

**SUBMISSION TO MINISTERIAL COUNCIL ON
CONSUMER AFFAIRS**

**SOLICITOR LENDING, INSTALMENT CONTRACTS
AND THE CONSUMER CREDIT CODE**

Prepared by

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and
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Introduction

The Consumer Credit Legal Service (Vic) (**CCLS**) and the Consumer Law Centre Victoria (**CLCV**) welcome the opportunity to make a submission on the *Credit & Financial Services Solicitor Lending, Installment Contracts and the Consumer Credit Cod Consultation Package* (the **Consultation Paper**).

Who we are

CCLS is an independent non-profit community legal service. CCLS provides legal assistance and advocacy to individuals and groups who have been mistreated in the financial services market and who are disadvantaged in their access to legal redress. CCLS also aims to influence and effect reform to unfair practices and the law through policy work, research and advocacy. The service is primarily funded by Consumer Affairs Victoria, Victoria Legal Aid, and the Federal Attorney-General.

CLCV is one of Australia's leading consumer and public interest organizations. A not-for-profit, independent organization, we undertake research, policy development, advocacy and education. The CLCV is currently working a range of issues that affect the consumer interest, including utilities, competition and consumer protection policies, financial services, telecommunications, exploitative credit and access to justice. The CLCV also operates a large consumer legal practice assisting thousands of low-income consumers each year with free legal advice and representation. The CLCV's work is focused on advancing the interests of consumers, particularly low-income and disadvantaged consumers.

Uniform Consumer Credit Code (UCCC)

We have previously expressed a range of concerns about the UCCC. The main areas of concern are:

- A lack of a licensing regime for credit providers and other protections provided to consumers of other financial services. This limits the ability of regulators to take effective action to address exploitative practices or systemic issues until after problems have occurred, and excludes many credit consumers to access to industry alternative dispute resolution;
- Widespread avoidance of coverage of the UCCC. Long delays in processing required amendments in response to industry practices fails to provide any deterrent to the development of avoidance strategies; and
- The UCCC is ineffective in preventing the most unfair and exploitative lending practices.¹

A key issue impacting on the relevance, and impact of the UCCC today is the increased involvement of third parties in the process of obtaining consumer credit. The UCCC recognises the role of linked traders, and proposed changes recognise the

¹ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, Submission to Consumer Credit Code Issues Paper, (August 2004), available at <http://www.clcv.net.au/index.aspx?id=222&newsid=33>.

role of finance brokers and of solicitors as intermediaries. However, the use of intermediaries remains an effective way of avoiding either coverage of the UCCC or consumer protections under the UCCC. The use of two or three intermediaries is not uncommon, and some intermediaries might not be covered by finance broker regulation, such as “car brokers”, loan introducers (who introduce borrowers to brokers) or companies established to facilitate vendor terms and similar agreements.

Unless credit legislation can cover the entire credit transaction, we will continue to see the involvement of intermediaries contributing to the reduction in consumer protection offered by the UCCC.

Solicitor Lending

We have previously documented a number of ways that consumers lose the protection of the UCCC², including the use of false business purposes declarations and the provision of credit by individuals who are not (or claim that they are not) in the business of lending. Some of these loans are arranged by solicitors. These forms of credit are often provided to the most vulnerable consumers by finance brokers and legal firms that focus on providing credit to consumers who already in financial difficulty. In many cases, there is more than one intermediary involved, for example one or two finance brokers (or introducers) as well as a legal firm.³ Such cases are often seen by CCLS, and they usually require more time and resources than other types of cases. One reason for this is that we must address the issue of whether the UCCC can be applied, for example by raising issues about the business purposes declaration or by ascertaining whether the lender was, in fact, in the business of lending. In some cases, where the lender is an individual, we must ascertain whether the individual has made a number of loans and is therefore in the business of lending.

Section 6 of the UCCC excludes a number of different credit arrangements from coverage of the UCCC. For example, loans between friends and family are excluded, as are some loans provided by individuals who are in the business of lending but where there is insufficient information about the individual’s business dealings to establish this. A loan may be excluded where the provider of the credit is an individual, even where the intention is that the loan is provided for the purpose of profit and the loan may:

- include significant interest, fees and charges;
- involve payment of fees to one or more intermediaries; and
- contain severe penalty fees.

The following case study illustrates the problems caused by the limited coverage of the UCCC.

² David Niven & Tim Gough for Consumer Credit Legal Service Inc., *The Operation of the Uniform Consumer Credit Code: Why is it failing consumers?* (August 2004) available at <http://www.ccls.org.au/pdfs/ucccreview.pdf> and Nicola Howell (2004) Solicitor lending to consumers: a study of interest only loans and asset based lending practices in Victoria, for Consumer Credit Legal Service Inc (Vic), available at <http://www.ccls.org.au/Copy%20of%20pdfs/summary.pdf>.

³ *Neuendorf v Rengay Nominees Pty Ltd* [2003] VCAT 1732.

The consumers approached a finance broker who put the credit application to a legal firm. The two lenders appeared to be the wives of solicitors. One of the husbands appeared to be a principal of the law firm arranging the credit. The other appeared to be a solicitor who had provided credit to consumers in the past. A clause in the Mortgage stated that “the Mortgagor acknowledges that the Consumer Credit Code will not apply to (or regulate) the Mortgage as the Mortgagor has been advised that the Mortgagee is not in the business of providing credit, nor does the Mortgagee provide credit as part of, or incidental to, any other of the Mortgagee’s business.”⁴

In our experience, many solicitor loans involve a number of intermediaries. While it is suggested that the solicitor has the “primary dealings with the debtor”⁵ our recent experience shows that this is rarely the case with solicitor lending. Our cases show one, or two intermediaries between the solicitor and the debtor.

While this type of lending has, in the past, been undertaken predominantly by legal firms, it is not always the case that a legal firm is involved⁶. Loans from individual investors are also arranged by finance brokers, and we cannot see any reason why accountants might not also arrange such loans (as suggested in the Consultation Paper).

Given the issues raised above, ideally, changes to the UCCC would address issues wider than solicitor lending, to cover all intermediaries involved in providing credit to consumers. It is likely that the outcome of the proposals in the Consultation Paper will simply lead to finance brokers or other persons replacing solicitors as the intermediaries between the lender and borrower. Legal firms who wished to continue their involvement in this work could simply establish a separate company (not a legal firm) to arrange the credit. Such a company could still refer all related legal work to the legal firm.

Will the proposed amendments cover the practice of solicitor lending to consumers? If not, how can the proposals be improved?

The proposed amendments would cover the practice of solicitor lending. However they would not prevent entities other than legal firms continuing to arrange unregulated loans from individual investors. Legal firms who wished to continue this form of lending could establish related firms to arrange the credit.

In our view, in order to provide UCCC coverage in all these circumstances, the following should be inserted into Section 6(1)(e) of the UCCC to ensure coverage of loans by individuals if commercially arranged:

⁴ Case Study, Consumer Credit Legal Service, 2005.

⁵ Uniform Consumer Credit Code, Post Implementation Review, Ministerial Council on Consumer Affairs, Final Report, December 1999, at 60.

⁶For example, see *Millard v H&H Lobert Nominees Pty Ltd* (1998) ASC 155-011.

*the person arranging the credit arranges the credit in the course of a business of arranging credit or as part of, or incidentally to, any other business of the person arranging the credit.*⁷

Should other service providers that facilitate lending (such as accountants) be included? If so, which occupations and why?

See above. We consider that loans facilitated by all intermediaries, regardless of their profession, should be covered by the UCCC.

Will the proposed amendments pose significant problems for solicitors in complying with the Code's provisions? If so, why? How can the provisions be improved?

See above. We do not believe that solicitors would continue arranging these loans if only those loans arranged by solicitors were regulated. However, these loans could continue to be arranged by other intermediaries (and if solicitors wished to continue to facilitate loans, they could establish a finance broking or similar business).

Will the deeming of law firms to be credit providers cause concern? If so, what are these concerns?

See above.

Do you think that the proposal outlined in the Drafting Note is a better alternative? If so, how can compliance with the Code's obligations be secured if the lender were to be the credit provider?

See above.

Sale of Goods by Instalments and Tiny Terms Contracts

From the perspective of our agencies, we consider that there is significant consumer detriment arising from the use of conditional sale of goods by instalments and tiny terms contracts that do not comply with the requirements of the UCCC. In particular, we have discussed problems arising in the area of motor vehicle sales in various other submissions and reports.⁸ As such, we support, in general, the proposal that conditional sales of goods by instalments and tiny terms contracts be specifically included in the UCCC.

Do the proposed amendments succeed in bringing conditional sale of goods and tiny terms under the Code? If not, how can they be improved?

The proposed amendments appear to succeed in bringing conditional sale of goods by instalments and tiny terms contracts under the UCCC. However, we note the following concerns.

⁷ Nicola Howell (2004) Solicitor lending to consumers: a study of interest only loans and asset based lending practices in Victoria, for Consumer Credit Legal Service Inc (Vic), available <http://www.ccls.org.au/Copy%20of%20pdfs/summary.pdf>.

⁸ CCLS and CLCV, above n 1; CLCV, *Buying a Car – Pitfalls for Consumers* (2004) <http://www.clcv.net.au/index.aspx?id=191&newsid=30>; Niven and Gough, above, n 2.

Firstly, we are concerned that the definition of “cash price” in Schedule 1 of the UCCC may give rise to problems determining the value of the charge. In this regard, we support the comments made on this issue in the submission to the Consultation Paper by the Centre for Credit and Consumer Law (the **CCCL Submission**) and suggest that the “cash price” should be defined as a market average cash price.⁹ Our casework experience suggests that proving that the cash price of goods (for example a car) is inflated could be a barrier to seeking redress. For this reason, we also consider that any credit provider that wished to argue that the UCCC did not apply because of a high cash price that applied to the goods should have the onus of proving that the cash price has not been inflated.

Secondly, we consider that consumers entering into contracts of this nature should have the full benefit of protection under the UCCC. For this reason, we consider that a provision similar to that in section 10(1)(f) of the UCCC should also apply to contracts that come under the UCCC through the operation of section 9B, so that the property passes to the consumer and a mortgage is taken to have been entered into. This would give consumers entering into these types of contracts the same protection as that provided for in relation to other types of credit contemplated by the UCCC. In our submission, this was the original intention of section 10.

Will the proposed amendments enable the credit providers to provide disclosures required under Section 15 of the Code?

We note the advantages to consumer of ensuring that credit providers are required to provide disclosures required under section 15 of the UCCC.

We also support the comments and suggestions made in the CCCL Submission in relation to this question.¹⁰

⁹ Centre for Credit and Consumer Law, Griffith University, *Credit & Financial Services: Solicitor Lending, Instalment Contracts, and the Consumer Credit Code Consultation Package* (November 2005) at 5.

¹⁰ As above, at 6.

Sale of Land by Instalments

As noted in the Consultation Paper, there are different ways in which sale of land by instalments contracts operate. Sales of land by instalments contracts (**vendor terms**) can be used in circumstances where a vendor is selling a property, and is prepared to extend credit to the purchaser over a short, or a longer, term. While not a common form of housing finance, it is occasionally used.

However, this form of contract is also used for the sale of a property, by an investor, who has obtained finance to purchase the property. In this case, the investor's financial institution has a mortgage over the property. In our experience, the property may be sold for more than its value (often 10 to 20% more, but in some cases around 80% more), and the interest rate charged is somewhat higher than the interest rate being paid by the investor. The term "vendor terms" is often used for these contracts, but they are also often called "wraps". In our experience, a wrap can leave the consumer exposed to major risk. The investor borrows to purchase the property, and the property is often highly geared, as this form of investment tends to be promoted on the basis that the purchaser pays off the loan. In many cases, there is no restriction on the investor if he or she wishes to draw down extra mortgage payments. If the investor fails to make the mortgage payments, the mortgagee has no legal obligation to the purchaser, and can sell-up the home to pay the investor's loan. In Victoria, the *Sale Of Land Act 1962* provides some limitations on sales of land by instalments to protect purchasers but there is still considerable risk associated with a wrap. For these reasons, we consider that wraps should be prohibited.

We note that all vendor terms contracts, other than in some limited circumstances, are prohibited in South Australia but that in most other States and Territories it is possible to enter into either vendor terms contracts or wraps.

However, despite the reservations expressed above, and in the absence of any prohibition on wraps in most States and Territories, we consider that these contracts should be regulated by the UCCC and that the approach taken in the Consultation Paper is appropriate.

Will the proposed amendments enable credit providers to provide the disclosures required in Section 15 of the Code?

We do not see any problem with the amendments enabling credit providers to provide disclosures, apart from potential difficulties in determining "cash price" – see below.

Are the proposed laws consistent with other legislation applying to vendor terms such as the Sale of Land Act 1962 (Vic)? If not, why not? What are the consequences and how can the proposals be improved?

The *Sale of Land Act 1962* (Vic) provides for a detailed scheme for the regulation of sales of land by instalments contracts. However, it is not a scheme that provides for the kind of requirements imposed on credit providers under the UCCC and we do not think that two schemes are incompatible.

Will the proposed amendments relating to the “charge” for the provision of credit present any tax implications for the vendor? If so, what are they and how can the proposal be improved?

We do not have a particular view on this issue. However, we would be concerned if any potential for the protection of consumers under the UCCC is reduced in order to protect tax benefits received by a vendor in these circumstances.

Will the proposed amendments enable the “cash price” of the land to be readily determined? If not, why not? How can the proposals be improved?

Establishing “cash price” can be difficult without expending resources on a qualified valuer. If the contract is a wrap, often the investor has purchased the property a short time before the contract is entered into. If the property was purchased in the previous 12 months, the vendor should be obliged to either obtain a qualified valuation, or to state the purchase price as the “cash price”. If purchased prior to that, the onus should be on the investor – not the consumer – to determine the “cash price” if there is a dispute.

Will the proposed amendments enable the “charge” for the provision of credit to be determined? Is the exclusion of “outgoings” appropriate? If not, why not? How can the proposals be improved?

The amendments would enable a “charge” to be determined. However, as stated above, the determination of “cash price” could present some problems. While the exclusion of “outgoings” from the cost of credit is probably appropriate, it is important to note that for many consumers who are unable to complete these agreements, a wrap becomes a very expensive tenancy. However, unlike other tenants, they have maintained payment of land rates and other expenses that a tenant would not usually be required to pay. This situation exacerbates the risks discussed above in relation to wraps.

Application of Part 2B of the *Fair Trading Act 1999* (Vic)

Despite our support for the inclusion of sales of goods by instalments, tiny terms contracts and sales of land by instalments under the UCCC, we note with concern that any contract covered by the UCCC is, at present, excluded from the consumer protections provided for in Part 2B of the *Fair Trading Act 1999* (Vic). On balance, we view the protections in the UCCC will provide some improved protection for consumers entering into these types of contracts, compared with the current arrangements. However, we are strongly of the view that it is not appropriate that contracts covered by the UCCC are excluded from Part 2B or any future legislation to be implemented on a national basis that prohibits unfair contract terms in consumer contracts.