



Law Council
OF AUSTRALIA

Legal Practice Section

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Manager
Banking and Access to Finance Unit
The Treasury
Langton Cres
PARKES ACT 2600

By email: creditreforms@treasury.gov.au

Dear Colleague

CONSUMER CREDIT REFORMS

1. This submission has been prepared by the Australian Consumer Law Committee (**the Committee**) of the Law Council of Australia's Legal Practice Section.¹ The Committee welcomes the opportunity to make a submission to Treasury in relation to the Consumer Credit Reforms, and notes that the views contained in this submission are those of the Committee, not necessarily the Law Council as a whole.

Introduction

2. The Committee welcomes the opportunity to comment on:
 - the draft National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020 (**the draft Bill**);
 - the draft National Consumer Credit Protection Amendment (A New Regulatory Framework for the Provision of Consumer Credit) Regulations 2020 (**the draft Regulations**); and
 - the draft National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020 (**the draft Determination**)

(collectively, **the draft Reforms**).

3. The members of the Committee are lawyers with extensive professional experience and expertise in consumer protection law from a broad range of practice types, including private legal practice, the independent bar, legal aid, community legal services, legal services in remote and regional communities and academia. The members of the Committee provide legal advice and representation to consumers from all walks of life in Australia, ranging from investors in sophisticated financial products to socially and economically disadvantaged people in remote communities.

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

Comment on the draft Reforms

4. It is the usual practice of the Committee when making comment on proposed legislation to assess the language and impact of each provision and provide suggestions about the most significant issues. However, in the case of the draft Reforms, the Committee takes the view that a more fundamental response is required. The Committee considers that the draft Reforms have the potential to undermine established essential consumer protections and replace them with an inferior system which will deprive consumers of a proper assessment of their capacity to borrow, and deprive them of remedies for losses caused by unsuitable lending.
5. The Committee notes that the draft Reforms are asserted to be 'aimed at promoting the flow of credit by reducing the time that it takes consumers and businesses to access credit so that consumers can continue to spend and business can invest and create jobs'.²
6. The draft Reforms are premised on the proposition that, under the existing *National Consumer Credit Protection Act 2009* (Cth) (**Credit Act**), Responsible Lending Obligations (**RLOs**) on consumer credit providers have 'imposed burdensome and unnecessary processes on both lenders and borrowers', describing the RLOs as both 'one-size fits all' and 'prescriptive'.³
7. In the Committee's experience and observation, this premise is unfounded. The RLOs are the opposite of a 'one-size-fits-all' approach to assessing suitability of a credit contract for a consumer. Rather, the RLOs require a credit provider to consider the individual consumer's requirements, objectives and financial circumstances and to determine whether the proposed loan will meet those requirements and objectives and not cause substantial financial hardship to the consumer.
8. These processes are not unnecessary and need not be burdensome, given the significant amount of individual consumer financial data available to credit providers in electronic form.
9. The Committee does not consider the Credit Act RLOs to be a significant burden for lenders. The protection that is given by the regime extends only to those who will be unable to meet their obligations at all or, or not without 'substantial hardship'. In *Australian Competition and Consumer Commission v Westpac*,⁴ the Full Court of the Federal Court of Australia made it clear that an irresponsible loan was one that would cause the borrower such hardship that the loss of the family home was inevitable or the financial burdens would impose 'severe toil, trial, oppression or need' on the borrower.
10. It is for those people who will lose their home or who will suffer severe toil when trying to meet their financial obligations that these laws must remain in place. Members of the Committee have seen and heard many stories, for example, of aspirational consumers who were encouraged to use the equity in their family home to borrow 100 per cent of the cost of an investment property. They have done this with the encouragement of an irresponsible broker or local bank lending officer and the lender has failed to give due consideration to consumer's ability to repay. The vulnerable

² Exposure Draft Explanatory Materials, National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020, [1.1].

³ Ibid [1.9].

⁴ [2020] FCAFC 111.

consumer, who lacks financial literacy and has very little understanding of the true cost of living, is lured into the loan with a dream of earning a 'nest egg' to support the family post retirement. But the dream fails to become a reality, they cannot maintain the repayments, the lender forecloses, they lose the family home and are forced into bankruptcy.

11. The Credit Act RLO regime is designed, when complied with, to guard against this eventuality.
12. The first recommendation of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**) presented on 1 February 2019 was:⁵

Recommendation 1.1 – The NCCP Act

The NCCP Act should not be amended to alter the obligation to assess unsuitability.

13. The first response of the Government to the recommendations of the Financial Services Royal Commission was:

*The Government **agrees** to this recommendation and the Commissioner's findings that 'not unsuitable' remains the appropriate standard for responsible lending obligations within the National Consumer Credit Protection Act 2009 (NCCP Act).⁶*

14. There were sound reasons for the Financial Services Royal Commission recommendation and sound reasons for the acceptance by the Australian Government of the recommendation that RLOs should not be changed.
15. The Committee notes that the draft Reforms are said to be a 'key part' of the Australian Government's response to the economic circumstances brought about by the COVID-19 crisis. However, the draft Reforms are not a temporary adjustment to exceptional conditions. They make permanent changes that will not expire when the crisis has passed.
16. The Credit Act was originally enacted in 2009 in the context of another economic crisis, the global financial crisis of 2007-08 (**GFC**).
17. The Explanatory Memorandum (**EM**) for the *National Consumer Credit Protection Bill 2009 (Credit Bill)*, provided lengthy contextual information and detailed commentary on important provisions.⁷
18. The outline of the EM notes that the Bill is the product of an agreement of the Council of Australian Governments to transfer consumer credit regulation to the Commonwealth and that key components of the reform include:

⁵ *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 1 February 2019) 20.

⁶ Australian Government, *Restoring trust in Australia's financial system: The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (4 February 2019) 6 (emphasis in original).

⁷ Explanatory Memorandum, National Consumer Credit Protection Bill 2009 (Cth).

- a comprehensive licensing regime for those engaging in credit activities via an Australian credit licence (**ACL**) to be administered by the Australian Securities and Investments Commission (**ASIC**) as the sole regulator;
- industry wide responsible lending conduct requirements for licensees;
- improved sanctions and enhanced enforcement powers for the regulator; and
- enhanced consumer protection through dispute resolution mechanisms, court arrangements and remedies.⁸

19. The outline goes on to say about responsible lending conduct:

In addition to licensing obligations, the Credit Bill includes a collection of conduct obligations applicable to all holders of an ACL, which apply responsible lending conduct requirements. Broadly, the responsible lending conduct obligations set in place expected standards of behaviour of licensees when they enter into consumer credit contracts or leases, where they suggest a credit contract or lease to a consumer, or assist a consumer to apply for a credit contract or lease.

The key obligation on licensees is to ensure they do not provide a credit contract or lease to a consumer or suggest or assist a consumer to enter into a credit contract or lease that is unsuitable for them. This obligation requires licensees to assess that the credit contract or lease is not unsuitable for the consumer's requirements and that the consumer has the capacity to meet the financial obligations under the credit contract or lease.⁹

20. The outline refers to sanctions and remedies, including:

The Credit Bill establishes a civil penalty and consumer remedy framework that promotes strong consumer protections, including a civil enforcement regime and broad civil remedies. The key provisions:

- *enable the court to grant remedies to consumers for loss or damage suffered as a result of a contravention of the Credit Bill, including through varying the contract as well as monetary redress...¹⁰*

21. The summary of the regulation impact statement includes, with reference to '[r]egulation impact on business: Sanctions, remedies dispute resolution and the courts':

While broader enforcement powers carry some potential additional compliance costs for industry participants, this outcome is expected to deliver greater net benefits for consumers particularly over time, through overall improvements to standards of industry behaviour.¹¹

⁸ Ibid 4.

⁹ Ibid.

¹⁰ Ibid 5.

¹¹ Ibid 8.

22. Importantly, the EM provides the following context for the Chapter 3 Responsible Lending Provisions:

*The May 2008 final Productivity Commission's report on the Review of Australia's Consumer Policy Framework (the PC Report) noted an increased use of credit in Australia over the last 20 years. Increased use of credit has led to higher levels of household indebtedness which **impacts on household financial capacity and ability to respond to changing circumstances such as interest rate increases, a slowdown in economic conditions or rising unemployment. Evidence suggests that these increases have come about mostly as a result of the growth in the size of home loans over the years...***

*The Productivity Commission in its review of consumer protection **noted that poor lending practices have contributed to a growing number of borrowers experiencing financial stress, and recommended consideration, in the context of a national credit regime, of what, if any, initiatives are required to promote 'responsible lending'.***

*The Productivity Commission commented that the purchase of financial services can entail significant monetary commitments, sometimes over long periods of time. Where imprudent lending decisions are made, the consequences for consumers can be **particularly costly.** Moreover, purchasing decisions will often involve complex product comparisons, with consumers frequently relying on intermediaries to make these comparisons on their behalf. However, assessing the quality of such advice, even after the event, can be problematic. Accordingly, effective consumer protection measures are particularly important for these services.*

Current regulation of credit for consumers, under the Uniform Consumer Credit Code (UCCC), primarily regulates credit providers (rather than credit assistants or intermediaries) in relation to matters such as the disclosure requirements to be met in order to provide consumers with credit contracts, or how to vary those contracts in the event of hardship or default. It does not comprehensively address the appropriateness of the initial provision of the credit to the consumer. That is to say, it does not regulate whether or not it was responsible to lend to the consumer in the first place. However, most lending institutions apply lending criteria to determine who they will lend to, which in large part consider the borrower's circumstances and the risk the loan poses to the lending institution.

Responsible lending conduct regulation encourages prudent lending and leasing to continue and imposes sanctions in relation to irresponsible lending and leasing.

The Code contains a provision that imposes 'up front' obligations on any party to a credit transaction. These obligations set out that 'a person must not make a [sic] false or misleading representation in relation to a matter that is material to entry into a credit contract or a related transaction or in attempting to induce another person to enter into a credit contract or related transaction'. This places accountability on all parties to a credit

transaction, borrower, credit assistant and lender alike to conduct themselves honestly and transparently.

Several Australian lending institutions have established responsible lending charters and processes. The United Kingdom introduced responsible lending laws in 2006.¹²

23. The summary of the responsible lending provisions includes:

The primary obligations in relation to the provision of credit (for example, lending); or the provision of credit assistance (for example, suggesting a particular credit contract or assisting with a particular credit contract) are: to make an assessment that the loan is not unsuitable for the consumer; and to assess that the consumer has the capacity to meet the financial obligations under the contract without substantial hardship.¹³

24. The detailed explanation of the responsible lending obligations of licensed credit providers includes:

The purpose for undertaking reasonable inquiries about the consumer's financial situation is to ascertain a reasonable understanding of the consumer's ability to meet all the repayments, fees, charges and transaction costs of complying with the proposed credit contract. The general position is that consumers should be able to meet the contract's obligations from income rather than equity in an asset.¹⁴

And

The standard for the consumer being likely to meet the financial obligations in the contract is an objective one. It is not directly linked to the credit provider's own internal standards and guidelines regarding assessing a capacity to repay. Such internal standards and guidelines would be expected to factor in the credit provider's own policies on risk exposures and may vary from time to time, in line with changes to the risk appetite of the credit provider, and the commercial and economic environment. Accordingly, the fact that an application for credit satisfied a credit provider's own policies for affordability does not necessarily mean that it met the standard in the legislation. However, it is expected that the types of inquiries made and assessments conducted for the purposes of the credit provider's internal standards and guidelines on affordability would, in most cases, be very similar to those that are required in order to assess the likelihood that a consumer can meet the financial obligations under the proposed contract.¹⁵

25. The considerations that underpinned the enactment of the RLOs have not changed, nor has the economic impact of COVID-19 changed these fundamental issues. The RLOs were enacted following extensive research, consultation with the states and territories and input from consumer and industry advocates. As the EM shows, the RLOs also derive from an understanding of the economic impacts of household debt,

¹² Ibid [3.8], [3.13]-[3.18] (emphasis added).

¹³ Ibid [3.25].

¹⁴ Ibid [3.140] (emphasis added).

¹⁵ Ibid [3.153].

which are not limited to risk of default but include the diversion of available household funds from expenditure on other goods and services into loan repayments.

26. The Financial Services Royal Commission found that lending decisions being made with reference to credit risk rather than the individual consumer's risk of default, prioritised bank profits over the interests of consumers to the detriment of consumers. As noted by Basten JA in *Fast Fix Loans Pty Ltd v Samardzic*:

*To engage in pure asset lending, namely to lend money without regard to the ability of the borrower to repay by instalments under the contract, in the knowledge that adequate security is available in the event of default, is to engage in a potentially fruitless enterprise, simply because there is no risk of loss. At least where the security is the sole residence of the borrower, there is a public interest in treating such contracts as unjust, at least in circumstances where the borrowers can be said to have demonstrated an inability reasonably to protect their own interests...*¹⁶

27. The draft reforms propose to substitute the Australian Prudential Regulation Authority prudential requirements for the RLOs. Prudential requirements are imposed to safeguard the lender and may be satisfied with asset-based lending because defaults within the lender's risk appetite will not harm the lender. The defaulting borrower is not so comfortable with such an outcome.
28. The Committee is concerned that there is a lack of evidence that the draft Reforms will make credit more widely available to the benefit of society and not at an unacceptable cost to society through an increase in bankruptcy, poverty and reliance on social security payments.
29. RLOs assist the economy rather than repress it. An unaffordable loan causes the borrower to divert family funds from the wider economy to banks as most of the borrower's disposable income must go to loan repayments. This has an unwelcome impact on the economy generally.
30. The Committee is concerned that far reaching permanent changes are proposed in the draft Reforms which are not supported by research or experience and which experience shows will lead to irresponsible lending and hardship to consumers and their families.
31. The Committee would welcome the opportunity to discuss this submission with the Treasury. In the first instance, please contact the Australian Consumer Law Committee Chair, Ben Slade at BSlade@mauriceblackburn.com.au.

Yours sincerely



Michael Tidball
Chief Executive Officer

¹⁶ [2011] NSWCA 260, [116].