Joint Submission from the Financial Counselling Sector

To: Senate Economics Legislation Committee

National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020

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“We are finally at the end of the road and there is nothing left for us to do.

Weekly food bills have [placed] a drastic amount of stress on us especially now as we are providing for our baby. The power and water and land rates are added stress for us. The long hours Jonathan has been required to do and still not having enough money for necessities has taken a toll on our marriage.

Family help out and pay for the odd meal or shoes and clothing for the baby. We feel she is our responsibility and we are failing as parents.

Prior to these loans we both felt proud and a sense of achievement. We both had impeccable credit histories, we now feel worthless, ashamed and depressed. We are going without meals sometimes. This has and continues to cause many sleepless nights as we continue to worry about what next for our family. It is just a horrible situation.”

This quote is from a client of the Financial Rights Legal Centre. The family were given a home loan and a credit card. The home loan was affordable, but the credit card was not. The debts were refinanced and more credit was added.

About Financial Counselling

Financial counsellors provide advice and support to people with money and debt issues. Working in community organisations, their services are free, confidential and independent.

Each year our sector provides advice and support to thousands of Australians experiencing various degrees of financial hardship.

About this Submission

This is a joint submission from the peak bodies in the financial counselling sector.

- Financial Counselling Australia
- Financial Counsellors ACT
- Financial Counsellors Association of NSW
- Financial Counsellors Association of Queensland
- Financial Counsellors Association of Tasmania
- Financial Counsellors Association of Western Australia
- Financial Counselling Victoria
- South Australian Financial Counsellors Association (also covering the NT)

There are around 950 financial counsellors in Australia.

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Glossary

Abbreviation	*Definition*
ADI	Authorised Deposit-taking Institution
AFCA	Australian Financial Complaints Authority
ASIC	Australian Securities and Investments Commission
Credit Act	*National Consumer Credit Protection Act 2009*
EM	The Explanatory Memorandum for this Bill
FSRC	Financial Services Royal Commission (short title for Royal Commission into Misconduct in the Banking, Financial and Superannuation Services Industry)
RLOs	Responsible Lending Obligations
SACC	Small Amount Credit Contract

1 The Financial Counselling Sector Opposes this Bill

1.1 Overview

The financial counselling sector is strongly opposed to this Bill and urges the Parliament to reject it.

The Bill does two main things.

First, it removes responsible lending obligations (RLOs) applying to credit licensees (except for credit licensees that provide small amount credit contracts or consumer leases).[1] Removing RLOs will harm people and families. These aspects of the Bill are discussed in Sections 1 and Section 2 of this submission.

Second, it imposes new requirements on providers of small amount credit contracts and consumer leases.[2] These changes will not adequately address the harm caused by these products, where people can too easily become overindebted. These aspects of the Bill are discussed in Section 3 of this submission.

The opposition to the Bill from the financial counselling sector is grounded in our everyday casework experiences, where we assist thousands of Australians each year who are struggling to pay their debts.

1.2 The Government's Rationale for the Bill is Flawed

The Government's rationale for removing the responsible lending laws is fundamentally flawed. The commentary about how the laws actually work is internally contradictory.

Responsible lending and the flow of credit

One of the reasons advanced for removing the RLOs is that it will improve the flow of credit.[3] The argument rests on two assertions, each of which are discussed below. These are that:

- because of the pandemic, in the future, people need easier access to credit to help the economy recover from the recession;
- the RLOs are currently hindering the flow of credit.

[1] Schedule 1.

[2] Schedules 2 and 3.

[3] See for example the Explanatory Memorandum at page 3.

Easier access to credit will hinder, not help, recovery from the pandemic

We agree the Government needs to support the community in recovering from the economic shocks resulting from the pandemic. While the public health situation has stabilised, those shocks and impacts are continuing, and public health risks with economic impacts from their management will be remaining for some time to come.

Although the economic recovery appears to be happening more quickly than expected, there are still significant shocks flowing through the business sector as JobKeeper ceases, and debt moratoria cease, and business insolvencies start to flow through. Cuts to the JobSeeker coronavirus supplement are also starting to see an increase in poverty levels with further cutbacks possible from the end of March 2021.

It is incredibly concerning therefore that the Government believes loading people up with more debt is the way out of a recession, when all the evidence points in the opposite direction. Research from the International Monetary Fund for example confirms that high levels of household debt holds an economy back.[4] At an individual level, when people take on more debt, it means they have less disposable income because more of their pay packet has to go toward their loans. How that helps the economy in anything other an initial sugar-hit, is hard to understand.

Excessive debt is already a problem in Australia. Australia has the second highest level of household debt to income in the world.[5] The most recent data from the Australian Bureau of Statistics shows that nearly one in three households are overindebted when comparing total debt to total income.[6]

More debt for people and families will hinder, not help the economic recovery.

RLOs are not stopping the flow of credit

It is very clear that the existence of the RLOs is not stopping the flow of credit.

- The most recent data from the Australian Bureau of Statistics, for December 2020, shows that lending for housing increased by 8.6% in seasonally adjusted terms, a 31.2% increase on December 2019.[7]

- Treasury's 2017 submission to the Financial Services Royal Commission said that: "there is little evidence to suggest that the recent tightening of lending standards,

[4] See https://www.imf.org/en/Publications/GFSR/Issues/2017/09/27/global-financial-stability-report-october-2017

[5] See AAP Fact Check - https://factcheck.aap.com.au/claims/is-australias-household-debt-the-second-highest-in-the-world

[6] See https://www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latest-release#articles

[7] https://www.abs.gov.au/media-centre/media-releases/record-housing-loan-commitments-continue-december

including through APRA's prudential measures or the actions taken by ASIC in respect of RLOs has materially affected the overall availability of credit".[8]

- In September 2020, CEOs of two of the major banks were asked about their views of the responsible lending laws when appearing before the House of Representatives Standing Committee on Economics.
    - Shayne Elliott, the CEO of ANZ said that: "I don't think there is a fundamental issue with the law as it stands … I don't see (them) as a barrier to supporting the economy".[9]
    - Matt Comyn, the CEO of Comm Bank said: "The responsible lending obligations are designed to increase consumer protections by putting more onus on the lending institution to understand a customer's financial circumstances … I think the design is sound … My overall views would be that there is an abundant supply of credit available in Australia …".[10]

There is simply no evidence of a problem with the flow of credit into the economy, and in the event a problem did emerge it is far more likely to be due to lack of demand rather than a supply problem.

The "one size fits all" argument

A core argument from the Government, and one that runs through the EM, is that the RLOs have become a "one size fits all" approach. What the Government proposes will instead become a "free for all" for lenders.

The RLOs are set at an individual level and this is the appropriate policy intent. To the extent lenders are applying the same processes to all applications, it reflects on the practices of lenders failing to focus on customer needs and circumstances when selling credit – a key issue of concern aired in the Financial Services Royal Commission. The Government's solution to the problem of getting the financial services sector to operate responsibly when it comes to selling financial products is not, as the Royal Commission recommended, to improve the enforcement of these requirements, but to instead remove them entirely. It is

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[8] Treasury, Submission Interim Report, Financial Services Royal Commission, 2017, Paragraph 174. This quote references the Financial Stability Review October 2018, 32-36.

[9] House of Representatives, Official Committee Hansard, Standard Committee on Economics, 4th September 2020, page 7, https://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/2085edc8-94d9-4504-852e-5c971b17db09/toc_pdf/Standing%20Committee%20on%20Economics_2020_09_04_8070_Official.pdf;fileType=application%2Fpdf#search=%22committees/commrep/2085edc8-94d9-4504-852e-5c971b17db09/0000%22

[10]House of Representatives, Official Committee Hansard, Standard Committee on Economics, 4th September 2020, page 51, https://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/2085edc8-94d9-4504-852e-5c971b17db09/toc_pdf/Standing%20Committee%20on%20Economics_2020_09_04_8070_Official.pdf;fileType=application%2Fpdf#search=%22committees/commrep/2085edc8-94d9-4504-852e-5c971b17db09/0000%22

truly perverse to cite the poor and damaging performance of a sector in relation to its obligations as a reason to remove those obligations.

Red tape argument

Another rationale for removing the RLOs is that they are said to increase red tape. In the context of ASIC Regulatory Guide 209 (RG 209) for example, the EM states that lenders have put in place complex and costly systems to "verify financial information provided by borrowers, down to the fine level of detail". This argument misrepresents RG 209. The guide makes it very clear that the RLOs are scalable. For example, RG 209.20 states: "the legislation allows licensees flexibility to determine what is appropriate in individual situations."

1.3 Responsible Lending is a Vital Consumer Protection

There are thousands of people who are at risk of being harmed

RLOs are a critical consumer protection. In many ways, they should be a financial health-check for consumers to ensure people are not sold unsafe debt that will harm them.

Removing RLOs will exacerabate risks for those already experiencing financial stress. According to the Australian Bureau of Statitics's Household Expenditure Survey, 15% of Australian families (1.3 million people), meet the criterion for financial stress. In addition, the study found that 44% of middle-income households and 14% of high-income households reported one or more indicators of financial stress over a 12 month period.[11] The ANZ Financial Wellbeing report also demonstrated that one quarter of participants were either sometimes, often, or always unable to pay bills or loans at the final reminder.[12]

This hardship will be exacerbated by the increasing numbers of Australians who are unemployed. Currently, 6.6% of Australians are unemployed (912,000 people)[13], even larger numbers are under-employed (8.5%), and Australia is going through one of the most difficult economic times in its history.

In addition to financial hardship, RLOs are an important protection for Australians who are not financially literate. The Household, Income and Labour Dynamics in Australia (HILDA) survey found that only 50% of Australians could answer five basic financial questions correctly.[14] The report found that poor financial literacy correlated to poorer financial

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[11] https://www.abs.gov.au/statistics/economy/finance/household-expenditure-survey-australia-summary-results/latest-release#key-statistics

[12] https://www.anz.com.au/content/dam/anzcomau/documents/pdf/aboutus/FWI-mar2020.pdf

[13] https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia/latest-release

[14] https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0009/3537441/HILDA-Statistical-report-2020.pdf

health. Collectively, this data demonstrates how critical it is that lenders, who are experts in the area of credit, do not take advantage of people who do not have the same expertise and may be vulnerable for various reasons.

This change overturns the first recommendation of the Financial Services Royal Commission

The first round of hearings of the Financial Services Royal Commission (FSRC) considered the responsible lending laws. This was in response to evidence that banks and other lenders were not complying with the laws as they stood, and that over-lending was a problem. The very first recommendation by Commissioner Hayne in the final report of the FSRC was that the laws did not need to change. He wrote that: "My conclusions about issues relating to the NCCP Act can be summed up as 'apply the law as its stands'.[15]

Commissioner Hayne may also have noted the views of Treasury in the background paper provided to the Royal Commission. Treasury noted that:

> "Responsible lending obligations provide an appropriate balance between protecting consumers who may misjudge or be tempted to take on more debt than they can afford and enabling lenders to provide credit. Along with other steps to maintain lending standards, the resulting lower rate of non-performing loans and of highly indebted households supports the prudential strength of banks and financial system stability."[16]

1.4 The Bill is Rushed, Consultation is Inadequate

Responsible lending obligations were included in Australia's credit laws in 2009, in response to the irresponsible lending practices of that decade. Importantly, the laws were the result of extensive consultation that took place over a number of years. In contrast, the Government is overturning these laws with very little thought and with very little time for stakeholders to respond.

The Government announced its proposed changes publicly on 25th September 2020. The draft legislation was released on 4th November 2020, with responses required in a ridiculously short timeframe - by 20th November 2020. The Government's original plan was to have the legislation come into effect by 1st March 2021.

We are thankful that the Senate has at least sent the Bill to Committee so there is some deeper consideration.

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[15] Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Volume 1, Page 60.

[16] Treasury, Background Paper 24, Submission on Key Policy Issues, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, paragraph 237.

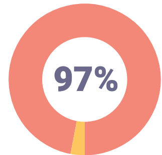
1.5 Financial Counsellors Say the Laws Should Stay

Financial counsellors and financial counselling agencies reacted with horror and disbelief to the Government's announcement that they planned to remove responsible lending obligations from the credit laws. In early November 2020, we conducted a survey of financial counsellors seeking their views about this: 97% of financial counsellors think the existing laws should remain. The infographic on the next page summarises the survey's findings. The full survey is available at the web link here. The survey also asked financial counsellors to provide some examples of irresponsible lending. We have included a selection of these in Appendix 1.

Save Safe Lending

What financial counsellors say about responsible lending laws[1]

1. The responsible lending laws should remain



of surveyed financial counsellors think that the responsible lending laws should remain.

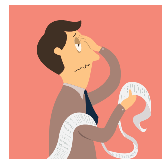
2. Vital consumer protection laws

94% of financial counsellors surveyed either strongly agreed (**87%**) or agreed (**7%**) that the responsible lending laws are an important consumer protection.

3. Powerful laws for client advocacy

Almost all of the financial counsellors surveyed **(93%)** use the responsible lending laws in advocating for clients (**78%** strongly agreed and **15%** agreed).

4. More financial hardship without laws



Almost all financial counsellors agreed **(92%)** that if the laws are repealed, financial counsellors can expect to see many more clients with unaffordable debt.

[1] Data is from a survey of financial counsellors conducted in November 2020. The response rate was 25%.

5. Repeal of laws will hinder the COVID19 Economic Recovery

The majority of financial counsellors (**71%**) agreed that if the laws are repealed, this will hinder the economic recovery from the pandemic (**52%** strongly agreed and **19%** agreed).

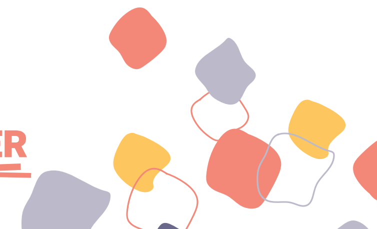
6. Significant impact on clients, their families and communities

Financial counsellors are very concerned about the impact of repealing the responsible lending laws on their clients and the community. They believe such a move will be harmful to individuals, families and the public.

7. Irresponsible lending still occurs despite the current laws

More than three quarters of financial counsellors provided examples recounting some of the worst cases they have come across.

STOP THE
DEBTDISASTER



2 Removal of Responsible Lending Obligations (Schedule 1)

This section addresses some of the specific concerns we have about the Bill, and why as a whole, it should not be passed. Our focus is on the parts of the Bill that will harm the clients of financial counselling the most and are based on our casework experiences.

2.1 Inadequate Verification will Lead to Overcommitment

What is changing

- The removal of RLOs will reduce obligations on lenders to verify the income and expenditure of people seeking credit.
- Lenders will be able to rely on the information provided by consumers, unless there are reasonable grounds to believe that the information is unreliable. Lenders will also be able to use benchmarks.
- The reforms are also designed to move to a so-called “borrower-responsibility” principle.

Why this will be a problem

- Lenders have incentives to lend as much as possible – not so much that a person defaults (although some will) – but enough to take them to the edge. There is a world of difference between credit risk for the lender and affordability for the borrower.
- Most people do not have an accurate understanding of where they are spending their money, nor to what extent they might be able to cut down on expenditure in the future. When people are asked to estimate their expenditure, many have great difficulty in doing so and tend overall to under-estimate.
- There are also many people who for various reasons are vulnerable – they have low financial literacy, are impacted by mental health issues or family violence, are already in financial stress and see more debt as a way out (as short sighted as that might be). These people will be open to exploitation.
- Particularly when people go to a bank, they put their trust in that institution to only offer them credit that is affordable. As we saw from the FSRC, that trust was misplaced.
- In total, all of these factors will lead to more and more people being loaded up with more and more debt.

Background

People are obviously responsible for the loans they enter into. If they struggle to repay, they face debt collection activity, the risk of an impaired credit file, the loss of assets (including sometimes their car or home), an inability to borrow in the future and in the worst case, bankruptcy. The impact on a person's life, their family and children can be enormous. It is simply not correct to say that there is very little borrower responsibility.

Credit is not a simple product and a mistake made in its purchase can be long-lasting.

The FSRC pointed out the problems with the use of benchmarks, with lenders choosing benchmark levels set at the 25th percentile of discretionary spending. Obviously 75 per cent of people will have a higher level of expenditure. The use of these kind of benchmarks will therefore systematically underestimate actual expenditure for the majority of people but allow lenders to offer higher levels of credit. As well, in the experience of financial counsellors, different consumers have different savings and spending patterns, depending on their individual circumstances. Benchmarks can mask the true position.

It is also worth noting that staff in banks and other lenders are subject to the same human weaknesses and frailties as the rest of us, and that commission-based selling of debt has not disappeared. People receiving short-term bonuses for increasing loan volumes, or even just knowing that this is what their promotion depends upon, will be strongly motivated to load people up with debt. Financial counsellors frequently see this in point-of-sale lending at consumer goods stores, where salespeople frequently talk vulnerable people into taking out credit cards with higher limits than they originally requested.

In this time of enormous technological change, including through open banking, it is becoming increasingly easy for lenders to work with borrowers to truly understand their financial position. For example, banks and other lenders, within the existing RLO framework, are drastically reducing the time it takes to provide approval for mortgages. One customer-owned bank can do this in 20 minutes for a straightforward application.

2.2 Removing "Requirements and Objectives" – Implications for DFV and Other Loans

What is changing

- The current RLOs require licensees to "make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract".[17]
- There will be no equivalent provision for either ADIs or non-ADIs.

[17] Section 130(1)(a) National Consumer Credit Protection Act 2009

Why this will be a problem

- The removal of an obligation for licensees to assess the borrower's requirements and objectives has implications for every single credit contract. The most serious concern is that it will encourage overcommitment. Some people will also end up with loans that they may be able to afford, but the loans are still the wrong type of product for their needs.

- There will be particular problems where there is family violence or financial abuse in a relationship. For example, financial counsellors see too many examples where one person (the perpetrator) forces the other partner to take out loans in their name alone. In these situations, the partner coerced into the loan has received no benefit. These loans do not meet that person's requirements and objectives, but if the RLOs do not exist, lenders will be able to turn a blind eye to any red flags of family violence or financial abuse.

Background

A person's requirements and objectives in taking out a loan are an important consumer protection mechanism. Some examples are:

- A person walks into a consumer goods store to buy a $1,500 laptop. They are signed up to a $10,000 credit card to make this purchase. The person only wanted enough credit for the laptop. In this case, the credit card would not meet the person's requirements and objectives. Financial counsellors commonly see this scenario.

- A couple very close to retirement wants to renovate their home. The bank provides them with a loan that will take them well past retirement and does not ask about how they plan to make repayments once they stop working. The couple have low financial literacy. When one partner subsequently dies, the surviving partner, now in her 70s, cannot afford the loan. She falls behind on the rates and stops eating properly in order to try and pay what she can. If the bank had checked the couple's requirements and objectives, asking whether they wanted to continue to be in debt when they retired and how they would meet repayments, the loan would not have been provided.

- From around 2012, large numbers of people were sold interest-only home loans: by 2015 they accounted for almost 40 per cent of all mortgages[18]; by 2017, this had grown even further to 50 per cent. Compared to a principal and interest loan, interest-only loans require lower repayments during the interest-only term. At the end of the interest-only term however, borrowers will need to make higher repayments. An interest-only loan will also cost more in total interest. Lenders however were not bothering to check with all borrowers about whether these loans

[18] See https://www.rba.gov.au/speeches/2018/sp-ag-2018-04-24.html. Both ASIC and APRA stepped in. APRA for example required ADIs to tighten the serviceability assessments and placed limits on the proportion of lending that could be interest-only.

would meet their needs in the medium to longer term, after the interest-only period ended.[19]

Some examples involving family violence are:

- A woman with two black eyes and who did not say a word, signed a personal loan contract. Her partner spoke for her and told her to sign. The debt was in her name alone.

- A woman entered into a car loan. The car was manual drive and she could not actually drive a manual car. The loan in reality was for her partner.

Because the current law includes these sorts of situations and objectives these sorts of situations involving family violence would raise red flags under the RLOs. In both of the examples above, the loans would not meet the borrower's requirements and objectives because the borrower received no benefit.

2.3 Return to Excessive Credit Card Debt

What is changing

- The Bill repeals the section of the Credit Act that stops ADIs from giving people excessive credit card limits.[20] These provisions came into effect a little over two years ago, on 1 January 2019.

- Prior to these changes, it was industry practice to assess credit card affordability on whether a borrower could afford only the minimum repayment, for example, three per cent of the limit. The changes from 1 January 2019, required all lenders to assess a credit card limit on whether a person could repay the limit in three years.

Why this will be a problem

- When combined with the removal of responsible lending obligations, the repeal of this section is likely to see people being given higher credit card limits than they can afford. This will be the case for both ADIs and non-ADIs. We note however that ADIs have a much bigger share of the credit card market than non-ADIs.

Background

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[19] ASIC Report 445. ASIC reviewed 140 consumer loan files. In 40% of files, the affordability calculations were incorrect. In over 30% of files, there was no evidence that the lender had assessed the borrower's objectives. It is only because interest rates have remained low, that the 2012-15 explosion in interest-only loans did not lead to financial stress for large numbers of borrowers when the interest-only period finished.

[20] The Bill repeals Division 5 of Part 3-6A of the Credit Act. See Schedule 1, Item 69 of the Bill and 1.60 of the EM.

The problems with credit card overcommitment are well documented. ASIC's research from 2018 for example, found that one in six people were struggling with credit card debt, either because they were in arrears, had persistent debt or were repeatedly only paying the minimum outstanding balance.[21]

Excessive credit card debt has been the single-most common issue facing financial counselling clients for many years. The financial counselling sector therefore welcomed reforms which meant a credit card limit would be unsuitable if the borrower could not repay it within a period set by ASIC. ASIC later set this period at three years. These reforms took effect on 1st January 2019, a little over two years ago.

The Government seems to recognise that there are problems with credit card overindebtness and is trying to retain some element of protection by:

- For ADIs that are banks – by pointing to a commitment in the Banking Code of Practice that says, "We will assess your ability to repay a credit card within a three-year period". We note there is no equivalent provision in the Customer Owned Banking Code of Practice.

- For non-ADIs – including in the proposed Ministerial standards a requirement for a non-ADI to assess whether a person could meet an obligation to repay a credit card limit over three years without substantial hardship.[22]

These provisions are not equivalent to those currently in the Credit Act and will not provide the same level of consumer protection. This is because the requirement to assess whether a person can repay a credit card limit within three years, sits within the broader framework of the RLOs. Once you remove the RLOs, with their individual-level requirements for a lender to verify the consumer's financial situation, any three-year test will be far less effective. Lenders will mechanistically apply a test – so meeting the new standards required of them by the legislation – but will be able to exploit any errors made by people when providing information to the lender.

2.4 Reduced Access to Justice

What is changing

- The Bill removes the RLOs for all lenders, apart from those providing SACCs and consumer leases.

- Consumers can obtain redress through AFCA,[23] but the circumstances will be limited to other contraventions of the Credit Act.

[21] ASIC, Report 580, Credit Card Lending in Australia, July 2018.

[22] Section 9 of the draft Ministerial standards.

[23] 1.76 of the Explanatory Memorandum.

Why this will be a problem

- It will be much harder for people to take a dispute about irresponsible lending to the free and independent dispute resolution body, AFCA (the Australian Financial Complaints Authority).

- People will lose the right to take lenders to court for lending misconduct.

Background

The responsible lending laws in the National Consumer Credit Protection Act provide individuals with rights to challenge irresponsible lending in one of two ways: through a court, or through free, independent dispute resolution provided by AFCA.

The ability of a person to access both of these avenues is severely curtailed under the proposed reforms. In relation to access to justice through the courts, borrowers will not be able to rely on the specific obligations set out in the responsible lending laws. The only potential causes of action will rest on unjustness or unconscionability, remedies which are more complex to argue and only available to people with either significant resources or able to access extensive free legal assistance. In a practical sense, court action will effectively be closed as an option for consumers.

In relation to AFCA, it is difficult to see how AFCA will be able to resolve disputes where a person believes the original lending was not responsible. This is because they will not have the same yardstick of responsible lending against which they can make that assessment. We also note that the Banking Code of Practice does not include specific obligations in relation to responsible lending as it is predicated on the existence of these laws. The only "hook" for AFCA in resolving disputes will be to rely on the broad requirement for banks to lend with the skill of a prudent and diligent banker.

The law around responsible lending will be removed altogether for authorised deposit-taking entities (largely banks), leaving standards set out by the Australian Prudential Regulation Authority (APRA) as the only relevant lending laws. These standards apply at a loan portfolio level, rather than providing rights to individual borrowers. Similar standards would be introduced for other lenders but will only require them to put in place systems, policies and processes. Failures would need to be systemic – individual failures would not sustain a penalty, or a court case and AFCA and consumers will not know how the systems, policies and processes operate in practice.

The FCA survey of financial counsellors quoted earlier, found that 93% of financial counsellors use the RLOs to help their clients. The removal/reduction of individual rights to redress will make the jobs of financial counsellors much harder and significantly reduces access to justice for people.

This reduction in legal accountability does not only reduce individual legal rights and protections. At the system level, it will encourage a diminution in lending standards, even a 'race to the bottom' for lending practices in the financial services market.

2.5 Penalties for Non-Compliance are Removed/Reduced

What is changing

- For ADIs, the Bill removes existing penalties for providing unsuitable credit. ADIs will be subject to APRA's prudential standards only.
- Non-ADI lenders will only breach a civil penalty provision where they are either:
  - have not established, maintained or documented the systems, policies and processes required by the Ministerial Standards at all;[24] or
  - repeatedly fail to implement those systems, policies and processes.[25]

Why this will be a problem

- APRA standards do not contain a civil penalty framework.
- If individuals are harmed because of irresponsible lending practices, the lenders involved will not be held to account.

Background

If laws are to be effective, they need to be enforced. This requires that the penalty regime is appropriate. In the absence of adequate penalties, lenders will have few incentives to comply.

2.6 Small Business Test will Drive Avoidance

What is changing

- Lending which is predominantly for small business already falls outside the Credit Act. This is the "predominant purpose" test.

[24] Item 67 of the Bill, inserting Section 133EB to the Credit Act.

[25] Item 67 of the Bill, inserting Section 133EC to the Credit Act.

- For non-ADIs, lending which is “in part” for a small business purpose will be excluded from the Ministerial Standards.[26] The small business purpose must not be “minor or incidental” to the overall purpose of the loan.

- For ADIs, APRA standards will apply to lending for small business.

Why this will be a problem

- We are concerned that this change will take large swathes of lending outside of the Credit Act, that in reality should be in it.

- Despite the inclusion of the words “minor or incidental” , the change may encourage sham “business” lending.

Background

It was common a number of years ago for unscrupulous lenders to avoid consumer credit regulation by asking people to sign “business purpose declarations”. People who may have been desperate for finance, or who simply did not understand what they were being asked to sign, effectively gave away their rights by saying that they were running a business. In reality, they were not in business, or the “business” was more akin to a hobby or was a minor source of income. These loans often caused significant hardship for the people affected. These changes will encourage the same behaviour, particularly since it is not clear what “minor or incidental” might mean in practice.

Financial counsellors are increasingly seeing more small business clients, commonly with five or fewer employees. It is noticeable the differences between the avenues available to assist individual clients with debts compared to small business clients. Small business clients have significantly fewer rights and protections, for example, rights to request financial hardship contract variations.

In our experience, business owners frequently mix personal and business debts. The proposed changes will see a lot of lending which is predominantly for personal or household use, instead categorised as small business loans. While this might free up credit to some businesses, there will be individuals who will lose the consumer protections of the Credit Act to their detriment.

2.7 Dismantling the Twin Peaks Framework

What is changing

- The Bill dismantles Australia’s twin peak model of regulation. The twin peaks model separates prudential regulation, which is the remit of APRA, from conduct regulation, which is the remit of ASIC.

[26] This change was made to the regulations in response to the pandemic and will be made permanent.

- The policy rationale for the separation is that prudential regulation and conduct regulation have quite different purposes.

Why this will be a problem

- By blurring the lines between prudential regulation and conduct regulation, neither APRA or ASIC will be as effective. Consumers will fall through the gap.

- APRA's focus is on system stability, soundness and the protection of depositors. It is not on consumer protection. This means that APRA may not be concerned if large numbers of consumers become over-indebted, as long as it does not affect the overall stability of the system.

- APRA is unlikely to take enforcement action if consumers are harmed by lending practices.

Background

The twin peaks model was recommended by the Wallis Inquiry in 1996. Some 25 years later, Commissioner Hayne in the FSRC also recommended that the twin peaks model be retained.[27] The model has been replicated by a number of other jurisdictions, including the UK, as it represents best practice.[28]

A good example of the difference between the system stability focus of APRA and one based on conduct and consumer protection, is found in APRA's guidance on mortgage lending. This includes guidance about how a bank should assess the credit card liabilities of potential borrowers.[29] The guidance suggests that assuming a potential borrower is repaying just three per cent of the card limit is adequate. This is a recipe for keeping people trapped in debt and is out of step with community expectations.

In the past, APRA's enforcement activity has occurred behind closed doors and will not focus on breaches by lenders where individuals are harmed, unless there are system-wide failures. As noted earlier, consumers and advocacy groups will not know what those systems are. APRA's enforcement review has yet to be finalised and there is no adequate civil penalty regime.

It is also hard to see how this proposal simplifies the regulatory architecture as APRA will now be the conduct and prudential regulator for ADIs, but ASIC will be the regulator for non-ADIs. ASIC will be the regulator for both ADIs and non-ADIs in relation to the product intervention powers and design and distribution obligations. If APRA through their supervision of ADIs observes problematic lender behaviour, in the past they might refer this to ASIC. It is less clear what will happen now.

[27] Recommendation 6.1, Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019.

[28] https://www.lowyinstitute.org/the-interpreter/financial-regulation-australias-twin-peaks-model-successful-export

[29] APS Residential Mortgage Lending 223, February 2017.

3 SACCs, Consumer Leases (Schedules 2 and 3)

3.1 We support the Stop the Debt Trap Alliance Submission

The proposed reforms to small amount credit contracts (SACCs) and consumer leases fall far short of what is needed to adequately address the harm these products can cause. We do not support these aspects of the Bill.

FCA, and all of the State and Territory financial counselling associations, are members of the Stop the Debt Trap alliance, a coalition of community organisations that advocates for fairer and safer SACC and consumer lease products. We support the submission prepared by the alliance provided to the Committee. Our comments below build on this.

3.2 This Bill Waters Down the 2017 Legislation

In March 2016, the SACC Review Final Report[30] made 24 recommendations. The Government accepted the large majority of the recommendations and released an exposure draft of legislation in October 2017.[31] This is an example of evidence-based policy where a consumer harm was identified, there was an independent review, a final report was issued with recommendations and the Government drafted legislation based on that review.

We are now in 2021, some four years after the initial release of the Government's draft legislation. It is incredibly disappointing that this Bill significantly waters down the 2017 draft legislation. While we believed that draft didn't go as far as urged by consumer groups, the overall package represented progress. This Bill however will actually make things worse for some people.

This is because the key to effective reform in the SACC and consumer lease market is to reduce the risk of people becoming overcommitted and trapped in debt. This was achieved in the 2017 draft legislation by setting a bright line for the amount of net income that could be used to repay a SACC or a consumer lease at a maximum of 10% for both products (or 20% combined).

The current Bill is a completely different package. The table on the next page compares some of the main elements of the current law, the 2017 draft legislation and the proposed law as set out in this Bill. The 2017 draft legislation would be more effective in preventing harm.

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[30] Review of the Small Amount Credit Contract Laws, *Final Report,* March 2016, available at: https://static.treasury.gov.au/uploads/sites/1/2017/06/C2016-016_SACC-Final-Report.pdf.
[31] Treasury consultation 22 October 2017 – 3 November 2017 with information available at https://treasury.gov.au/consultation/c2017-t229374.

Current Law	2017 draft	Proposed Law	Comment
SACC **Protected earnings amount** (the PEA is the maximum amount that can be put toward a loan repayment)			
For people who receive 50% or more of their income from social security 20% of gross income	*For all borrowers* 10% of net income	*For people who receive 50% or more of their income from social security* 10% of net income, (The total repayments under a SACC and consumer leases cannot exceed 20% of net income) *For all other people* 20% of net income (Note: these are the figures expected to be in the regulations[32] and are not in the actual Bill)	The 2017 draft is preferable as it covers all borrowers and is net income.
SACC **Rebuttable presumption**			
A loan is unsuitable if a person has had two or more SACCs in the past 90 days, or is currently in default	Remove – but only if the net income PEA is in place	Repealed	Repeal may make the proposed PEA less effective. The 2017 position is preferable.
CONSUMER LEASES **Protected earnings amount** (the PEA is the maximum amount that can be put toward a lease payment)			
No PEA	*For all borrowers* 10% of net income	*For people who receive 50% or more*	The 2017 draft is preferable as it

[32] See Section 3.19 of the Explanatory Memorandum.

		of their income from social security 20% of net income (though the collective total repayments under all SACCs and consumer leases cannot exceed 20% of net income) *For all other people* 20% of net income (Note: these are the figures expected to be in the regulations[33] and are not in the actual Bill)	covers all borrowers and is net income.
CONSUMER LEASES **Establishment fee** (can be charged in addition to the base price)			
Not provided	Not recommended	20% of the base price of the goods	This is a new and high charge that will increase the costs of these goods.
CONSUMER LEASES **Delivery fee, installation fee**			
	Reasonable one-off delivery cost outside the cost cap	Fees can be included in the overall cost cap (so that the 4% per month lease charge is calculated including these fees)	These fees will increase the costs of these goods.

For people in receipt of social security benefits, the extent to which they may become indebted through a SACC is an improvement. But this change is outweighed by the overall package. The changes for consumer leases are clearly a backwards step. Together some people could be in the position of spending up to 40% of their net income on SACC and consumer lease repayments.

[33] See Section 4.59 of the Explanatory Memorandum.

Appendix 1 – Some Examples of Irresponsible Lending

The selection below are some indicative examples of irresponsible lending provided by financial counsellors participating in the survey FCA conducted in November 2020. In total, nearly 140 financial counsellors provided examples. The 15 excerpts below are a representative selection.

- An 18-year-old given a $15,000 car loan. She was coerced by her violent partner and the car was for him. The client was left with an unaffordable loan for a product that she received no benefit from, and she experienced financial abuse.

- A credit card provided to a man with schizophrenia, who believed he had a job (which didn't exist). Two credit limits were also approved. No one ever checked for pay slips or confirmation of his employment. He ended up with debt of $22,000, which put his family at risk of not being able to pay for their everyday needs. Because of responsible lending laws, we were able to achieve a waiver of the debt.

- Clients who owed $195,000 in credit card debt. Most of this debt was a result of irresponsible lending by one creditor.

- A wheelchair bound, widowed woman with a disability and three children was provided with an initial credit card of $5,000. This kept being increased by the creditor, who offered $5,000 increases until her debt amounted to $40,000.

  The client used the funds to pay for her children's schooling and medical expenses, such as braces. The creditor also sold the client insurance which she'd never be able to claim on, as it was only for employed people (she was not employed, as she was receiving the Disability Support Pension). This insurance was paid for over 12 years.

  She was suffering emotionally, physically and medically, as she wasn't buying her own medication to maintain the repayments on this debt. The client suffered for years due to this debt.

  I have personally seen hundreds of cases during my eight years as a financial counsellor. I cannot bear to think what would happen if we didn't have these responsible laws as back up, to advocate and protect our most vulnerable community members in the future.

- A man with disabilities who had two personal loans, four credit cards and two online debts. This client didn't comprehend the consequence of having to repay loans.

- There are many examples. One is a bank, lending tens of thousands to a teenager for a car loan. He'd only just started his first casual job. Any examination would have shown there was no chance he could make the repayments.

- [I have seen] lenders who continue to advance money to consumers who are unemployed and are clearly problem gamblers. The lenders don't do any checks on the consumers' ability to repay the debt and ultimately, they end up having to sell their house to repay the debts.

- A home loan over 30 years offered to a 70-year-old pensioner.

- A co-worker had a client with an acquired brain injury, who was signed up to a business car loan for a prestige vehicle via a dealership. The ABN had never been used.

- More than $70,000 worth of credit provided to a part-time employee in a remote community to purchase a new four-wheel drive. The client's comprehension of the contract he signed was highly questionable. The vehicle is no longer functional, and the client has debt that he has no capacity to pay.

- Migrant clients in their early sixties. They had no super, were working as fruit pickers. They already had a mortgage but were given a second home loan. They were in arrears on the loan within 12 months.

- XXX gave a 69-year-old aboriginal man, who was close to retirement, a $60,000 car loan. After only owning the car for a year he was forced out of his job due to his health and had to retire. He is now on an Age Pension and can't afford to pay for the car loan. Basically, XXX made no enquires regarding his ability to pay this loan into the future. XXX knew, or ought to have known, that my client was close to retirement age. This is still an ongoing case.

- A lender had offered a personal loan and a credit card to a couple who requested financial hardship assistance. They already had multiple personal loans and credit cards (not joint) multiple periods of reduced household income and no equity in any assets. They presented to us with an estimate of $150,000 in unsecured debt.

- A car yard allowing a woman to co-sign a loan for a sports car that she would never drive, and the family could not fit into. She was living on a Centrelink allowance and was clearly being coerced into taking out the loan.

- One of my client's had no money to buy food. She had so many loans that she had no money left to live on.