National Finance Broking Legislation: Joint Consumer Submission

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Dear Sirs/Mesdames,

National finance broking legislation
Joint consumer group submission

This response has been prepared by the Consumer Action Law Centre ["Consumer Action"] and Consumer Credit Legal Centre (NSW) ["CCLC"] on behalf of the following organisations:

- Australian Financial Counselling and Credit Reform Association
- CARE Financial Counselling Service/Consumer Law Centre (ACT)
- Centre for Credit and Consumer Law
- CHOICE
- Consumer Action Law Centre
- Consumer Credit Legal Centre (NSW)
- Consumer Credit Legal Service (WA)
- Financial Counsellor's Association of NSW
- Public Interest Law Clearing House (NSW)

In preparing this submission we have had access to the submission prepared on behalf of the Mortgage Finance Association of Australia (the "MFAA submission") and we make reference to that submission where relevant.

The above organisations are strongly supportive of the draft National Finance Broking Legislation (the **draft legislation**) and believe it should be legislated as a matter of urgency. We believe that the draft legislation would, if implemented, greatly assist Australian consumers of credit. The aspects of the legislation that, in our view, particularly valuable for consumers include:

- the requirement for brokers to independently satisfy themselves that the borrower can repay the loan without hardship;
- the requirement that brokers be licensed;
- the requirement that brokers act efficiently, honestly and fairly and in the best interests of consumers;

- the requirement for finance brokers to be members of an external dispute resolution (**EDR**) scheme;
- the provision of a public register of brokers and brokers' representatives;
- the requirement that brokers hold mandatory professional indemnity insurance; and
- the requirement that brokers disclose the commissions they receive

We note that the draft legislation, in some respects, imposes higher conduct standards on borrowers compared with lenders. For example, preventing brokers from refinancing consumers with more expensive credit, and requiring brokers to independently verify a consumer's capacity to repay a loan, both may impose better and stricter standards on brokers than on lenders. However, two key points must be noted:

1. The involvement of brokers in a transaction can limit a consumers' access to remedies they would otherwise have against the lender. For example, the chances of having a credit contract re-opened are reduced if the claim arises due to misleading or unfair conduct by the broker; and

2. It is accepted that there are problems with the current credit regulation that need to be addressed, including the lack of an effective obligation to assess ability to pay.

Currently, the opportunity is to reform the law relating to finance brokers, and if positive incremental advances can be made, then they should be made. We must avoid the situation where lenders and brokers can argue that they should have the same obligations as each other – this would lead to a "lowest common denominator" approach to regulation and would ignore the fact that they fulfil very different roles.

We note the strong objections by some industry representatives to some of the detailed provisions of the legislation. We also question whether this level of detail is best placed in legislation rather than in a more flexible regulatory instrument. Therefore, in the interests of ensuring the speedy progress of this urgently needed legislation, we suggest that the principles of the provisions dealing with assessment of capacity to pay and appropriate finance be preserved in the legislation, and that some of the more detailed requirements be moved to a mandatory code of conduct, the content of which could be negotiated during and after the passage of the overarching legislation. This would enable the important regulatory framework, including licensing, access to external dispute resolution, general duties to the consumer, and disciplinary processes to be established as a matter of urgency pending the resolution of some of the more contentious details.

We suggest that principles to the following effect remain in the legislation (some of these are copied or adapted from principles put forward by the MFAA, others are additional):

- "a broker must act fairly and responsibly towards the consumer";

- "a broker must not supply the lender with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete";

- "a broker must take into account the borrowers' capacity to repay any credit contract without undue hardship";

- "a broker must only recommend or arrange credit or other financial products that are consistent with the borrowers' credit requirements and appropriate to the borrower's apparent needs and circumstances";
- "a broker must not improperly or unfairly fail to provide details of credit products that meet the borrower's credit requirements and would be appropriate to the borrower's apparent needs and circumstances";
- "a broker must not favour his or her own interests above those of the borrower";
- "a broker should record the reasons for any credit proposal recommended or arranged. Where a credit proposal is intended to replace existing credit arrangements, the broker's reasons should include the comparative cost of any new arrangement as compared to the previous arrangements, any substantive change to the terms of the credit including the amount and timing of repayments, the cost of exiting the current credit arrangements, and any other factor relevant to the needs of the consumer";
- "The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes";

We anticipate that further detail in relation to best practice in this regard would be included in mandatory Code of Conduct referred to above.

More detailed commentary is included below on the need for these specific principles to be enshrined in the legislation. Comment is also provided on the current drafting of some provisions in the event the legislation is to proceed in close to its current form.

Matters not currently covered by the draft legislation

Fees and Commissions

Consumer groups have unsuccessfully argued for a cap on fees and commissions in the past. We are not repeating that submission in this instance, although we continue to believe there is a case for such a limitation.

In this submission we are advocating a prohibition or cap on the amount of fees that can be directly financed from a loan at settlement. Whereas the majority of brokers obtain their income from commission paid by lenders, some brokers (some of whom are classified as "introducers" by lenders rather than brokers) obtain their income from significant fees charged directly to the consumer and paid upon settlement of the loan out of the funds advanced (this may or may not be in addition to a commission paid by the lender). In the worst cases of predatory lending experienced by our clients, these fees are substantial, exploitative, and could not be paid by the borrowers unless they were financed as part of the loan.

As demonstrated by the following table showing the amounts paid to brokers by actual clients of consumer assistance agencies compared to their loan amount[1], the amounts charged by some brokers bear no relationship to the amounts borrowed and are arguably more an indication of the relevant borrowers' personal disadvantage or desperation (and arguably the risk perceived by the broker in undertaking a "dodgy" transaction).

Brokerage by Loan Size		
Loan amount	Brokerage	Percentage of loan
$122,000	$19,615	16%
$255,000	$19,855	7.7%
$255,000	$8,920	3.4%
$502,000	$16,000	3.1%
$110,000	$2,995	2.7%
$223,750	$5,500	2.4%
$300,000	$4,030	1.3%
$170,000	$1,105	0.65%
$256,000	$300	0.12%

In our experience those clients who pay the highest fees are those with the least capacity to meet their repayments on an ongoing basis and the addition of these fees to the outstanding balance of their loan exacerbates this problem. Often the fees are successfully hidden until settlement of the loan by obtaining the borrower's signature on incomplete documentation. In short, this practice is simply equity stripping – the brokers takes his or her fee at settlement and the lender later recovers the entire amount plus interest and default charges from sale of the security property when the borrower inevitably defaults.

We submit that a prohibition on financing such fees into the loan amount, or a cap on the amount of brokerage that can financed from the loan, would effectively reduce the incidence of predatory loans. Even if the funds to pay such fees are obtained from other sources of credit, it would be much more difficult to obscure the amount of the fees if the borrower needs to apply for a second loan, or use a credit card, to pay those fees.

Industry participants[2] at the Predatory Lending Forum[3] held in Sydney on 29 August 2007 unanimously supported placing a limit[4] on the amount of broker fees which could be financed as part of a loan.

There is a precedent for this strategy in the United States. North Carolina has specific provisions applicable to high cost lending including a complete prohibition of financing fees or insurance premiums into a mortgage loan covered by the legislation. We are not seeking

[1] Details derived from an unpublished survey conducted by CCLC in May 2005 of legal aid, community legal centre and financial counselling clients who had refinanced their home loan in the previous five years in response to financial difficulty and then found themselves in financial difficulty again. More details are available in the CCLC submission to the Productivity Commission review of the Consumer Protection Framework, Submission 95 available at http://www.pc.gov.au/inquiry/consumer/submissions

[2] Industry participants included ABACUS, the Australian Bankers Association and the Mortgage Finance Association of Australia.

[3] The Forum was an initiative of the Predatory Lending Project, an alliance of Legal Aid, CCLC and other specialist consumer/credit legal centres, the Public Interest Law Clearing House and member law firms formed to address predatory lending in the home mortgage market.

[4] Time did not permit a full discussion about what that limit should be.

selective application of this rule as is the case with the targeted predatory lending laws in North Carolina. At the same time, we are not seeking to prohibit or limit the financing of all fees, only brokerage fees. In effect, because of the predominance of brokers who are remunerated solely by lender commissions, the provision is self-targeting. We aware that some brokers charge fees to the consumer, do not collect lender commissions to maintain their independence, and do not charge exorbitant or exploitative amounts. Those fees could be collected directly from the consumer rather than financed into the loan. Alternatively, there could be a monetary limit (appropriately indexed) on the amount that could be financed.

Comments on the specific provisions of the draft legislation

Definition of Credit

We are greatly concerned that the definition of credit does not include consumer leases, vehicle leases, equipment leases or any other variation on financing arrangements which do not technically include the deferment of debt. This creates an anomalous situation where many transactions conducted by brokers will not be covered by the Act. Not only is this undesirable itself, but it opens up the possibility of product steering to avoid coverage of the Act and the development of practices to exploit the loophole thus created. The definition must be amended to include leases and any other arrangement that would be commonly included in the financing options made available by brokers and other relevant intermediaries.

Definition of Broking

Consumer groups welcome the broad definition of finance broking and particularly the inclusion of advice about credit arrangements (such as mortgage reduction schemes) even where another broker negotiates the credit. We also support the inclusion of car dealers and retail outlets where credit is made available to consumers for the purpose of purchasing goods, although we anticipate some fine tuning of the provisions may be necessary to ensure that responsibility for compliance with the legislation in those circumstances vests in the most appropriate entity. Credit available at point of purchase is not only a common source of consumer credit complaints, but the landscape is increasingly complex with a range of credit and leasing products sometimes made available.

Granting and revoking licenses

We strongly support a nationally uniform and coordinated approach to licensing. The draft legislation appears to allow each jurisdiction to tailor licensing application processes. Noting that a licence in one jurisdiction will qualify brokers to trade in all jurisdictions, we are concerned that jurisdictions with ‘softer touch’ licensing practices will invite forum shopping.

It is our view that the appropriate regulatory authority should have the right to refuse a license application if the applicant has breached consumer protection legislation. This could be achieved by adding a subsection (d) to subsection 11(2) reading: ‘if he or she has been found by a court to have breached a consumer protection provision of the *Trade Practices Act* or any equivalent State or Territory consumer protection act.'

In particular, there may be licensees who have been found by a court to have engaged in misleading and deceptive or unconscionable conduct and to whom it would not be appropriate to grant a license. Breaches of consumer protection laws obviously harm many consumers, and many individuals who breach such laws have a predatory attitude and do not have a suitable character to be finance brokers.

A national system would also deal better with the problem of cancellation of licences. As a broker need only hold a licence in one jurisdiction to trade nationally, there needs to be a coordinated approach to a regulator identifying malpractice and revoking licences. If New South Wales, for example, identified a ground for cancellation of a broker's licence, it would be incongruent for them not to be able to cancel it merely because the licence was obtained in Victoria.

Length of license

In section 10(3) of the draft legislation, the length of broker licenses is not defined. The summary explaining this subsection advises that the length of the broker license will depend on the local jurisdiction. We see no reason for the length for which a license is granted to be non-uniform and depend on jurisdiction. It seems incongruous that in a national market, the length of licenses issued depends on the location in which they were issued. The length of licenses should be consistent.

Liability of credit providers for unlicensed brokers

We strongly support the liability of credit providers for the actions of unlicensed brokers. The regulatory system should not be dependent on consumers knowing that they must deal with registered or licensed brokers. Educating consumers of this fact would be an expensive exercise for government, consumer groups and those members of industry who take part. It will also never be 100% effective and there will always be desperate people who agree to deal with operators outside the regulatory regime regardless of their knowledge. To be effective the onus must be on credit providers to deal with licensed/registered brokers only and the consequences of doing otherwise must be an automatic implied agency relationship between the broker and the credit provider for the purposes of dealing with complaints by the consumer. This is the **<u>only</u>** way that illicit operators can be effectively excluded from the market.

Business purposes loans

a) Misrepresentation of consumer loans as business purposes loans

The use of business purposes declarations to avoid the UCCC is matter of serious concern to consumer assistance agencies. We acknowledge that work is currently being undertaken by government and other stakeholders to address this issue via amendment of the UCCC. It is vital that this legislation addresses this conduct. It is also important that this legislation is consistent and complementary with any amendment to the UCCC. Further, brokers and other intermediaries covered by the draft legislation should not be able to avoid compliance with the draft legislation itself by classifying loans as business or investment purposes, as is currently the case with the broker legislation in both NSW and Victoria.

We note that the inclusion of section 33(2) in the draft legislation is intended to address this issue. We have a number of concerns with this approach:

- The placement of the section in Part 3 Division 1 means that the section will not come into play until Schedule 1 Section 2 has been overcome. While the onus is on the broker in Schedule 1 Section 2 to show that the service has been provided for a bona fide business transaction, the two stage process of having to first counter any suggestion that the finance was provided for a bona fide business purpose in the Schedule before section 33 (2) can be considered seems to add unnecessary layers of complicated legal argument and potential for divergent and unintended interpretations. If there is a gateway provision regarding business purpose transactions then it should be placed in the schedule.
- The current drafting of section 33(2) places too much weight on the requirement to make inquiry of third parties in establishing a business purpose. Firstly there may be practical problems in finding an appropriate third party to verify some genuine business transactions. Secondly, the experience of the clients of consumer assistance agencies and the case law both suggest that the practice of using "tame" third parties, particularly accountants, to verify the financial position of applicant borrowers, some of whom they have never met let alone inspected their financial records, is fairly well-entrenched. This method could be easily adapted for verifying non-existent business purposes. It may be difficult to prove a "business relationship" in all such cases. Thirdly, and most importantly, the focus on third party inquiries reduces the section to a "tick-a-box" requirement that detracts from the real issue – that being that the broker should ensure that business transactions are bona fide, something which could be established from a range of evidence including but not limited to documentation (such as business financial records or a business plan), third party inquiries, the existence of an ABN and/or business name etc.

It is important to note that the issue to be addressed by this part of the legislation is not, as could be implied, that brokers cannot rely on the instructions of their clients. On the contrary, our experience is that many consumers fully disclose their financial position, including arrears on an existing loan or loans to the broker, and it is the broker that suggests that the loan be falsely categorised as being required for a business. The need for verification is largely directed at making it more difficult for brokers to encourage consumers to sign false business purposes declarations, or to simply dictate paragraphs for consumers to sign setting up false business or investment purposes.

We submit that section 33(2) should be moved to the Schedule and that the specific requirement in relation to third parties should be deleted and replaced as follows:

> "unless the finance broker is satisfied, upon making reasonable inquiries, that the credit is sought wholly or predominantly for other purposes."

The meaning of "reasonable inquiries" is something we think could be appropriately explored in a mandatory code of conduct.

We also submit that there should be very specific provisions carrying a penalty for breach, applicable to all types of finance (not excluded as a result of the Schedule), to the effect that:

- "The broker must not supply the lender or any other person with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete." (almost identical to a principle suggested by the MFAA submission)

- "The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes."

While the latter section is somewhat repetitive of the former, it serves two additional purposes:

1. To assist where actual subjective knowledge of the broker is difficult to establish;
2. To serve as a very clear message to industry participants that the use of false business purposes declarations is an unacceptable practice. This is necessary because it is apparent from current industry practice that procuring a false business purpose declaration does not carry the same import as presenting, for example, false income information. The experience of our clients (and staff) is that some sales representatives present a business or investment purposes declaration as simply a method of accessing a broader range of finance products, or a tax concession (regardless of the real purpose of the loan).

b) Bona fide business transactions

We support the inclusion of broking for small business customers within the purview of the Act. There has been widespread recognition that small businesses customers of credit and other financial services can be as vulnerable as individual consumers making household domestic purchases. The economic damage done by unacceptable market conduct in this market sector is potentially as destructive as in the personal domestic domain. In recognition of this, the general regulation of financial services under the *Corporations Act* 2001 (Cth) includes small business and investors, as does the limited credit jurisdiction under the *ASIC Act* 2001 (Cth). Important industry codes, such as the Code of Banking Practice[5], cover small business and investors.

We note that the MFAA submission argues that there is no evidence of problems in the small business finance broking market. CCLC asserts the contrary. In the months immediately

[5] Code of Banking Practice cl. 1.1.

following the release of the March 2003 report, "*A report to ASIC on the finance and mortgage broker industry*", CCLC received many calls from business and individual investors recounting very similar stories to those contained in the case studies attached to the report. As many of the structural problems such as conflict of interest, and a lack of adequate regulation or required standards, apply to all forms of finance broking, these complaints were not entirely surprising. As CCLC is funded to assist individuals rather than businesses, we could not provide any advice or assistance in those cases. We recognise that some small business broking is very different in nature and impact to large personal purchases such as residential housing, and that speed is often of the essence. However, it is vital that such customers are at the very least given adequate information about the nature and cost of products and services provided and access to external dispute resolution in the event of a dispute.

We submit that most of section 32 should also apply to small business transactions. Further, most of the principles outlined in the opening section of this submission should also apply to small business broking. The following principles as a minimum must apply to all transaction including those conducted for small business:

- "a broker must act fairly and responsibly towards the consumer";
- "a broker must not supply the lender with any information which the broker knows, or ought to know, is misleading, deceptive, inaccurate or incomplete."
- "a broker must not favour his or her own interests above those of the borrower"
- "The broker must not procure a false business purposes declaration from a consumer, or otherwise arrange a business or investment loan when the broker knows, or ought to know on the basis of the information provided, that credit is required for predominantly personal, domestic or household purposes."

We also note that the current wording of the Schedule 1, subsections 2(1) & (2) is that the exemption applies where "a finance broker provides the service to a consumers for the purpose of a bona fide business transaction...". We are concerned that these subsections could be interpreted as the broker's subjective intention, divorced from the borrower's intention or any objective information (as has been the case with some decisions involving Section 6(1)(b) of the UCCC). As stated above, we think that section 33(2) (amended as suggested) should be moved to Schedule 1, or the determination as to whether this Act applies should be clearly stated to turn on the actual use of the funds, rather than either party's intention.

Borrowers' capacity to repay

As stated above, we strongly support the requirements for finance brokers to investigate the borrower's capacity to repay the loan without hardship. However, as also stated above, we submit that this broad principle only should be incorporated into the legislation, with the detail and extent of the broker's duties to be set out in a mandatory Code of Conduct.

We note the MFAA submission's argument that it is the lender in any credit transaction who should assess capacity to pay and that the duty of the broker should be confined to supplying the lender (or any other relevant person) information which is to the best of their knowledge neither misleading, deceptive or inaccurate. We also note that lending criteria vary from lender to lender and product to product, making it difficult to set any single standard of capacity to pay.

We have seen evidence of the following practices engaged in by brokers which frustrate the lenders ability to properly assess capacity to pay, most of which would be addressed by the MFAA suggested solution:

- Encouraging borrowers to extrapolate their income from a very short, atypical period or otherwise exaggerate their income;
- Encouraging borrowers to fabricate their income, including arranging for accountants to provide false verification for general capacity to pay, for a particular income level or a non-existent business which apparently generates income;
- Taking blank, signed forms from borrowers and completing them afterwards with incorrect income details;
- Altering loan application forms, including income details, after borrowers have completed and signed the forms with genuine income details.

We therefore support the principles put forward by the MFAA to the effect that:

- "a broker must act fairly and responsibly towards the consumer";
- "a broker must not supply the lender with any information which the broker knows is misleading, deceptive, or inaccurate."

We would alter the second principle slightly to read that "a broker must not supply information that *he or she knows, or ought to know*, is misleading, deceptive, inaccurate or incomplete." This is necessary to get around the difficulties presented by proving a broker's subjective knowledge when it is patently obvious from the information available that the broker should have had the requisite knowledge.

However, we are also aware of lenders who give little attention to capacity to pay on some products, particularly low-doc and no-doc products. For example, the lending criteria of one lender states that for one particular product if the borrower has an ABN, and the LVR is no greater than 75%, no proof of income is required. While it would be clearly preferable that lenders also had a duty to properly assess capacity to pay, the current law is at best ambiguous. However, as stated in our opening comments, the involvement of brokers in a transaction can limit a consumers' access to remedies they would otherwise have against the lender. For example, the chances of having a credit contract re-opened as unjust are reduced if the claim arises due to misleading or unfair conduct by the broker and the broker is not found to be the agent of the credit provider. Of course we would enthusiastically support any move to increase lenders' obligations in this regard, but this is an opportunity to ensure that brokers do not steer consumers towards these products inappropriately, and in full knowledge that repayment will be exceedingly difficult, if not impossible. Further, in our experience to date, the inappropriate distribution of low-doc and no-doc products is conducted exclusively through brokers, making the broker's role in the transaction an appropriate point for intervention.

Other examples of affordability issues that brokers fail to take into account in recommending products to consumers include, for example:

- Balloon payments at the conclusion of loans;
- Short-term, interest-only mortgages where the entire amount outstanding becomes payable within a 12 months to five years;
- Home loans that have a period (which may or may not be equal to the term of the loan) of no repayments and capitalised interest, or "pre-paid interest", that are not reverse mortgages and therefore require the sale of the home at the end of the term;
- The need to meet repayments on other credit accounts that are not refinanced by the loan.

While it is not the role of the broker to set lending criteria and precise formulas for determining serviceability, brokers should not be able to recommend or arrange products that the borrower clearly cannot afford. We therefore propose an additional principle to possibly replace the current section 33(3 - 6) to the effect that:

> "a broker must take into account the borrowers' capacity to repay any credit contract without undue hardship".

More detail about what is required to meet this standard could then be included in the mandatory Code of Conduct.

In the event that the above provisions remain in the legislation in close to their current form, then we make the following comments:

- The prohibition on having reference to assets in assessing ability to pay (as opposed to assessing whether the security is adequate) could be more narrowly construed. Generally speaking, we support the principle that loans should be repaid from income, including projected rental income for investment properties. However, a complete ban on taking into account asset values does appear to be needlessly inflexible, particularly if the general principle of appropriate finance is adopted. We suggest that the section, if it remains, should require that , capacity to pay should not be reliant on the sale of the borrower's home;
- The requirement to take into account future events is very broad. Brokers, like lenders, should not be required to have a crystal ball, or extensive actuarial training. It would also be inappropriate to project pay rises in assessing capacity to pay. However, there are certain very predictable events that should be taken into account in assessing the affordability of a loan, such as balloon payments, the requirement to pay out short-term mortgages at the end of the term, the unavailability of Centrelink payments for dependent children once they reach a certain age and imminent retirement to name a few. The section could perhaps be reworded as a requirement

to take into account reasonably foreseeable changes in the borrower's circumstances which may impact on capacity to pay.

Credit recommendations and comparisons

Section 36 addresses matters to be complied with if a broker puts forward two or more credit proposals. We are concerned that this section will work to the detriment of consumers by discouraging brokers from making multiple options available to the consumer and from recommending one over another because of the more onerous obligations imposed in these circumstances. In the worst examples of broker misconduct that the authors of this submission are aware of, the broker presents one option only. This provision will have little effect in those scenarios and is therefore more likely to deprive more mainstream consumers from being presented with a range of options.

Section 37 deals with reverse mortgages. The extra protection given to consumers entering into reverse mortgage contracts is appropriate. Reverse mortgages are often hard to understand, can cause consumers to discount long-term needs, and are generally sold to older consumers (some of whom are especially vulnerable). However, we are concerned at the narrowness of the definition of 'reverse mortgage' in the draft legislation. We perceive that there is a risk that equity release loan agreements may, after the enactment of the draft legislation, be structured to escape the definition in the draft legislation. Further, other credit products requiring particularly complex advice (such as shared appreciation mortgages) are not covered by the provision.

The availability of reverse mortgages, along with general marketing encouraging people to "release" their equity, appears to have created fertile ground for misrepresentation, misunderstanding and unjust conduct. In a number of instances, loan agreements have been misrepresented to elderly consumers as reverse mortgages, or as equivalent to reverse mortgages in effect, when in fact they are neither. For instance, in March 2007 Consumer Action's legal advice line dealt with a case involving a 62 year old man with Alzheimer's disease who was given a secured personal loan that was misrepresented as a reverse mortgage by a well-known non-bank lender. CCLC is also acting for three couples in their 60s who were sold five year loans with capitalised interest instead of a reverse mortgage. All three couples face the necessity of selling their home in order to repay the loan at the end of the five-year term with significantly reduced equity. All three couples had intended to live in their homes until death or serious incapacity forced them to move. CCLC has also seen examples of elderly consumers being sold equity release products such as a line of credit secured by their home in lieu of a reverse mortgage. One such couple is now faced with selling their home despite the elder member of the couple having reached 70, having used most of the equity they drew down to make repayments on the loan. While it could be argued that such products do not meet the borrower's credit requirements, this may be difficult to prove if the broker has drafted the consumer's credit requirements to fit the product intended to be sold.

Section 38 places particular obligations on brokers where a transaction involves the refinancing of existing credit commitments. Again we support the imposition of specific obligations in these circumstances. We also support the specific duties contained in the section. However, we feel that the section does not adequately address some of the common disadvantages of refinance arrangements including:

- The increased risk associated with transferring unsecured debt to secured debt, particularly where that security is the family home;
- The increased risk of incurring further unsecured debt when the original problematic debt has been "dealt with" without addressing any underlying imbalance in income and expenditure;
- Encouraging borrowers to borrow more than necessary "just in case" and risking unnecessary higher indebtedness.

There are also other issues pertinent to credit "advice" that are not addressed in the legislation, including but not limited to the implications of interest-only loans and secured lines of credit, and the appropriateness (and questionable effectiveness) of some mortgage reduction packages.

We submit that the detailed provisions in the draft legislation be replaced with a variation on the principles proposed by the MFAA submission in relation to the comparison of credit proposals. The following should be applicable to all transactions regardless of whether the broker puts forward multiple credit options and/or the borrower is refinancing and/or the product proposed or arranged is a shared equity or equity release product. We submit that these provisions could replace the current sections 35(3), 36, 37 & 38:

- "a broker must only recommend or arrange credit or other financial products that are consistent with the borrowers' credit requirements and appropriate to the borrower's apparent needs and circumstances";
- "a broker must not improperly or unfairly fail to provide details of credit products that would be appropriate to the borrower's apparent needs and circumstances";
- "a broker must not favour his or her own interests above those of the borrower"
- "a broker should record the reasons for any credit proposal recommended or arranged. Where a credit proposal is intended to replace existing credit arrangements, the broker's reasons should include the comparative cost of any new arrangement as compared to the previous arrangements, any substantive change to the terms of the credit including the amount and timing of repayments, the cost of exiting the current credit arrangements, and any other factor relevant to the needs of the consumer."

Again we anticipate that further detail in relation to best practice should be included in the mandatory Code of Conduct. Specific guidelines in relation to reverse mortgages, shared equity products, secured lines of credit, and other equity release products should be included in the Code of Conduct.

Alternatively, if the provisions are retained, the Section 37(1)(b) commencing "if, after making inquiries of the borrower….." should be reworded to ensure that there is a positive obligation on the broker to make such inquiries. The current wording of the section could possibly be construed otherwise. Consideration should be given to extending the coverage of this section to include a broader range of products, particularly any product where the debt may increase over time despite the borrower complying with the terms and conditions, or where the amount owed has a relationship to the current property value. Loans where the amount owed does not necessarily decrease despite repayments (interest-only/line of credit loans) also require specific advice. This issue should be covered in either the legislation or the Code of Conduct (if that course of action is adopted).

Penalties

The penalties for serious contraventions of the draft legislation should be set somewhat higher. For instance, unlicensed broking should carry a harsher maximum fine than $22,000. Such a low fine runs the risk of creating the situation where the benefit an individual gains from breaching the law (e.g. broking without a license) outweighs the fine s/he must pay if caught. It is equally important for there to be adequate funding for enforcement action by regulators.

Definition of professional misconduct

The definition of professional misconduct should be expanded to include breaches of provisions in consumer protection acts. Clearly, a broker who engages in misleading and deceptive and/or unconscionable conduct under the *Trade Practices Act* while providing a broking service has committed misconduct. Breaches of consumer protection acts in the course of providing a broking service should constitute professional misconduct.

Administration of compensation fund

The proposed compensation fund should not be controlled by the regulator, and its governing body should be entirely separate from the regulator. To separate the compensation fund from the regulator would be consistent with good governance principles. The board of the compensation fund should be independent and representative – it should have an equal mix of consumer and business representatives.[6]

Type of EDR schemes that should be approved

Only EDR schemes approved by the Australian Securities and Investment Commission (**ASIC**) should be approved for the purposes of the draft legislation. ASIC-approved EDR schemes meet minimum consumer protection requirements. The simplest way to ensure that brokers belong to EDR schemes that are capable of, and willing to, fairly and effectively resolve consumer/trader disputes is to approve only ASIC-approved schemes. ASIC has a strong consumer protection record and years of experience in monitoring and approving EDR schemes. The requirements it imposes on EDR schemes it approves are appropriate.

[6] Section 57 of the *Motor Car Traders Act (Vic) 1986* requires the Claims Committee of the Motor Car Traders Guarantee Fund to consist of at least one business representative, one consumer representative and one lawyer.

Stay of proceedings brought by a lender

We strongly support the range of consumer remedies provided for in Part 4 of the draft legislation. In particular, we support the ability for a proceeding begun by a lender against a borrower for repossession of a home to be stayed where proceedings have begun under this legislation against a broker (either in a court or through an external dispute resolution process). Consumer groups have long lobbied for recognition that remedies against a broker are often inadequate when the real issue at stake is often an unsuitable loan. For this reason we have lobbied in the past for brokers to be deemed the agent of the lender. While we have been unsuccessful on that count, we believe that this provision is an important measure to avoid serious injustice.

We are aware of considerable industry opposition to the section 54 provision for a stay. We believe that opposition is unfounded. The provision is couched very narrowly, and there is ample provision for the court to have regard to the lender's interests in granting the stay. The stay is only available where: the borrower's residential home is at risk; where the action against the broker could, if successful, prevent the need to foreclose on the home; and the interests of either party will not be irretrievably affected if such an order is made. We submit that the circumstances in which all three of the above pre-conditions apply will not be frequent. Further, to allow the lender to take action to take possession and sell a person's home in such circumstances is manifestly unfair and potentially results in unnecessary personal and social costs.

We submit that the section should not only be retained but amended slightly as follows to ensure that appropriate borrowers are not needlessly excluded from its application:

1. The term "irretrievably affected" is very broad. Arguably, a very minor but enduring deterioration in the lender's position would warrant the rejection of a stay application. Section 54 should require the lender to demonstrate that they will be *substantially and irretrievably* affected in order to defeat the application for a stay.
2. Section 54(4)(b) arguably makes some capacity and willingness to make repayments on the part of the borrower essential to obtaining a stay. There is no need to make the requirement to make repayments on the part of the borrower pivotal in itself. While most home loans are large enough that some ongoing repayments would be necessary to prevent irretrievable deterioration of the position of the lender *and* the borrower, this will not be the case with smaller loans. CCLC has been involved in cases involving smaller loans, secured by registered or equitable mortgage over the borrower's home, where the recovery of the broker's fees, set up costs and other damages such as default interest and legal fees, would be sufficient to set off the entire loan. The ability to make repayments pending the outcome of the broker proceedings should be but one issue to be canvassed in determining whether the interests of the parties will be substantially and irretrievably affected.

The MFAA submission also argues that the provision is unnecessary, needlessly duplicating the Supreme Courts' broad discretion to grant stays in possession proceedings. A perusal of the case law in relation to mortgages under the Contracts Review Act in NSW and the recent UCCC matter of *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook*[7] reveals that whereas most of these cases involved brokers, their role receives little, if any attention, by the Court. While this is a natural consequence of proceedings in which the dispute for adjudication is between the borrower and the lender, we submit that there is arguably little awareness among Supreme Court judges of the key role played by brokers in today's mortgage market. Further, the provisions of the draft legislation are both new and novel, in so far as they clearly recognise the blurring of roles between brokers and lender as a result of lenders effectively outsourcing some, or all, of their direct customer interface. As a result, a specific provision which gives the Court a clear mandate to grant a stay in the circumstances outlined, and importantly guides the exercise of that discretion, enables borrowers to have access to a stay in appropriate circumstances, while ensuring that all parties are protected from the consequences of applications which are ill-conceived in terms of their long-term impact.

The MFAA submission also raises the prospects of increased PII premiums or other barriers to getting PII cover as a result of this stay. In the light of the narrow construction of the circumstances in which the stay is available, and the requirement for the court to have regard to any irretrievable affect on the lender's interest, we think that claims for damages as a result of this provision and a consequential impact on PII premiums or availability is unlikely.

We also believe consideration should be given to a broker being able to be joined to a proceeding brought by a lender for repayment of a debt, where there is no threat of repossession of a home. Brokers are not exclusively involved in home or securitised lending, and if a consumer has an action against a broker in relation to such a loan, then it is fair and efficient for that to be dealt with in the context of any action by a lender for repayment of a debt.

Mortgage repossessions take a serious toll on individuals, families, and communities. They also increase the demands on government and community services. Unnecessary repossessions should be avoided if at all possible. While we do not believe the stay provision will be widely used, its absence would mean that some consumers with unjust loans would face pyrrhic victories whereby having won their case against the broker they still lose their home.

Limitation periods

In section 52 of the draft legislation consumer remedies are subject to a 3 year limitation period. This limitation period is unreasonably short. In some situations, consumers will not be aware that they have suffered loss until well after the finance broking service was provided. A 3 year limitation period will mean that deserving consumers are denied a remedy. A 6 year limitation would be more appropriate – far fewer consumers would be unaware of their loss after 6 years compared with 3 years. Ultimately, limitation periods are a balance between individual justice and general commercial certainty, and in our view a 6 year limitation period would constitute the best balance.

[7] [2006] NSWSC 1104.

Implementation of legislation

We note that the draft legislation states that the 'current arrangement is for similar, but not necessarily identical, bills to be introduced in other jurisdictions'. Our concerns about this would likely be shared by other stakeholders. From our perspective, the non-uniformity could cause a reduction in coordination between the various regulators to the detriment of consumers.

While we would certainly support non-uniform legislation that is substantially similar to the draft legislation, it is worth considering the feasibility of taking a uniform approach such as that existing for the Uniform Consumer Credit Code (**the UCCC**).