Consumer Credit Reforms

Legal Aid NSW submission to The Treasury

20 November 2020

323 CASTLEREAGH ST SYDNEY NSW 2000

Legal Aid NEW SOUTH WALES

About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 25 offices and 243 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged. We offer telephone advice through our free legal helpline LawAccess NSW.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited, and pro bono legal services. Our community partnerships include 27 Women's Domestic Violence Court Advocacy Services, and health services with a range of Health Justice Partnerships.

The Civil Law Division provides advice, minor assistance, duty and casework services from the Central Sydney office and 20 regional offices. It focuses on legal problems that impact on the everyday lives of disadvantaged clients and communities in areas such as housing, social security, financial hardship, consumer protection, employment, immigration, mental health, discrimination and fines. The Civil Law practice includes dedicated services for Aboriginal communities, children, refugees, prisoners and older people experiencing elder abuse.

Should you require any further information regarding this submission, please contact:

Brianna Terry
Senior Solicitor
Strategic Law Reform Unit
[redacted]

or

Jo Evans
Senior Solicitor
Consumer Law
[redacted]

Introduction

Legal Aid NSW welcomes the opportunity to comment on the proposed consumer credit reforms set out in the Draft National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020 (the **NCCP Bill**), the Draft National Consumer Credit Protection Amendment (A New Regulatory Framework for the Provision of Consumer Credit) Regulations 2020 (the **NCCP Regulation**) and the Draft National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020 (the **Non-ADI Standards**).[1]

Legal Aid NSW has extensive experience assisting consumers with problems arising from credit products, including assisting some of the most vulnerable consumers in our community, including consumers with cognitive impairment, language or literacy issues, low levels of education, young people, Aboriginal and Torres Strait Islander people, and those experiencing domestic and family violence or elder abuse. We also acknowledge research, which is consistent with the experience of our solicitors, that everyone is likely to experience vulnerable circumstances at some point in their lives, due to common, unavoidable and unpredictable life events such as illness, job loss, financial shocks, the death of a loved one and natural disaster. Life events such as having children, ageing and disability can also contribute to consumer vulnerability.[2] Further, the Consumer Policy Research Centre has found that:

> Some vulnerable circumstances are transient and people will move through them with the right support; other circumstances will necessitate longer-term assistance. Risks of consumer vulnerability will also change over time, as a result of regulatory, business, technological and social changes, and new understandings of consumer needs.[3]

In the 2019/20 financial year, we provided over 1600 legal services to clients on consumer credit matters. Our clients include people experiencing systemic and chronic vulnerability, as well as people who experience sudden and unexpected vulnerability due to, for example, sudden or unforeseen job loss, illness, injury or relationship breakdown. Our casework aligns with National Legal Aid's description, that:

> [t]he consumer experiences of people living in poverty or financial hardship are characterised by: limited consumer choices; an urgent requirement to enter into transactions to provide for their basic needs; participation in markets which other consumers avoid; and a lack of market based solutions to address their needs.[4]

Legal Aid NSW's consumer law service is long running, and predates the current consumer protection regime. From this perspective, we have seen the positive impact for many consumers of the introduction of responsible lending obligations (**RLOs**) in 2011 in the *National Consumer Credit Protection Act 2009* (the **NCCP Act**). The proposed reforms

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[1] Legal Aid NSW's submission is based on our case wok experience. Our submission also benefited from Jeannie Marie Paterson and Nicola Howe's paper, *Everyday Consumer Credit Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, Background paper 4 for the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.*

[2] O'Neill, Emma, 'Exploring regulatory approaches to consumer vulnerability: A report for the Australian Energy Regulator', *Consumer Policy Research Centre* (1 November 2019), 7.

[3] Ibid.

[4] As described by National Legal Aid and quoted in Productivity Commission, *Review of Australia's Consumer Policy Framework*, (Inquiry Report No 45, 2008) vol 2, 294.

will reduce many of these consumer protections including reducing RLOs. We are concerned that this will significantly disadvantage many consumers, especially consumers in highly vulnerable circumstances, and increase the risk of financial abuse. In particular, we are concerned that the reforms will negatively impact on consumers with cognitive impairment, language or literacy issues, low levels of education, young people, Aboriginal and Torres Strait Islander people, and those experiencing domestic and family violence or elder abuse.

Prior to the introduction of the NCCP Act, the Productivity Commission undertook a review of Australia's consumer policy framework. It recommended that the Australian Government adopt a common overarching objective for consumer policy:

> …to improve consumer wellbeing by fostering effective competition and enabling the confident participation of consumer in markets in which both consumers and suppliers trade fairly and in good faith.

The Productivity Commission recommended this overarching objective be supported by six operational objectives which should aim to:

- Ensure that consumers are sufficiently well-informed to benefit from, and stimulate effective competition;
- Ensure that goods and services are safe and fit for the purposes for which they were sold;
- Prevent practices that are unfair or contrary to good faith;
- Meet the needs of those who, as consumers, are most vulnerable, or at greatest disadvantage;
- Provide accessible and timely redress where consumer detriment has occurred; and
- promote proportionate, risk-based enforcement.[5]

We consider that these objectives remain relevant today. However, we are concerned that the proposed reforms will move the credit protection regime further away from realising these objectives.

While access to credit and financial products is often necessary for individuals and families to achieve their economic goals, if it is poorly managed "*credit can be a source of considerable hardship and despair*."[6] The impacts of financial hardship are far reaching, often impacting many other aspects of life including health, education and employment. A regulatory balance is therefore required to allow the provision of credit to enhance the welfare of individuals, families, and businesses, without credit itself being a cause of financial hardship and distress. We are concerned that the proposed reforms do not appropriately strike this balance.

[5] Productivity Commission, *Review of Australia's Consumer Policy Framework*, (Inquiry Report No 45, 2008) vol 1, 63.

[6] Jeannie Marie Paterson and Nicola Howe, *Everyday Consumer Credit Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans*, Background paper 4 for the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 1.

Reduction of responsible lending obligations

Legal Aid NSW is significantly concerned about the impact that the proposed reduction in RLOs will have on consumers experiencing wide ranging vulnerability, including, for example, poverty, poor financial literacy, family and domestic violence, job loss, ill health or injury. The existing responsible lending obligations provide consumers with valuable protections and assist consumers to make more informed choices regarding accessing credit and using credit effectively. The proposed reduction of RLOs increases the risk of consumers obtaining loans they cannot afford and becoming overindebted.

The NCCP Bill contains markedly less stringent requirements for lenders to verify the information provided by borrowers. We are concerned that as a result, lenders will not fully understand the real financial position of the borrower and will not be able to be satisfied that a borrower can repay their loan without substantial hardship. This increases the risk of consumers accessing financial products that may lead to significant hardship. While Legal Aid NSW acknowledges the importance of borrower responsibility, we consider that it should also be tempered with protections because all consumers can experience vulnerability at different times in their lives.

Impact on consumers experiencing domestic and family violence

Legal Aid NSW is particularly concerned that the proposed reforms will increase the risk of financial abuse in situations of domestic and family violence.

The proposed amendments potentially allow lenders to undertake minimal verification of an applicant's financial position and rely on reasonable estimates of a customer's expenses. This risks enabling perpetrators of financial abuse to more easily obtain credit via an on-line application process, either jointly with the victim or in the victim's sole name. The "red flags" that would be raised under the current RLOs regime by the lender's obligation to assess the suitability of the loan, including taking reasonable steps to verify a borrower's financial situation and their requirements and objectives in seeking the loan, may be missed.

This is a regressive step for people at risk of or experiencing family or domestic violence, including elder abuse, who are often burdened with debt that they had little or no benefit from. The proposed reforms would reduce the opportunities to prevent such loans from being issued, and reduce victim/survivor's access to remedies, as they would be unable to rely on breaches of RLOs as an avenue of redress. Instead, victim/survivors may be limited to seeking a remedy under the unjustness provision in the National Credit Code. This is, as it was prior to the 2011 reforms which introduced the RLOs, problematic and evidentially challenging as the borrower needs to establish that the lender had a level of awareness of duress, coercion or undue influence being exerted over the borrower at the time the loan was entered into. This is illustrated by the following case example.

Lucy's story

Lucy was a nurse. When she was 22, her partner convinced her to apply for a car loan for a sports car. She was renting with her partner and already owned a vehicle (under finance) at the time. She also had three credit cards. Her partner also owned a car. Her partner said he needed the sports car but had a bad credit rating and told Lucy to apply for the car in her name.

Lucy was in an abusive relationship and eventually consented to applying for the car loan out of fear. Lucy never provided documents or information about her financial circumstances to the lender. Her partner attended the car yard and arranged finance for the vehicle by submitting pay slips and information about Lucy's expenses. Her partner did not record her credit cards and other debts in the lending assessment. Lucy attended the car yard on one occasion to sign the loan documents. Lucy's partner then drove the vehicle exclusively. Both parties made payments on the loan.

When Lucy separated from her partner, he kept the vehicle and said he would continue to make payments on the loan but stopped after they separated. Lucy then received default notices regarding the loan, seeking repayments of $15,000. Lucy was able to raise arguments that the loan was unjust and, in the alternative, that the lender had breached the responsible lending provisions because the loan was unsuitable and she could only comply with the loan with substantial financial hardship.

Credit Cards

Legal Aid NSW has significant concerns about the impact of removing RLOs in relation to credit cards. Credit cards are a highly accessible form of credit for consumers experiencing vulnerability and financial hardship, including consumers with cognitive impairment, language or literacy issues, low levels of education, young people, Aboriginal and Torres Strait Islander people, and those experiencing domestic and family violence or elder abuse. Credit cards can put some consumers at significant risk of entering a debt spiral that can lead to court debt recovery proceedings, and loss of assets including family homes.

Legal Aid NSW is particularly concerned about the proposed two-tier consumer protection system regarding credit cards issued by Authorised Deposit-taking Institutions (**ADIs**) and non-ADIs. The proposed reforms would subject credit cards issued by ADIs to fewer consumer protections than those issued by non-ADIs, by removing the requirement for ADIs to complete a suitability assessment based on a consumer's ability to repay the credit card limit over a fixed period of time, as currently required by ASIC. We consider that the same consumer protections that apply to credit cards issued by non-ADIs should also apply to credit cards issued by ADIs. The following case example illustrates the detrimental impact of credit card debt on vulnerable consumers, in the absence of sufficient consumer protections.

Susan's story

Susan is divorced and has no dependent children. Susan purchased a modest home in Western Sydney with her share of the proceeds of her property settlement. The home is her only asset. Susan worked intermittently due to poor health.

Susan obtained a credit card from a bank in 2008 [prior to the introduction of RLOs] with a $15,000 limit. No income verification was requested; and the application was approved based on the income and expenditure provided in the application. Susan received an unsolicited offer to increase her credit limit in 2009. Susan accepted the offer and no income verification was requested. Susan applied for and obtained a further credit card from the same bank in 2010 with a $7,000 limit, again no income verification was requested; and the application was approved. Susan's physical and mental health deteriorated, she struggled financially and fell into arrears on her credit cards. Susan applied for and obtained a credit card from a different bank and used the third credit card to make repayments on her outstanding credit card debts. Susan's credit card debts spiralled to over $35,000 and she faced the prospect of losing her home.

Expansion of the definition of small business loans

Legal Aid NSW is concerned that the extended definition of a small business loan in the Non-ADI Standards will remove important consumer protections from a broader range of loans and may result in an increasing number of consumers being encouraged to access unsuitable business loans when they are unable to access personal credit.

The Non-ADI Standards set out the systems, policies and process requirements for the conduct of non-ADI lenders, and does not apply to credit provided to small businesses. Loans provided for business purposes is defined broadly in clause 6(2) to include all genuine loans where the business purpose of the loan is not merely minor or incidental.

This is significantly broader than the current small business credit exception under section 13 of the National Credit Code, which excludes loans where the predominant purpose of the loan is a business purpose.

The proposed expanded definition of small business credit will remove vital consumer safeguards from an increased range of loans. For example, clause 9(2) of the Non-ADI Standard is an important protection against unsuitable asset-based lending (where the consumer could only comply with their financial obligations under the contract by selling their home, which is not their intention at the time of entering into the loan). However, this protection will not apply to small business loans.

Debbie's story

Debbie is an artist and entered a business loan to purchase a car, which was to be used jointly for business and personal use. Due to the high interest rate and limited art sales she went further in debt to satisfy the original loan repayments. She was unable to obtain a personal loan, so she refinanced her loan to obtain extra credit, largely to pay for personal living expenses. She used a very small portion of this loan to pay for art supplies. The lender was on notice that the predominant purpose of her loan was for domestic purposes, but the lender did not comply with requirements under the *National Consumer Credit Protection Act 2009* to assess the suitability of the loan.

When Debbie came to Legal Aid NSW she was in severe and long-term financial hardship and suffering from anxiety as a result. Although she had already repaid the principal and significant interest towards the loans she received, she was still in significant debt due to the large interest and penalty fees. Legal Aid NSW was able to assist Debbie to obtain relief from her unsuitable loan and begin her economic recovery.

Under the proposed changes, Debbie would not have the benefit of those consumer protections and would continue to struggle to meet her daily living expenses. In this case, the refinancing arrangement was for more than an incidental but not predominant business purpose. As such, the lender would not be required to comply with the Standard.

Margaret's story

Margaret and her daughter Sally are co-owners of a property where Margaret lives, taking care of Sally's three young children. Margaret suffers from multiple health conditions and is unable to work. Sally suffers from depression and psychosis and is reliant on social security payments. Sally had started making homemade jam which she sometimes sold at a local farmers market. Sally was in severe financial hardship and sought a $15,000 loan through a commercial lender.

In the context of elder abuse, Sally coerced her mother to co-sign the loan documents. The loan was secured by way of second mortgage against the property. Sally used most of the money for personal and domestic purposes.

Shortly after entering the loan, Sally could not afford the repayments and went into default. The lender would not provide a suitable hardship arrangement and the credit provider threatened to take possession of the family home. Margaret is now at risk of losing her home.

As this loan would likely be considered a business loan under the proposed changes, the hardship provisions in the NCCP Act would not apply and the lender would not be required to consider hardship arrangements.

Lack of redress for individual consumers

The Explanatory Material for the Non-ADI Standards explains that its purpose is to:

> *…ensure non-ADI credit providers establish, maintain and implement systems, policies and processes directed toward credit being provided where the licensee has assessed that a borrower will have the capacity to repay any credit provided without substantial hardship.*

However, Legal Aid NSW is concerned that it is unclear whether an individual consumer can seek redress for a breach of a Non-ADI Standard. While consumers are still able to lodge disputes with an External Dispute Resolution (**EDR**) scheme, it is unclear how the EDR scheme will apply to a standard aimed at implementing systems, policies and processes, to an individual case. It is also unclear whether the Non-ADI Standards will give rise to any basis for an individual consumer claim in a court if a lender falls short of their own systems, policies or processes, or breaches a Standard.

Similar concerns arise for ADI lenders which under the proposals will be governed by Australian Prudential Regulation Authority (**APRA**) standards. It is unclear how an EDR scheme would interpret these standards in individual cases, and unclear whether the standards give consumers a right to seek redress for a breach of these rights in any court.

Extension of low limit credit contract and consumer lease consumer protections

Legal Aid NSW strongly supports the proposed strengthening of consumer protections for small amount credit contracts (SACCs) and consumer leases announced by Minister Frydenberg (which are not detailed as part of this consultation). We have previously made extensive comments and recommendations regarding these products[7], and welcome the Government's commitment to limiting consumer harm while ensuring financial inclusion for consumers experiencing vulnerability. In addition, we suggest that enhanced protections should include broad anti-avoidance protections to prevent credit providers from predatory practices.[8]

Conclusion

The proposed reforms mark a shift away from a complementary system of individual consumer protection and prudential regulation, in favour of a focus solely on prudential regulation. Legal Aid NSW is concerned that this will result in significant harm to vulnerable consumers and their families.

The stated rationale for the consumer credit reforms is to reduce barriers to the provision of credit. However, we refer to Commissioner's Hayne's statement in Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry:

> Treasury indicated that '[t]here is little evidence to suggest that the recent tightening in credit standards, including through APRA's prudential measures or the actions taken by ASIC in respect of [responsible lending obligations], has materially affected the overall availability of credit'.[9]

[7] We refer to our February 2020 submission into *National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2019 (No. 2)* which, in response to the proposed Bill, sets out recommendations for avoiding consumer harm (available at <https://www.legalaid.nsw.gov.au/__data/assets/pdf_file/0005/39245/200226-LANSW-submission-National-Consu~Protection-Small-Amount-Credit-Contract-and-Consumer-Leases-Reforms-Bill-2019.pdf>). Legal Aid NSW has also previously provided submissions to the Independent Review of the Small Amount Credit Contract Laws (the SACC Review) and made submissions on the Final Report in May 2016 (available at *<https://static.treasury.gov.au/uploads/sites/1/2017/06/C2016-016_Legal_Aid_NSW.pdf>)* and the Interim Report in January 2016 (available at *<http://consumercredit.treasury.gov.au/content/downloads/SACCsubmissions/InterimReport/Legal_Aid_NSW.pdf>).*

[8] For example, encouraging vulnerable consumers to take up higher value loans above $2000 in order to avoid responsible lending obligations.

[9] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, February 2019), vol 1, 57.

Legal Aid NSW does not support winding back consumer protection in the way outlined in this consultation, particularly when there appears to be little evidence that the flow of credit is currently restricted.