dispute resolution processes, government enforcement action, and access to advice and assistance. CCLC also provides extensive web-based resources, other education resources, workshops, presentations and media comment.

Thank you for the opportunity to respond to the **Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (the Bill).** The following is a submission to both the inquiry being conducted by the Parliamentary Joint Committee and the Senate Committee.

Submissions

CCLC commends the work that has occurred in drafting the Bill. With some exceptions detailed in this submission we are strongly supportive of the amendments proposed by this Bill. We consider that all of the areas of proposed reform are important and needed. In particular, we believe that enhanced consumer protections for consumers dealing with high cost small amount credit lenders are both necessary and urgent.

Small amount credit contracts

CCLC supports the amendments regarding high cost short term loans and in particular the cap on costs under these loans proposed by Schedule 4 of the bill. While we have long lobbied for a comprehensive cap on the cost of credit at 48% as we have had in NSW for some years, we recognise that the overall package strikes a reasonable compromise in terms of cost, but also contains other measures that together with the cap on costs should result in a net benefit for disadvantaged and vulnerable consumers.

We particularly support:

- The caps on the cost of credit
- The cap on the total amount recoverable under the small amount lending regime (many of our clients are crippled by default charges which accumulate indefinitely)
- The ban on multiple small amount loans and refinancing of small amount loans
- The fact that small amount loans are defined as unsecured

The need for consumer protection legislation

There is a real and urgent need for consumer protection legislation for consumers who use high cost small amount finance because:

- The consumers who use this type of credit are often desperate and on a low income (usually Centrelink).
- It is high cost credit and therefore dangerous. Consumers who use this type of credit often get caught in a debt trap.
- Small amount, high cost loans are used in a majority of cases for essential living expenses. Consumers who cannot afford basic living expenses in the first place clearly cannot afford their basic living expenses in addition to debt repayments. This again leads to a debt trap where money is borrowed again to meet the increasing shortfall between income & essential expenditure.
- The industry cannot manage self regulation. The high cost, small amount credit industry has been tirelessly inventive on how to avoid the law.
- There is a failure of competition in this market. This is evidenced by consistent avoidance of the law and similar costing across the industry.

Case Study

Our client is an aged pensioner over 70 years old. She rang the Credit and Debt Hotline recently in a very distressed state because she has been caught in a vicious cycle pawning her jewellery to one company to pay the fees and charges on a pay day loan with another. She sometimes manages to recover the jewellery only to have to pawn it again shortly afterwards. Every time she pays off some of the interest she borrows more because she does not have enough to live on. She does not know the amount now owed, is afraid to open her mail and is scared her family will find out what a mess she's in.

Suggested improvements to the Bill

While we support the overall thrust and intent of the draft legislation we have a number of concerns:

- Undermining financial literacy and encouraging misleading marketing by allowing creditors to quote a rate other than an Annual Percentage Rate
- Possible Avoidance
- Enforcement expenses
- Other technical comments on the legislation
- Consequences of breach of the caps

We have read the comments of the Legal Aid Queensland submission on the issue of disclosing an APR and concur with those comments – small amount contracts should be required to disclose the equivalent APR to ensure that consumers are not misled.

We will therefore focus our detailed comments on the other points above.

1. Possible Avoidance

The introduction of a comprehensive cap in NSW was followed by the introduction of a range of techniques to avoid the cap and charge more than the legislation intended to allow. These loopholes were closed incrementally via amendments, including the latest changes made as part of the referral of powers legislation [Credit (Commonwealth Powers) Act 2010], but some techniques persisted and some new models emerged.

Case Study

Our client wanted to borrow $1000. In order to so she was required to "borrow" a DVD set on money management for which an extra $400 was added to the contract. She was then charged 48% on $1400 instead of $1000. When our client wanted to borrow more money at a later date, she was forced to "borrow" the same DVD set at a further cost of $400.
The following table evaluates the techniques in use both immediately before and after the enactment of the Credit Act against the draft legislation.

Case Study

We have now had 4 separate consumers who have used this same company through different agents. In each case they are lent an amount in cash but the loan is documented as a consumer lease. The clients are asked to volunteer goods they already own as "security" (fridges, washing machines, etc) but the paperwork reflects an arrangement whereby the consumer is leasing these goods from the lender even though they belong to the consumer.

The advantages of this arrangement for the high cost lender are that the amount borrowed is never recorded in the contract, only the amount of repayments; the cap is avoided and the loans are high cost; disclosure under the NCCP is significantly less than required for loans.

The clients are very disadvantaged with at least two of the four reporting mental illness as an ongoing challenge.

Technique	Permitted under draft legislation	Solution	Comments
Deferred establishment fee applied when contract paid out "early" – written as 48% compliant over longer period and then direct debits taken for larger repayments over shorter period including the DEF	No- Should be caught by 23A, 31A & 24(1A)	n/a	Important that this does not become a problem with general loans (over $2,000) – acknowledging the problems with current draft being overly onerous (constant recalculation required) it is vital that the 48% cap looks at the contract in its entirety rather than just at the outset.
Additional payments to CP deducted in cash & not reflected in contract	No - Should be caught by 39A (1) no part of credit amount to pay CP or prescribed person & 24(1A)(b) – requiring or accepting payment in respect of monetary liability not imposed consistently	n/a	This should be a breach of several provisions of the Credit Act because of the failure to fully disclose the terms of the contract.

	with this code– specifically 31A		
Mystery consumer B (contract is set up to involve two consumers, each liable for a different and separate amount – the consumer in a non-cap state signs first for a nominal amount loan, then the real borrower is signed up in a cap state such as NSW, jurisdictional provisions of the former UCCC relied on to determine that the law of non-cap state applies because it was signed there first).	No longer possible because national cap	n/a	n/a
Payment for draw down plus payment by reference to no weeks outstanding rather than amount	No- Should be caught by 23A, 31A & 24(1A). If structured as continuing credit then not small amount and must be under the 48% cap.	n/a	
A series of techniques requiring the borrower to purchase or lease other goods and services in order get a loan, or access the proceeds of the loan: a. Payment required for card used to access/draw down credit b. DVD Sale or lease c. Cheque cashing fee d. Broker fees	These techniques should be caught if the payment is accepted by the lender and financed under the contract by virtue of s39A. We are concerned however about the possibility of these amounts being charged by an entity other than the CP – for example a broker or other separate entity. (Although arguably this would be 3rd line forcing). We note that s. 32B(3) does not apply to small amount credit contracts.	Duplicate the effect of s32B(3) in relation to small amount contracts also. We also query whether the combined effect of s 11 of the NCC and the small amount lending provisions will be sufficient to deal with the sale of a DVD as opposed to a	We note that there are some objections to s32B(3). If this sections is amended in response to those concerns, then it must be absolutely clear that any arrangements where the price of goods are inflated, or where goods or services are essentially forced on the debtor as a condition of lending the money, or necessary to the practical completion of the contract (eg accessing the cash) then they must be caught.

		leasing arrangement. And/or ban broker fees for small amount credit	
Sham leases - We have seen a number of cases (so far all involving the same credit provider) where the credit contract is disguised as a lease over the consumers own goods thereby by passing all disclosure requirements and any limits on the cost of credit.	While a sham if proven should fall foul of the law, the cap on credit and not leases creates an incentive to set up these types of schemes. It also means that genuine lease customers are left with inadequate protection in circumstances where a loan would be more suitable and affordable.	The caps should be extended to include leases.	
Sham diamond sales	While we aware of this arrangement we do not have any contracts to evaluate.		

Case Study

A CCLC client borrowed from 10 different pay day lenders in varying amounts, and in some cases multiple times between July and October 2010. In all cases the money was used to pay a combination of the previous loans and current bills. With one lender he repeatedly returned for amounts between $700 and $740. Each time he repaid a loan from this lender he borrowed a similar amount again. He presented at CCLC because this practice has become clearly unsustainable and he cannot repay the amounts outstanding. This client has a job but has borrowed to unsustainable levels one small loan at a time. In each case the lender purported to assess his ability to pay but this consisted of no more than checking he had payslip and a bank account.

Recommendations:

- Brokerage fees and other ancillary "services" should be banned for small amount credit or in the alternative section 32 B(3), or a provision with equivalent effect should be applied to small amount credit contracts also to ensure that the costs are not inflated by brokerage fees, or other ancillary "services".
- There should be a section introduced to deal with avoidance generally and give ASIC the power to deem conduct avoidance in breach of that section.
- There should no possibility of moving avoidance techniques from small amount lending into the general lending sphere to avoid the 48% cap applicable to other contracts.
- The cap on costs should be extended to consumer leases.
- A civil penalty should be included for any breach of section 23A

Enforcement Expenses

Section 39B is essential to consumer support for this package. As it allows higher amounts to be charged initially in some cases than under existing law in some States and Territories, the capping of crippling default fees and other charges is essential to ensure net benefit for consumers. The exclusion of enforcement expenses from the operation of s39B has the potential to negate its effect entirely. Lenders could set up separate entities for the purpose of pursuing the consumer for payment and then charge these expenses back to the original entity to be added to the amount recoverable under s39B. As the amounts involved are essentially small and there is no security to repossess, we submit that the only real enforcement expenses that should be able to be claimed are those allowed by the small claims (or equivalent) jurisdiction in each state for the pursuit of a claim through the court.

Recommendation

Enforcement expenses are defined specifically and limited to only those allowed by the equivalent small claims jurisdiction in each State/Territory in Australia.

Other Technical Issues with drafting:

1. Consequences of breach of provisions

    a. We note that s 23A (2)(a) and (b) is intended to completely void any provision of a contract that imposes a monetary liability inconsistent with the Code, meaning the CP loses all fees and charges imposed by the provision, as opposed to those which exceed the amounts permitted to be charged only. This interpretation is supported by the Commentary on this section distributed along with the exposure draft. We query whether this intent could be avoided by imposing the unlawful charges in different provisions of the contracts to those that are permitted.
    b. We also note that section 39B (2) also uses similar terminology (provision....is void) but the rest of the section implies that it is only amounts charged above and beyond the limitation set in sec-section1- that is that the entire charge is not void, only the amount which exceeds twice the adjusted credit amount.

We submit that these sections should be made clearer so that any court or EDR scheme interpreting the law is left in no doubt of the consequences of a breach in either case, and any difference in intention (if one exists) is not obscured by the use of similar language.

2. Sections 124C and 133CD prohibit certain activities around increasing the limits of small amount credit contracts. It is unclear how this is relevant if a small amount credit contract cannot be a continuing credit contract. A possible avoidance mechanism is continuing credit contracts.

3. We note that some small amount lending contracts currently payment fees (eg $2 for direct debit, $3 for cash/cheque, $3 for bank transfer) – while these are clearly excluded in the range of charges that can be included in a small amount lending contract, it should be clear that they are included in the calculation of the 48% cap for other contracts.

Recommendations:

- The legislation is clear that a breach of the interest rate cap means that no interest or fees are payable.
- Clarify the regulation of continuing credit contracts and sections 124C and 133D. Small amount credit lenders should be clearly banned from using continuing credit contracts
- Charges for direct debits etc should be included in the calculation of the interest rate cap

Consequences of breach of the caps

While the exposure draft has specifically addressed the consequences of breaching the small amount lending provisions, it remains ambiguous on the consequences of breaching the generally applicable 48% cap. We note that there are a number of possible interpretations and no settled precedent on the issue:

- Loss of all fees and charges
- Potential of some or all fees and charges as a civil penalty only (i.e not available except via court or regulator action)
- Loss of fees and charges which exceed 48% (an outcome put forward as appropriate by an EDR scheme recently)
- The imposition of an amount of interest that is "reasonable" in the circumstances (the approach often taken by courts when looking at excessive interest as part of an overall unjust contracts claim).

Further, while a breach of the small amount lending cap is possibly clearer for individuals (subject to our comments above), it is not clear that it lead to a consequence under the civil penalty regime.

We submit that the consequences of breaches of both caps need to be clear with reference to:

- Deterrence
- Individual remedies via EDR
- Class and regulator action under the civil penalty regime.

Recommendation:

If the interest rate cap is breached it should automatically mean that no fees or interest are payable on the loan.

Commencement Date

The legislation for the regulation of small amount credit is very urgent. Two of the major states with this type of lending already have an interest rate cap so it is hard to understand why a long transition period is necessary.

Recommendation:

We recommend that the commencement date for Schedule 4 of the bill be 1 July 2012.

Prohibitions on refinancing (sections 124C and 133CC) and simultaneous loans (sections 124B and 133CB)

CCLC strongly supports these sections. We contend that the vast majority of consumers accessing these loans are on very low incomes so it is crucial to prevent multiple refinancing and debt traps.

Recommendation:

- the Bill is amended to include a prohibition on repeat borrowing to complement the refinancing bans at section 124C and 133C; and
- the bill is amended to include a regulation-making power for sections 133CB and 124B, and create regulations which describe the investigations that must be made by a lender or a credit assistance provider.

Additional consumer protections

CCLC supports the Consumer Action Law Submission in calling for the following additional protections.

Recommendation:

- prohibit lenders using —employer authorities to secure repayment of a loan—any garnishing of wages should only be done in accordance with court-supervised processes;
- prohibit contracts requiring loans to be repaid in a single repayment period and/or prohibit contracts from requiring any one repayment (including any fees or charges,

including default fees) being greater than the principal borrowed. This recognises that single repayment loans pose the greatest harm to consumers; and

- prohibit lenders requiring the signing of a direct debit authority and/or introduce a requirement for lenders to offer a range of repayment mechanisms—not just direct debits. This recognises that payday loans are commonly repaid by direct debits which remove payments from the debtor's account as soon as payment is deposited. Where a borrower has insufficient income to both repay debt and buy essentials, direct debit authorities ensure the debt is prioritised leaving them unable to pay for rent, groceries and utilities. This ensures that lenders wear little risk of losing their money on even the most irresponsible loans. In turn, this removes financial incentives to loan responsibly and actually creates incentives for irresponsible lending by encouraging repeat borrowing.

Consumer Leases

CCLC strongly supports the proposed reforms to increase consumer protection in relation to leases. A major problem in the past has been that leases have had a significantly lower consumer protections leading to the use of this product by predatory lenders.

The current problems faced by consumers using leases are:

1. Being promised that they can buy the goods with the lease contract directly contradicting that representation
2. Being penalised (often for the whole term of the contract) simply because the goods needs to be returned early for some reason. The concern is that this penalty does not represent the cost to the lessee of the early termination
3. Avoidance of the lease provisions by using indefinite term leases, leases under 4 months and false business purpose declarations
4. Difficulty in understanding the cost of credit due to a failure to disclose an interest rate - many low income/disadvantaged consumers pay very high costs to lease their goods and have to keep paying long after the goods have lost all value
5. Consumer misunderstanding about the effect of a loan or a lease
6. Difficulties returning the goods
7. Regulation on the use of the term "rent – to –buy". This is misleading when used in conjunction with a lease as it creates an expectation of a right to buy.
8. Issues arising when the goods are stolen. The insurance offered by rental companies is often inadequate. Many low income consumers cannot afford contents insurance.

Case Study

Ms. J has the full time care of her adult son who has serious mental illness including agoraphobia. Ms. J approached a big retailer to buy a television for her son as this is his main entertainment as he cannot leave the home. The retailer arranged a lease but assured Ms. J that for a small payment she could buy the television at the end of the contract. Ms. J got into financial hardship around a year later. She approached the lessor for help. The lessor told her they would be repossessing the TV and she would have to repay the whole contract even though it had another two years to go.

Recommendations

- Regulations created under section 175D should provide that statements disclose that the lessee will not own the goods at the completion of the lease. This should be very prominent in the key facts disclosure and be boxed and in bold.
- Regulate indefinite consumer leases
- The Annual Percentage Rate disclosed in the contract and the key facts statement
- The costs of the lease on early termination are capped at 3 months lease repayments after the return of the goods.
- That if the goods are lost or stolen the market value is assessed at the time of the theft and the consumer is only liable for this amount.
- "Rent-to-Buy" leases should be deemed a sale of goods by instalments
- The end of lease statement required by s175H to be prescribed in the regulations must include:
    - exactly when the lease ends
    - when the goods have to be returned
    - how and where to return the goods
    - how much is required to be paid and how this is calculated (if terminating early)
    - if the goods can be bought the total cost must be disclosed (and this should be reflected in the APR, or as an alternative APR that applies if the consumer wishes to buy the goods at the end of the contract)
- 177J - ASIC should have a longer time limit to investigate unjust leases. The time limit should be 2 years from the end of the contract or 6 years from the date of the lease - whichever is later. This is essential as an ASIC investigation into systemic misconduct may need to cover leases going back a few years.

Case study

A consumer wanted to buy her son an X-box for Christmas but did not have the cash and had voluntarily cut up her credit card. She knew she did not have time to replace the card before Christmas as it was only two days away. She was offered a consumer lease instead. The terms were very expensive – even compared to a credit card – the equivalent of between 30 and 40% interest after 12 months of payments. The salesperson said that for one extra payment the goods could be retained. As this was a present it was very important that goods could be retained at the end of the contract. The consumer reluctantly agreed to proceed.

The 12 monthly payments were made and then a 13th to secure ownership of the goods. The direct debit, however, continued to come out for a 14th month. The consumer contacted the lease company to complain. They said that contrary to what the salesperson had said it was necessary to contact the company and negotiate the amount of the final payment or the lease would continue indefinitely! This meant that the final cost of the goods could not be accurately estimated in advance and clearly exceeded the 30 or 40% per annum the consumer had reluctantly agreed to pay.

Financial Hardship

CCLC strongly supports the proposed changes outlined in the Bill for financial hardship. Financial hardship is the number one reasons for consumers seeking assistance in relation to credit.

Remedies for unfairness and dishonesty: Section 180A

CCLC strongly supports this section. Many of the cases dealt with by CCLC over the past 10 years have involved unfair and/or dishonest conduct by intermediaries such as finance/mortgage brokers. Without these amendments there is a risk that either consumers will be left without recourse, or that credit providers will bear the brunt of any remedy in circumstances where another party is at fault or partly at fault.

Reverse Mortgages

We also strongly support the changes being made in relation to reverse mortgages. This is a complicated area of credit and one which may involve people who are vulnerable and disadvantaged due to aging. We are concerned that in some respects the amendments do not go far enough.

Case Study

Mr. F is an aged pensioner and has been on the aged pension for the last 10 years. During that time he had a credit card with a major bank. That credit card had got to around $30,000 through a series of unsolicited limit increases offered by the bank. If the bank had made any enquiries it would have been obvious that Mr. F could not repay the credit card debt. Mr. F approached the bank for financial hardship. The bank offered to refinance him into a reverse mortgage. Mr. F felt very uncomfortable about this as he knew he might need to go onto a nursing home at some stage. He was also very worried about his children's inheritance. Mr. F tried to cancel the reverse mortgage but the bank told him he couldn't because the request to drawdown the loan had been sent that day. Mr. F received no advice prior to getting the reverse mortgage.

Access to advice

Reverse mortgages are a potentially very dangerous product. Consumer advocates believe that this type of product is fraught with possible consumer detriment and that a strong regulatory framework is required that is accompanied by funded independent specialist legal and financial advice. The proposed legislation does not address the advice issue. As a minimum this advice should be funded by industry levy or optimally by the government.

I note that by definition consumers who access reverse mortgages are often receiving the aged pension as their sole source of income. Legal advice from private legal practitioners is inadequate because it only explains the contract and there is almost no specialist knowledge. The legal costs are not affordable. Similar problems apply to financial planners.

The Productivity Commission Report

The Productivity Commission's recent report *Caring for Older Australians* identifies the need to provide for future funding of aged care and proposes:

"That *older Australians should not be required to sell their home to meet their aged care co-contributions or accommodation costs. For older Australians whose financial capacity is mainly in the form of their principal residence, there be a Government-backed Australian Aged Care Home Credit scheme, which they could flexibly draw against for their care co-contribution and other aged care accommodation costs up to a specified limit. The scheme would be designed to protect those remaining in the former principal residence, such as a spouse, partner or dependent child with a disability (and other protected persons). The scheme would charge interest on the outstanding balance at a rate equal to the consumer price index, but, as a safeguard, there would be a minimum asset floor below which no further funds could be drawn, and interest would be no longer charged.*

The proposal to use the family home to assist with the future costs of aged care, to ensure that appropriate options will be available to older Australians in the future, will only be effective if reverse mortgage products offered by credit providers are appropriately regulated. In particular, the reverse mortgage legislation must be harmonised to ensure it works with the productivity commission recommendations.

To be able to meet the above recommendations of the Productivity Commission it is essential that the proposed legislation address:

1. Adequate disclosure to ensure that consumers will be able to access aged care by using the family home. If the reverse mortgage means that the consumer may lose that opportunity the warnings need to be very specific. I am concerned that the current disclosure proposed will not meet that requirement

2. That older persons have access to adequate advice to properly consider the impact of a reverse mortgage on the ability to access aged care.

As pointed out in our earlier submission it is essential that elderly, and often vulnerable, consumers contemplating obtaining such products obtain independent and expert legal AND financial advice. Otherwise there is no way of ensuring, for example:

1. That alternatives such as downsizing are considered

2. That the social security implications of the funds released are considered e.g. a reduction in the rate of the age pension

3. That resultant limitations on the age care options available are considered

Expert advice is required before the product can be obtained so that an informed choice can be made.

As it stands, the reverse mortgage draft legislation is not consistent with the productivity commission recommendation. As a matter of sound public policy this needs to be addressed.

Technical changes

Recommendations

18C should require legal and financial advice