

SUBMISSION

Financial Services and Credit Reform Green Paper June 2008

**Submission on behalf of the
Legal Aid Commission of New South Wales to
The Treasury
Australian Government
1 July 2008**

The Legal Aid Commission of New South Wales (Legal Aid NSW) is established under the *Legal Aid Commission Act 1979* (NSW) and is an independent statutory body. It provides legal services to socially and economically disadvantaged people. Legal services include representation in federal and state courts and tribunals. It also works in partnership with private lawyers in representing legally aided people.

Our experience in consumer law

In the 2006-2007 financial year Legal Aid NSW assisted more than 162,736 clients with civil law matters through information, advice or representation. Legal Aid NSW solicitors frequently advise clients and litigate a range of matters under consumer protection legislation, including many that are credit related. In the 2006 -2007 financial year Legal Aid NSW either acted in or funded approximately 205 new consumer law litigation cases. Legal Aid NSW has recognised expertise in the area of consumer credit law and has made numerous previous law reform submissions.

Legal Aid NSW has also dealt with a significant number of matters in which finance brokers have been involved.

Overview

Legal Aid NSW agrees that there is need for reform of the present regulatory environment in relation to credit due to the difficulty in implementing agreed solutions to problems in a timely manner under the current regulatory framework and the importance of addressing predatory lending for both consumer protection and economic management reasons.

By way of example of the problems with achieving timely reform under the current structure:

1. the hardship threshold was \$125,000 when the legislation commenced. In December 1999 the Post Implementation Review (PIR) recommended that it be changed “to a level sufficient to cover most Australian home mortgages”¹. It was not until 5 November 2004 that it was changed, at which time it was changed to \$324,940;
2. in December 1999 the PIR recommended that default notices under s80(3) of the UCCC, which are required to be served before enforcement action is commenced, contain information as to the hardship variation provisions of the UCCC. Despite this recommendation being non contentious it has still not been implemented².

Legal Aid NSW will limit its comments to Part 1 of the paper “Mortgages, Mortgage Broking and Non-Deposit Taking Institutions” and Part 6 of the paper “Other Credit Products”.

¹ Post Implementation Review.Final Report. December 1999. Recommendation 2.10

² Post Implementation Review. Final Report. December 1999. Recommendation 2.11

Part 1 of the paper provides three options for Commonwealth regulation:

1. maintain status quo;
2. regulate all credit; and
3. regulate mortgages (and consequently mortgage lenders and brokers)."

For the reasons set out above the first option is not appropriate. Of the remaining options Legal Aid NSW prefers the second for the reasons set out below.

General remarks in relation to current regulatory scheme

At present there is in existence largely uniform legislation regulating consumer credit – the UCCC. Although this legislation has attracted much criticism from consumer representatives, particularly in relation to the weak provisions around responsible lending and the ease with which it has been able to be avoided by unscrupulous lenders via the use of sham business purpose declarations, it has the virtue of regulating virtually all forms of consumer credit.

In relation to the use of sham business purposes declarations there is under consideration a proposal supported by consumers and industry representatives to have the Code apply where the credit has been applied for personal, household or domestic purposes irrespective of the declaration³. In addition there have been a number of court decisions against lenders which should limit the use of sham business purpose declarations to avoid the UCCC in the future⁴.

³ This proposal has been developed by the coalition referred to in the joint media release issued 4 September 2007 by the Australian Bankers' Association
<http://www.bankers.asn.au/default.aspx?ArticleID=1112>

⁴ e.g. *Permanent Mortgages v Cook* [2006] NSWSC 1104, *Bahadori v Permanent Mortgages* [2008] NSWCA 150

Currently the UCCC regulates both consumer mortgages and other consumer credit and Legal Aid NSW believes it appropriate that there continues to be one piece of legislation which regulates both.

Consumer protection needs are not related to whether consumer credit is secured or unsecured – it is irrelevant to the consumer whether they lose their home due to bankruptcy because of an inability to meet unsecured commitments or due to mortgage default. It is also difficult to see a distinction from an economic management perspective as irresponsible lending is capable of enabling consumers to acquire and/or keep assets they cannot afford irrespective of whether that lending is secured or unsecured.

Courts in NSW have recognised the public interest in discouraging irresponsible lending secured over the family home⁵ and there was agreement amongst the participants in the House of Representatives inquiry into home loan lending that irresponsible lending can, at the very least, exacerbate economic downturns⁶.

Given the above considerations compelling reasons would need to be provided to support the Green Paper's preference for the third rather than the second option. Legal Aid NSW does not believe the Green Paper provides any such reasons.

Comments on reasoning in Green Paper

The Green Paper states: "The primary rationale for the Commonwealth to regulate in a particular area is the existence of a national market consisting of consumers with uniform characteristics and needs"; and then goes on to

⁵ Perpetual Trustee Limited v Khoshaba [2006] NSWCA 41, especially Basten,JA at [128]

⁶ House of Representatives Standing Committee on Economics, Finance and Public Administration "Inquiry into home lending practices and the processes used to deal with people in financial difficulty" September 2007 Report pp 54-56

suggest that whilst the markets for mortgage lending, mortgage advice and margin loans have these characteristics the markets for other credit may not.

No evidence is provided for the assertion that there may be regional differences in such markets other than the statement “there have been difficulties in maintaining the uniform credit regime among states. Examples are the interest rate caps that apply only in NSW, Victoria and the ACT and the ACT’s special credit card regulations.”

In fact these differences are more accurately explained by different philosophical approaches to regulation as between different states and territories and, also, by some states and territories going it alone because of the generally acknowledged difficulties of obtaining timely amendments of the UCCC to address agreed problems. The fact that Queensland now has an interest rate cap⁷ is, we submit, not attributable to changing regional needs but rather a change of approach.

Further, it is not likely that the Australian market for credit cards would be one in which the “needs of consumers” differs on a regional basis. Yet, if the Green Paper’s preferred course was to be followed, the responsibility for the regulation of this market would remain with the States.

As regards the remaining reasons given in the Green Paper:

1. “there would be significant transitional and ongoing costs for both the Government and business.” – whilst there would be costs for the Commonwealth there would be a reduction in costs for the States and there would be no significant transitional costs for business if the Commonwealth simply took over the administration of and the legislative responsibility for the UCCC;

⁷ Queensland passed a bill to cap interest rates inclusive of fees and charges on 1 May 2008

2. "The States and Territories would be entirely excluded from the regulation of consumer credit." This is a consequence rather than a reason and there is, in any event, no reason as to why the Commonwealth could not legislate to allow for regional needs if such needs were identified.

Conclusion

For the reasons above Legal Aid NSW would support the Commonwealth taking over the administration of and legislative responsibility for the UCCC.

Legal Aid NSW strongly supports the retention of interest rate caps in the legislation as our experience of predatory lenders who use sham business purpose declarations to avoid the UCCC is that extremely high interest rates do not necessarily deter vulnerable consumers who are often either misled or do not understand their effect. We commonly hear consumers allege that they were told that the high interest rate was only to be charged as an interim rate and they would be transferred to a "normal" loan after making a few payments; or that they misunderstood how the interest rate applied, for example 10% per annum rather than per month. The issue often comes down to one person's word against another with the onus on the consumer.

As regards regulation of mortgage broking Legal Aid NSW supports the Commonwealth taking over this area for the reasons set out in the Green Paper.

Legal Aid NSW is grateful for the opportunity to make a submission in relation to the Green Paper and looks forward to the opportunity to make further comment in this area. For further information please contact John Moratelli via email john.moratelli@legalaid.nsw.gov.au or by telephone on (02) 9407 2948.