

Consumer Credit Code Amendment Bill 2007
Consumer Credit Amendment Regulation 2007-09-04
August 2007

Joint Consumer Response
September 2007

This response has been prepared on behalf of the following organisations:

Consumer Action Law Centre (Vic)
The Centre for Credit and Consumer Law (Qld)
Legal Aid Queensland
Consumer Law Centre (ACT)
CARE Financial Counselling (ACT)
Consumer Credit Legal Service (WA)
Consumer Credit Legal Centre (NSW)

The Legal Aid Commission of NSW has also had considerable input in relation to some sections of this submission but, due to time constraints, is still awaiting internal approval of the completed document. We hope to obtain their endorsement within the next few days.

We thank the State consumer protection agencies and the working group for the opportunity to respond to these important proposals.

All of the above organisations have first-hand experience of consumer detriment as a result of problematic fringe lending as a result of extensive advice and casework, or consultation and research, or all of the aforementioned.

In this document the Uniform Consumer Credit Code or "UCCC" has been referred to throughout as "the Code".

Importance of Mandatory External Dispute Resolution

Before considering the specific proposals contained in the consultation package, we note that a requirement for all lenders to be members of an ASIC approved external dispute resolution scheme would be extremely beneficial for all borrowers affected by fringe lending. We realise that this recommendation is being considered as part of a separate process but take this opportunity to reiterate how important that development would be in the context of fringe lending, and to appeal to the State government representatives to do anything in their power to expedite that process.

Summary of Responses

The following proposed amendments are supported, albeit with suggestions for further reform in some cases:

Clause 4: capture of fees paid to third parties etc in determining whether the Code applies, amendment to refine the definition of pawnbroker.

Clause 6: requirement to express fees and charges in the “nature of interest” in the APR.

Clause 7: prohibited securities.

Clause 8-10, 12: minor amendments to give effect to other changes.

We also support the changes to section 72 in **Clause 11** in relation to fees. We note, however, some confusion created by the drafting. We also note that while we are enthusiastically in favour of limiting default fees to underlying costs, this strict approach would not be necessary in relation to other categories of fees if all States implemented a comprehensive cap on the cost of credit.

While strongly support the intention behind **Clause 5** and the related **Clause 13**, we are strongly opposed to the solution proposed for the reasons outlined below. We are seeking more time to consult with industry and put forward an alternative proposal.

Detailed responses to the proposed Clauses

Clause 4 - Amendment of s7 (Provision of credit to which this Code does not apply).

Insertion of sub-section (1A): Supported

The stated purpose of the proposed subsection is to "capture fees and charges that may or may not be set out in the credit contract, but which must be paid to a person including a person other than the credit provider, in connection with the credit contract." We support this amendment.

The amendment generally addresses the problem of credit providers avoiding the Code by loading up commissions and associated administrative charges (such as “cheque cashing fees”) in order to avoid coverage of the Code. It should bring within the ambit of the Code all loans where the effective cost to the consumer is in excess of the prescribed limits regardless of whether those costs are described as credit fees or charges, or paid to a third party, or charged as part of a separate arrangement that is nonetheless necessary for the credit contract to be put into effect.

Simply capturing these short-term loans using "broker loaded" fees to split entities or related entities, and other tactics, to avoid regulation will enhance protection for the usually vulnerable consumers using these products. The unjust contracts provisions of section 70, section 66 in relation to hardship variations, and the enforcement protections in section 80 of the Code will apply, for example.

The amendment will not, however, capture such fees for the purpose of the interest rate caps in NSW and the ACT, and it will not necessarily allow these fees to be challenged under the proposed clause 72.

The clause is specifically stated to be confined to the purpose of s7(1)(b), suggesting that the extended definition is not intended to give any broader rights in relation to these fees other than to bring the main contract within the ambit of the Code. The request in the accompanying notes in the consultation package clearly envisages possible disclosure of these fees, but nothing more. (The question in relation to appropriate disclosure is considered below.)

The maximum interest rate provisions in both NSW and the ACT both refer to interest charges and all fees and charges *under a credit contract*.¹ This means that there remains an incentive for fee splitting and other strategies to continue, despite the proposed clause 7(1A). We submit that these provisions should be amended to address this.

Similarly, while the proposed Clause 72 is very broad, and the words “under a credit contract” have been omitted from Clause 72(1)(f), the reference to the *credit provider’s* underlying costs or losses in Clause 72(6) is likely to ensure that the clause is not interpreted to include the ability to challenge payments to third parties, including split entities, as unreasonable. We suggest that consideration also be given to addressing this potential loophole.

Disclosure: We submit that this could be achieved fairly simply by adding a clause in 15(G) [that would be 15(G)(d)] requiring the disclosure of fees or charges payable by the debtor to anyone else in connection with the provision of the credit, whether or not the fees and charges are payable under the contract.

<p>The amendment to capture fees payable to third parties or under associated arrangements is supported but we recommend further amendment to address the fact that these fees will not necessarily be caught by the comprehensive interest caps in NSW and the ACT, or the proposed Clause 11.</p>

Amendment of sub-section (7) and insertion of sub-section (11):

Supported in so far as the intention is to refine the current exemption. However, we note that the continued exemption of pawn broking from all but the unjust contracts provisions of the Code is an anomaly. Pawnbroking should not be exempt from the Code. Pawnbroking involves the provision of credit and consumers should be entitled to the same protections for pawnbroking loans as they are for other loans regulated under

¹ Consumer Credit (New South Wales) Act 1995, Section 11(2), Consumer Credit (New South Wales) Special Provisions Regulation 2007 – Regulation 6(2), Consumer Credit Act 1995 (ACT), Section 8B(2) and the Consumer Credit Regulation 1996 (ACT), Regulation 5(2).

the Code. There is no good reason to have pawnbroking separated from the Code with separate, non-uniform legislation in each state and territory.

We support the proposed amendments in relation to the definition of pawnbroking but note the continued exclusion of pawnbroking from the majority of the Code is an unjustifiable anomaly.

Clause 5 - Amendment of s11 (Presumptions relating to application of Code): Opposed

The provisions of section 11, particularly s11(2) in relation to business and investment purpose declarations, have constituted a well-known loophole to compliance with the Code, depriving vulnerable borrowers from the protection the Code affords and rendering the law optional for those intent on avoiding it. What has been created by s11(2) is a two-tier system, perhaps best described by two different employees of a finance broker giving evidence in the NSW CTTT about the same transaction:

*Employee 1: The Applicants [the borrowers] would have been unable to obtain a personal loan as they were **unable to provide proof of income**. The only appropriate means to obtain finance would be a mortgage (emphasis added).*

*Employee 2: It would have been impossible for the Applicants to obtain a personal loan, if they [the broker] **cannot do a loan conforming with the provisions of the Code then it may be appropriate to obtain a different type of loan**. A limited credit history must have been provided by the Applicants as the Respondent [the broker] only arranges private mortgages in such circumstances (emphasis added).*

In this way, those borrowers most in need of protection because they are desperate for funds and are unable to qualify for a mainstream loan, are left vulnerable to asset lending, inappropriate short-term loans and the imposition of unconscionable fees and charges. Finance broker legislation in both NSW and Victoria is also dependent on attracting the jurisdiction of the Code and is therefore also avoided in the same manner.

We appreciate that the intent behind the proposed amendments is to close this loophole and extend the protection of the Code to those most in need. Unfortunately, in our view, the proposed amendment will make it easier for lenders who wish to avoid the Code by using sham business purpose declarations compared with how s11 operates currently.

The proposal contained in clause 5 has a number of fatal flaws if the intention is to improve protection for vulnerable borrowers and seriously curtail avoidance of the Code. There is ample evidence of the desire of unscrupulous lenders to avoid the Code. We see no reason as to why the methods which allow the current s 11 to be abused won't be exploited just, if

not more, effectively if the proposal proceeds. For the following reasons we believe that the proposal will make the current situation worse:

1. The proposed 11(2)(b), allows the presumption in favour of the application of the Code to be defeated simply by “information” given “by or on behalf of the debtor” that the loan is wholly or predominantly for a business or investment purpose, or both”. This is a very low evidentiary burden for the credit provider. The proposed subsection does not require that the “information” supplied by or on behalf of the borrower is consistent, or credible, or that it contain any substantial detail. Nor is there any requirement for the credit provider to form any opinion as to the purpose for which the credit is intended, let alone any need for such an opinion to be formed on a reasonable basis. Nor is there a requirement for any verification of purpose. Instead of getting a business purpose document signed, unscrupulous credit providers or brokers can simply supply a document, or complete the lenders application form, setting out a spurious business or investment purpose. Indeed in many cases in which we have assisted consumers to *successfully* challenge the validity of a business purposes declaration, there has been information supplied to the lender, or the lender’s representatives, sufficient to satisfy this clause.
2. The existing sub-section 11(2) of the Code creates a conclusive presumption excluding the application of the Code by the simple signing of a business (or investment) purpose declaration (“**BPD**”), creating considerable difficulties for borrowers seeking the protection of the Code where such a declaration has been taken. Section 11(3) however provides an opportunity for borrowers who had signed false BPDs, often on the advice of a broker, to argue before the court that the lender, broker or other relevant party was actually aware that the credit was for personal or domestic purposes, or had reason to believe that this was the case, and allowed the transaction to proceed despite this (thereby colluding in the deception and benefiting from the lower regulatory burden in relation to non-Code loans). This is an important provision that, while able to be circumvented by a meticulous lender/intermediary intent on doing so, did allow some important cases to succeed where the lender or its representatives were, or should have been, on notice that the loan was not for a genuine business or investment purpose but was being documented as such to avoid the need to comply with the Code.
3. Once a business purpose declaration has been set aside, either because it is technically invalid, or because of s 11(3), the court must then make a decision about purpose of the loan in accordance with section 6 of the Code. There has been a divergence of judicial opinion as to how to interpret s 6(1)(b) of the Code. This subsection limits the application of the Code to situations where “the credit is provided or *intended to be provided* wholly or predominantly for personal, domestic or household purposes” (emphasis added).

There have been a number of different approaches taken to the interpretation of this subsection. For example:

- a) *Rafiqi & Anor v Wacal Investments Pty Ltd* (1998) ASC 155-024 in which Brabazon DCJ held, that "The fact that in s. 6(5) the words 'purpose for which credit will be **used**' appear, put the emphasis on the *information given by the debtor to the credit provider* (emphasis added). Section 6(1)(b), it was held, allows an objective approach to be adopted, namely that the purpose for which credit is intended to be provided will be that which a reasonable person standing in the shoes of the credit provider would have understood the predominant purpose for which the credit was provided. And also that "Any other interpretation would put an intolerable burden on the credit provider."
- b) *Linkenholt Pty Ltd v Quirk* [2000] VSC 166 in which Gillard J held, at [98], "In my opinion, it is appropriate to consider what the money was used for in order to determine the purpose of the provision of the credit. In considering the question it is important to consider the substance of the transaction in the context of its performance."
- c) *Dale v Nichols Constructions Pty Ltd* [2003] QDC 453 in which the approach taken in *Rafiqi* was expressly rejected with McGill DCJ saying "In my opinion whether credit is provided for a particular purpose for the purpose s of s 6(1) depends on the intention of the borrower at the time the credit is provided, and not the intention of the lender."
(p.7)

In this context it is important to note the importance of the conclusive presumption under s 11(2) in countering the argument that "any other interpretation would put an intolerable burden on the credit provider". This was specifically referred to by McGill DCJ, at [28], "If paragraph (b) is concerned with the debtor's actual purpose, that is consistent with the structure of s 11. Section 11 starts from the presumption that the Code applies...However the credit provider is not thereby put in the position of being forced at a later stage to prove the true purpose of the borrower when entering into the transaction in order to escape the operation of the Code, the prospect of which concerned Brabazon DCJ. [37] Subsection (2) provides a mechanism by which a credit provider can protect itself from a debtor who might not be frank about the true purpose of the loan ..." And the comments of McGill DCJ were recently referred to by Smart AJ in *Benjamin v Ashikian* [2007] NSWSC 735, at 75 - "The Code provides a way for credit providers to protect themselves in s 11. While s 11 is an evidentiary provision nevertheless by subs (2) there is a conclusive presumption...."

In our view the proposed Clause 5 virtually invites the Courts to adopt a *Rafiqi* approach to purpose, thereby winding back the advances for

consumers in the more recent case law. The proposed clause 5 does this in two ways, firstly by removing the conclusive presumption afforded by s 11(2) which has lent some comfort to judges in reaching a more consumer friendly interpretation of s6(1)(b), and secondly in placing what appears to be conclusive importance on any “information” given to the credit provider by or on behalf of the debtor.

4. It would appear that once the credit provider has obtained the required information under clause 5, which will often be via a finance/mortgage broker, it doesn't matter what information they later acquire to suggest that information is false, they are still entitled to rely on having satisfied the clause. Arguably this clause could be satisfied prior to the completion of a loan application form, and certainly prior to the supply of any information pursuant to pre-contractual conditions. This is not always the case at present. While the current provisions require the declaration to be completed prior to the contract being entered into, in practice the declaration is often supplied to the credit provider along with other application documentation. If it can be shown the credit provider knew or had reason to believe that the declaration was false "at the time the declaration was made" the declaration will be ineffective. In *Permanent Mortgages v Cook* it was held that the declaration was made at the time it was *received* by the credit provider's solicitor and, as at this time it was accompanied by other documents that should have established some doubt as to the truth of the matter declared (“given reason to believe” that the loan was in fact for personal purposes), it was ineffective. Under the proposed clause, this other information would be completely irrelevant.

Similarly, under the proposed provision, a credit provider having received inadequate or inconsistent information as to purpose, as in the Cook's case, could simply rectify this by asking the question again and receiving the “right” answer.

5. The proposed clause leaves the current position at common law that the broker will generally be considered the borrower's agent undisturbed. Under the current s 11(3) the credit provider will be fixed with the broker's knowledge of the falsity of the declaration, thereby rendering it ineffective, where the broker "obtained the declaration from the debtor".

In short, while the special evidentiary value currently attributed to business/investment purpose declarations has been removed, the replacement retains many of the weaknesses of the current provisions and yet lacks the balancing effect of the current sub-sections 11(2) and (3). In the words of Patten A J in the NSW Supreme Court matter of *Permanent Mortgage v Cook* “...it is clear that the Plaintiff [the lender] whilst perhaps indifferent to the Defendant's actual purpose, intended to ensure that the transaction was not affected by the Code.” The proposed amendments will do nothing to address this central issue, namely that lenders need have no genuine interest in the loan's “actual purpose”, only an interest in having sufficient “information” on which to rely to ensure that the loan is not covered by the Code.

We are working to develop an alternative amendment to address this issue. We intend consulting industry representatives in this process. Additional time will, however, be required to complete this process. We will endeavour to complete this task as soon as possible, and by 3 December at the latest.

Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook [2006] NSWSC 1104 (24 October 2006)

A truck driver with an intermittent work history, including periods of illness and accident related incapacity, and his wife (who had no income of her own apart from any social security/family tax entitlement) sought to refinance their home mortgage, which was seriously in default. They also sought funds to cover a very expensive short-term loan taken out to cover mortgage arrears. This was the last in a long series of refinances, all of which were for exclusively personal purposes.

The loan application submitted to the solicitors for the lenders was deficient in a number of respects:

- The loan purpose was blank
- The Question “is the loan purpose predominantly (more than 50%) for investment or business purposes or for both?” was blank
- The assets and liabilities section was blank
- There was an adequately completed income declaration that, in addition to details of the borrower’s income, had the words “This loan is to pay out a previous loan with Liberty Financial which is in default” handwritten on it by the borrowers’ solicitor.

There was nonetheless a validly completed business or investment purposes declaration signed by the borrowers, albeit in the form of an Oath rather than a declaration.

The learned Judge, his honour Patten, AJ, found first that the lender had failed to rebut the presumption in 11(1) that the Code applied and that it was therefore only left to decide whether the lender could rely on the business/investment purpose declaration in accordance with s11(2). He determined that the declaration was valid despite the deviation in form (Oath rather than a declaration), but that the lender could not rely on it as a result of s 11(3). Specifically, at the time they (or their agents, in this case their solicitors) received the declaration from the debtor, they “knew or had abundant reason to believe that the credit was to be applied wholly or predominantly for personal, domestic, or household purposes [65].”

In drawing this conclusion his honour summarised the knowledge of the lender as follows:

The knowledge of the Plaintiff when it received Meehans letter of 10 April comprised, inter alia, 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 and that, in a number of significant respect [sic], the Lending Procedure Manual of La Trobe had not been complied with [64] .

It is pertinent to then consider this case against the proposed Clause 5. So far, so good - the lenders have failed to make inquiries about the purpose of the credit to be provided. It is relevant at this point, however, to return to the facts of the case to consider what happened next.

Having received the inadequately completed application form, the lender's solicitors remitted them to the borrowers' solicitor for additional information. At that point, the borrowers added in the word "refinance" against the question requesting details of the loan purpose; answered the question in relation to whether the loan for predominantly for business or investment purposes, "no"; and completed the assets and liabilities section. Again the lender's solicitors were dissatisfied and wrote to the borrower's solicitors as follows:

We note that you indicated that the loan was not predominantly for business purposes. Please confirm if this is true. If no, we require confirmation that the loan is predominately for business purposes and an explanation as to why this question was answered no and authority to amend your clients answer to "yes" on the relevant form."

In response to this the borrowers were called into their solicitor's office and advised of the need to amend their answer to yes if they wished to obtain the loan. This amended form was then faxed back with a covering note to the following effect:

We also enclose herewith amended and initialled Application for Finance form. We note that our clients complete this form without assistance and as such misunderstood the questions and answered incorrectly.

It is possible that this exchange would have been considered sufficient to satisfy the requirements of the proposed Clause 5 amendment 11(2): the lender has made a clear inquiry about whether the loan is intended to be for a business or investment purpose and the borrower has replied with a form amended to say "yes". Further, while it has been argued that some judges have failed to give proper consideration to the beneficial nature of the legislation in applying s6(1), determining whether the presumption in 11(1) has been defeated, or in determining whether a credit provider knew or had reason to believe a loan was in fact for a predominantly personal purpose in accordance with s 11(3), Clause 5 only serves to exacerbate this problem by giving legislative authority to this "asked and answered" approach.

Recent CCLC Cases

CCLC recently won a case in the CTTT where the consumers had signed not only a business purpose declaration, but also a "business loan application form" detailing a business name and false loan purpose. The consumers in

question wanted the money for kitchen renovations. They did have an ABN and bred dogs, for which they were paid \$300 or \$400 per dog. However, they only sold a handful of dogs in any given year, and were reliant almost exclusively on social security payments. The broker was fully informed of their true intentions in relation to the loan and coached them in relation to the application by asking “if you had a proper business, what would it be?” to which they replied “mobile dog wash” because they had seen this on the TV. The loan was for \$10,000 with an interest rate of 10% per month, reverting to 15% in the event of default. The case was primarily successful because of a technical problem with the timing of the signing of the business purposes declaration, but the Tribunal member also indicated that he would have attributed the knowledge of the broker to the credit provider under section 11(3) had the declaration been otherwise effective.

We have now spoken to two other couples, unknown to each other, who have dealt with the same broker and credit provider, although one did not proceed with the loan. In each case the same question was asked: “If you had a business, what would it be?” As a result a nurse’s assistant became the operator of a private nursing business, and a geologist’s assistant a weed control specialist (in a drought). In each of these cases the callers were seeking loans for wholly personal purposes such as debt consolidation and home mortgage arrears. In each case the interest rates were between 8% and 10% *per month*, and up to 15% per month if in default. None of these cases would have succeeded in attracting coverage of the Code under Clause 5. While they may not succeed under the current provisions, there is at least a possibility that the broker’s knowledge of the true purpose, and the credit providers arguably intentional ignorance, will be considered relevant.

We strongly oppose the amendment in relation to business purposes declarations. We agree that these provisions are in vital need of reform to address ongoing and widespread avoidance of the Code and seek further time to propose an alternative solution.

Clause 6 – Amendment of s15 (Matters that must be in contract document)

We are broadly supportive of an amendment that ensures the annual percentage rate (APR) disclosed on credit contracts includes fees that are in the nature of interest. We commend the attempt to ensure that contracts do not disclose a low annual APR while disguising large flat fees. Including disguised fees as interest, where it is appropriate to do so (that is, where they are in the nature of interest), will provide more confidence in the use of APRs which we agree are widely used and understood by consumers.

Despite this, we are concerned about how the amendment will operate in the context of recent judicial interpretations relating to interest. In *Director of Consumer Affairs v City finance Loans* [2005] VCAT 1989, it

was held that a number of large fees were not interest, even where there was a relationship between the size of the fees and the amount of the principal sum. Considering this, it appears that lenders will still be able to disclose an annual percentage rate, that does not include large fees that relate to the principal advanced, as these amounts might not be interpreted to be "in the nature of interest".

We note that the Regulatory Impact Statement states that the intention behind this clause is to allow consumers to make comparisons between credit providers and to understand the cost of credit (page 17). While the amendment may, noting our concerns above, ensure that contracts disclose an APR instead of disguised fees as the cost of the loan, we do not believe the proposed amendment will actually assist consumers make comparisons and understand the cost of credit. To do that, we believe that section 14(3) should be strengthened so a comprehensive comparison rate is required in pre-contractual disclosure. Currently, there is no obligation to provide a comparison rate in pre-contractual disclosure (there is, however, obligations to provide comparison rates in advertising under Part 9A of the Code). Considering that the cost of credit includes not only the interest rate but also fees and charges (and also considering the uncertainty around whether some fees and charges are "in the nature of interest"), we recommend an amendment to the Code to enable the making of regulations that provide that a comparison rate shall be mandatory pre-contractual disclosure in specified contracts.

We support the proposed amendment in relation to including all charges in the nature of interest in the annual percentage rate, albeit with concerns that it will not necessarily achieve the intention proposed. We recommend the Code be amended to enable pre-contractual disclosure of a comparison rate to be made mandatory by the regulations in relation to all contracts, specified contracts, or a specified class of contracts.

Clause 7 – Amendment of s46 (Prohibited Securities)

We are clearly in favour of the intention behind this proposal. The use of blackmail securities is a problem that has plagued disadvantaged consumers and complicated the work of financial counsellors in every state for many years. The taking of security over items of high value to the consumer and no value whatsoever to the creditor is an unfair and discriminatory tactic which should be prohibited as a matter of urgency. It is of considerable concern that this amendment should be made prior to the commencement of any personal property security reform nationally which may have the effect of further legitimising and enabling this practice.

However, we have concerns that the proposed clause does not go far enough. While we appreciate the certainty and consistency offered by the reference to prescribed property under the Bankruptcy Regulations, this definition falls short of the intention to stop the practice of taking blackmail securities. Many households may have property that, while of limited

monetary value (especially second-hand), is not covered by the Bankruptcy regulations including, for example, DVD players (the regs refer to VCR units), video game units (such as X-Box, Playstation), additional phones or appliances and adult sporting or recreational equipment. Personal computers are not mentioned at all and are arguably vital to participation in many aspects of contemporary social, political and economic life, in addition to leisure activities.

While Regulation 6.03 Subsections (2)² and (4)³, and the general commercial imperative, ensures that many of the items not included in the list are not taken by the trustee in bankruptcy, this will not necessarily be effective against small lending establishments who have no intention of seizing the goods in question, only in making the borrower believe that this is a real possibility. Most importantly, the intent of the proposed reform is to *prevent* the taking of blackmail securities, not to engender further arguments about which household goods are or are not encompassed by the Bankruptcy Regulations.

We contend that there should be no need to take security at all on loans below \$5,000, except where a mortgage is taken over goods purchased with the loan proceeds as envisaged by the exemption in the proposed clause [Clause 46 (3)]. While we appreciate that taking security over the borrower's property may be necessary to protect the lender from significant losses on larger loans, this argument is not as strong in the cases of smaller loans. Further, the risk of sham security arrangements intended to influence the borrower to repay this loan over and above all other commitments, even necessities, is much higher with smaller loans where the lender has less interest in the true amount likely to be recovered upon the sale of the security.

We further suggest that taking security over small loans (under \$5 000) encourages asset lending inimical to the UCCC. The signatories to this submission call for a lower limit on secured lending except as envisaged in Clause 46(3) on an urgent basis given the increased ease of registering security following the likely consequences of personal property securities reform. We submit that the primary focus of the lender should be on the borrowers realistic ability to repay, rather than seeking leverage to prevent default.

² Household property (including recreational and sports equipment) that is reasonably necessary for the domestic use of the bankrupt's household, having regard to current social standards.

³ (a) the number and ages of [members](#) of the bankrupt's household; (b) any special health or medical needs of any of those [members](#); (c) any special climatic or other factors (including geographical isolation) of the place where the household residence is located; (d) whether the property is reasonably necessary for the functioning or servicing of the household as a viable and properly run household; (e) whether the costs of seizure, storage and sale of the property would be likely to exceed the sale price of the property; (f) if paragraph (e) does not apply -- whether for any other reason (for example, costs of transport) the sale of the property would be likely to be uneconomical.

Our primary submission is therefore that lenders should not be permitted to take security in relation to loans of \$5,000 or less, and that the proposed Clause 7 should apply to loans above this threshold.

We note that the current Bankruptcy Regulation does not list many personal and household items that were not invented when the list was last reviewed. We ask for the list to be reviewed and in the event that it is not, we seek a mechanism to enable a safeguard list to be made pursuant to the UCCC. Alternatively we ask for a guideline to the regulation so that it is easy for para-legal staff to assist with easy recognition of assets protected under the provisions. This is because unscrupulous fringe lenders dealing with disadvantaged consumers are able to exploit uncertainty in the absence of clear direction.

In the absence of a prohibition on any security being taken on loans below \$5 000, the proposed amendment is supported on the basis that:

1. SCOCA support an urgent request for a review and update of the Bankruptcy Regulation to reflect current community expectations about "necessary household property" and in particular to request amendment including total protection of goods for personal or household use only which have a realizable value of less than \$300 per item; and basic computing software and hardware used for basic household tasks such as banking and shopping, e-mail and accessing the media, and for children's education and entertainment; and any item which is sold for the purpose of caring for or use by a child.
2. A sub-committee with appropriate representation is set up immediately to draft regulations under proposed Clause 46 (4)(b) and (5) to augment the Bankruptcy Regulation pending its satisfactory amendment.

We submit lenders should not be permitted to take security in relation to loans of \$5,000 or less (except for goods purchased with the loan proceeds), and that the proposed Clause 7 should apply to loans above this threshold. Alternatively, as a second best option, we support the proposed amendments provided we able to obtain suitable assistance in seeking an update of the Bankruptcy Regulations and appropriate interim arrangements in the draft regulations under the Code.

Clauses 8 – 10 – Minor Amendments to ensure consistent effect of other provisions

Supported

Clause 11 – Replacement of s72 (court may review unconscionable interest and other charges)

The intent behind these provisions is vitally important in protecting vulnerable and disadvantaged consumers. We support them in principle, but have some further suggested amendments, which would clarify the scope of the

provisions, and focus on what we see as the real issue – overall cost of credit to consumers.

We also recognise, that these provisions are likely to be hotly contested by industry as they have ramifications, which permeate all lending sectors. For this reason we make a number of observations in relation to the proposals which may be useful for government decision-makers.

1. Firstly, our primary submission in relation to controlling the cost of lending to vulnerable consumers is that the most appropriate tool is an interest rate cap, *inclusive of all fees and charges*, such as currently exists in NSW and the ACT. While far from perfect (48% is still very expensive credit and beyond the means of some consumers to repay, and some products cease to be profitable to offer), it is our contention that this strikes the right balance between freedom of contract and consumer protection. Further, by capping the overall cost of credit, the focus of the legislation is appropriately on the impact on the consumer rather than any other incidental consideration.

The proposed clause 11 appears to limit all fees to cost recovery, and to therefore insist that all profit is disclosed in the interest rate (there is some inconsistency in the drafting which is discussed below). This appears to be based on a number of erroneous assumptions:

- a) That disclosure of all profit as an interest-rate will protect vulnerable consumers. Consumers who need money urgently are often completely immune to messages about price. Prior to the introduction of the cap in NSW for example, some outlets continued to attract ample trade despite advertising comparison rates in their shopfront window in excess of 900%. This problem is exacerbated when consumers' cognitive abilities are affected by intellectual disabilities, gambling or substance addiction, or mental illness. The proposal seeks to control changes in interest rates but has no impact on the initial interest rate.
- b) That limiting fees to cost recovery will keep costs reasonable. It is more expensive to supply smaller amounts of credit than larger amounts. As lenders in this sector are often at pains to point out, maintaining a shopfront, staff, lending guidelines and procedures, retaining legal services, and accessing funds all cost money, and to a certain extent do not vary greatly whether the amount lent is \$200 or \$20,000. As a result, some loan products will be very expensive and have a high impact on vulnerable consumers, regardless of whether the fees and charges imposed exceed cost recovery.

In other words the provisions focus on eliminating profit margins on fees and disclosing profit as an interest rate. Neither of these measures necessarily gets to the central issue, which is the overall cost to the vulnerable consumer. Contrary to this, a comprehensive cap says this is the maximum you can charge consumers (as a percentage of the amount borrowed) and if you can make money at that rate, it is of no interest to us what your profit margin is. If some products cannot be offered at that rate, then that is unfortunate, but it is more important to

provide meaningful protection for the considerable number of vulnerable consumers who access these loans to their considerable detriment (see case studies from CCLC Productivity Submission below).

2. The ability to challenge default fees on the basis that they exceed costs is a protection, which is long overdue in all states. We strongly support these provisions in their current form. While these provisions arguably do little more than restate the current common law provisions in relation to contractual penalties, they provide a far more effective means of enforcing these principles, the systemic breach of which impacts disproportionately on those consumers with less income and other resources. However, we suggest that the different nature of default fees and penalty fees is such that there should be a separate section devoted to these fees. This would address our concerns below about the uncertainty of drafting.

A possible new section might read:

S72X(1) The Court may, if satisfied on the application of a debtor, mortgagor or guarantor that a credit fee or charge arising because of a default by the debtor under a credit contract is unfair [or unreasonable] under this section, annul or reduce all or any of the rate or rates or the fee or charge and may make ancillary or consequential orders.

S72X(2) A credit fee or charge arising because of a default by the debtor under the contract is unfair/unreasonable only if it appears to the Court that the fee or charge is more than a reasonable estimate of the credit provider's loss arising from the default.

3. We fully support a change in terminology from unconscionable. However, we question whether a test of 'unreasonableness' provides any greater certainty for consumers, business or the Courts. We suggest that a test of 'unfairness' might be more appropriate. Unfairness or fairness is a test now used in many consumer contexts, including unfair contract terms regulation in Victoria; the terms of reference of the EDR schemes; and the Corporations Act provisions on licensing of financial services providers.

We also note that the drafting of clause 11 is a little confusing. The proposal appears to distinguish between fees that are charged for providing a product/service, and fees which are charged for breaches of contract, in so far as the proposed section 72(7) allows reference to be had to standard commercial practice generally in relation to the former (non-default fees) and not the latter (default fees). There is a tension, however, between the specific sub-sections that clearly imply unreasonableness as a result of exceeding the underlying costs of service provision alone, and the sub-section (72(7)), which refers to general commercial standards. It is unclear whether the reference to commercial standards is in relation to establishing what the underlying costs are, or whether it is implied that some fees and charges may exceed costs a little (have a profit margin) and reference will be made to commercial standards to determine whether that margin is unreasonable. For this reason, we have suggested that the provisions about default fees be separated from

the s72 provisions relating to other credit fees and charges, and that the legislative intention in relation to other fees be clarified.

4. We also note that the suggestion that any credit fee or charge must be limited to cost-recovery (or a little bit more than cost recovery) goes further than the RIS recommendations, and places a significant constraint in how credit providers structure their products.
5. We are concerned that the reference to standards of commercial practice generally, may be interpreted to mean a reference to other “similar” contracts, and lead to a lowest common denominator approach to the interpretation of the section. While we note that there are considerable cost variations across different lending sectors, we submit that the beneficial intent of the provisions would be better achieved by the insertion of the word “fair” before the phrase “commercial practice”. Of course if “fair” were adopted as the standard terminology for the section, as opposed to “unreasonable”, this insertion would be superfluous.

We reiterate that we are strongly in favour of a comprehensive cap on the total cost of credit in order to protect vulnerable consumers. We also reiterate that we are strongly of the view that default fees should be limited to cost-recovery, consistent with the law on penalties.

However, within a comprehensive cap regime, it is immaterial the extent to which credit providers build in any profit into interest, into non-default fees or a combination, as long as consumers also have the added protection of being able to challenge a particular fee or charge on the grounds of unreasonableness or unfairness. That is, that the comprehensive limitation to cost recovery would be unnecessary if all States had comprehensive cost caps, although the credit provider’s underlying costs might be one factor the court could take into account in determining whether a particular fee was unfair.

In the absence of a comprehensive cap, the situation is quite different. The proposed clause 72 would in those circumstances be a considerable improvement on the “carte blanche” currently afforded the fringe credit industry in many States. We believe these provisions will be particularly useful in Victoria where an interest rate cap working in tandem with the proposed provisions will provide considerable protection for consumers over and above the status quo, whereby the interest rate cap can be completely avoided by expressing the cost of credit largely in fees rather than interest.

Our primary contention is that there should be:

1. A uniform comprehensive cap on the cost of credit in all States inclusive of all fees and charges
2. The ability to challenge default fees on the basis that they exceed a reasonable estimate of the loss to the credit provider as a consequence of the default
3. The ability to challenge other fees on the basis that they are unfair or unreasonable.

In the alternative, in the absence of comprehensive rate caps, we support the proposed changes to section 72 contained in Clause 11.

Extract from CCLC Productivity Commission Report

Case Study 9 - Small Amount Lending

Borrower 1 is 45 years of age. She has been on the Disability Support - \$500 loan for which direct debits are used to ensure repayments of \$45 Pension for 3 years. She suffers from serious depression.

Borrower 1 pays rent of \$180 per week, which is 69% of her pension payment. She fell into arrears with the repayment of her rent and was threatened with eviction if her rental arrears were not brought up to date. She applied for a personal loan from a few mainstream lenders without any success because she could not demonstrate that she could afford to make the requisite repayments.

Desperate to keep a roof over her head, she successfully applied to a specialist small amount lender for a \$2000 loan. The loan was not regulated by the UCCC because it was extended under a Bill of Exchange. The amount payable 32 weeks after the date of the contract was \$2,753.32. The majority of the borrower's necessary household items, including a fridge, microwave, lounge, dining table, washing machine, cloth dryer and a television, were mortgaged to secure the contract. The cost of borrowing \$2,000 over 32 weeks under this contract is \$753.00, or the equivalent of 104%, if expressed as an annual percentage rate.

The contract does not disclose the amount of weekly or fortnightly repayments. If she were to repay the loan fortnightly, she would have to pay \$172.06 per fortnight. Borrower 1's fortnightly pension is \$525. She would have a shortfall of approximately seven dollars per fortnight just paying her rent and this loan. She would have no money at all with which to pay food, electricity, phone, transport or medication for example.

Not surprisingly, Borrower 1 has not been making any weekly or fortnightly payments and will not be able to repay the \$2,753 on the termination date.

Case study supplied by financial counsellor, Regional NSW.

Case Study 10 - Small Amount Lending

Borrower 2 is a 55 year old receiving the Disability Support Pension and living in Department of Housing accommodation. She also suffers from mental illness including psychosis, schizophrenia and anxiety.

She has two loans from different small amount lenders:

- \$500 loan for which direct debits are used to ensure repayments of \$45 per fortnight, outstanding balance now \$1,171.98 including accumulated interest, fees and charges

- Loan for which the original loan amount is not known, but the balance is now \$400 and fortnightly repayments of \$88.33 are direct debited from her pension.

Borrower 2 also has rental payment for her fridge and washing machine of \$47.00 per fortnight. She also has a Centrelink repayment of \$20.00 per fortnight, and another regular repayment of \$21.00 per fortnight. With her rent also being directed debited, she has very little pension that she actually receives in her bank account to pay for food, utilities and other living expenses.

Case study supplied by financial counsellor, Outer Metropolitan Sydney

Case Study 11 - Small Amount Lending

Borrower 3 is a male who suffers from schizophrenia. He borrowed \$1000 under a promissory note secured by a bill of sale over his home unit. The amount repayable over 12 months is \$2,476, an effective interest rate of almost 150%. The contract also disclosed a number of possible penalty charges including \$48 for a dishonoured direct debit (\$35-50 may also be payable to the borrower's bank for this dishonour), \$20 for the reschedule of payment, and a penalty service charge of 48% per annum payable on the remaining balance for any period during which the borrower is one or more repayments in arrears. Clearly Borrower 3's home unit is at serious risk for a \$1,000 loan.

Case study supplied by financial counsellor, Regional NSW.

Case Study 12 - Small Amount Lending

Borrower 4 is a 33 year-old living in Department of Housing accommodation. She is a sole parent with 6 children. She has an unsecured debt of \$4000 to a small amount lender. Her repayments are \$142 per fortnight. The loan was taken out for Christmas/birthday presents for the children and to repair her old car. She now has an Eviction Notice for \$3000 in rent arrears.

Case study supplied by financial counsellor, Outer Metropolitan Sydney

Case Study 13 - Small Amount Lending

Borrower 5 is a 68-year-old woman on the Disability Support Pension. She has three loans from two different lenders, all taken out in late 2006 in order to simply survive. All three loans disclosed the purpose of the loan

was to purchase white goods. Two of the three loans avoid the UCCC by using a Promissory Note and a Bill of Exchange arrangement. Two of the loans were secured over basic household necessities. The interest rates were approximately 163%, 224% and 44% respectively. The cheapest loan was UCCC compliant. The client could not pay any of the loans as they fell due and the interest and charges began to accumulate.

Case study supplied by financial counsellor, Outer Metropolitan Sydney

Case Study 14 - Small Amount Lending

Our client T needed money for airfares to visit a sick relative and responded to an advertisement in the local paper. The advertisement stated "Easy Loans No Credit Checks". T rang up and asked if she could borrow \$2,500 and explained the purpose of the loan. She said she was out of work and was receiving Centrelink benefits.

She was asked and confirmed that she had an existing mortgage on a house. An appointment was made and the next evening Mr 'D' arrived at her home. Our client signed some documents consisting of a 'statement' that detailed the Loan amount to be \$3,550, which included (but did not explain) a 'fee' of \$1,050 and a document purporting to authorise an unregistered mortgage plus a caveat on her land and home.

D stated he wouldn't charge any interest but if the whole loan was not paid back within one month, he would lodge the caveat and charge 10% interest per month. P agreed to the loan, as she had no other way of getting the money. The caveat was in fact lodged the day after the loan was approved.

P could not pay out the loan within one month and 4 weeks later she was sent a 'Default Notice' from D stating she would be issued with a bankruptcy notice and that she would be forced to sell her house if the balance plus accrued interest was not paid within 30 days.

Case Study 15 - Small Amount Lending

CCLC was approached by Ms. A, who had received a Statement of Claim (Equity Division of the Supreme Court) filed by a small fringe lender seeking possession of her home. Our client had taken out a small loan of \$5,000 to pay strata fees on her home unit. In fact the amount borrowed was for about \$3,500 with the remaining \$1,500 representing fees and charges added at settlement. The interest rate was 5% per month. The lender had taken a second unregistered mortgage over her home unit. The loan was described as being for business purposes even though it was for personal purposes. A first mortgage was held by a major bank. The borrower could not pay in accordance with the terms of the loan and the lender's first claim in order to stop the Supreme Court proceedings was for an amount in excess of \$20,000.

Proposed Section 72(A)

We strongly support this provision. Action taken by a Government Consumer Agency in relation to fees and charges under a contract or class of contracts on behalf of debtors would be the most efficient and effective way of protecting consumers. Attempts to test the current provisions of the act as far as they go have often been thwarted by the need for consumer assistance agencies to act on behalf of a particular identified client, or group of clients. Often there is little financial or other benefit to be gained by the lead client or clients, and therefore little incentive to remain involved in proceedings that may be anything from inconvenient to distressing and intimidating. Clients are also subject to pressure from credit providers to pull out of the proceedings, including monetary compensation which, though usually very small amounts, is very attractive to disadvantaged clients.

We retain some scepticism, given the dearth of enforcement action taken under the Code to date, about whether such actions will in fact be taken by government consumer protection agencies. As such we would also support the addition of the capacity of independent consumer organisations to make applications under Division 3, similar to the operation of the Super Complaints provisions in the UK.

Action taken in any state should have application nationally. Further, a mechanism needs to be included in the provisions to ensure that any amounts required to be refunded by a credit provider in relation to a class of contracts, which cannot for practical reasons be given to the affected borrowers, or all affected borrowers, can be paid into the relevant consumer credit fund or financial counselling trust fund in each state (or apportioned between them).

<p>We strongly support the provisions enabling Government Consumer Agencies to take make applications on behalf of a particular consumers or consumers generally. We also seek rights for consumer organisations to make applications along the lines of the Super Complaints system in the UK.</p>

Clause 12 - Amendment of s100 (key requirements)

Supported

Clause 13 – Amendment of s150 (Presumptions relating to application of this Part)

This amendment is not supported for the same reasons set out in relation to clause 5 above.

Regulations – Direct debit disclosure

While we appreciate the intention behind the proposed disclosures, we are concerned that this information will be lost in the large amount of information required to be digested at the outset of the loan. At worst, it could detract from

other key information relevant to the decision whether to proceed with the loan. Further, the time that the borrower needs this information is not when the loan is taken out, but rather when he or she defaults.

We commend the State consumer protection agencies and the Ministers for their willingness to address this important issue, but question whether there might be a more targeted mechanism to address the problem. Credit providers could be required to send the required information to consumers within 30 days of the first time a direct debit payment is dishonoured. Such a notice could include:

1. Details about how to cancel the direct debit with their financial institution to avoid further fees
2. A warning about the consequences of breaching their contract and the importance of making alternative repayment arrangements
3. A notice about hardship and how to request a Hardship Variation in appropriate circumstances.

We also note that the recommendation of the Post-Implementation Review in relation to including information about Hardship Variations on section 80 notices remains outstanding. This should be attended to immediately.

We do not support the proposed disclosures as part of the pre-contractual or contractual disclosure. We contend that credit providers should be required to send a notice to borrowers within 30 days of the first time a direct debit dishonour occurs, including also information about Hardship Variations. We also call for information about Hardship Variations to be included in section 80 notices.