



**CONSUMER LAW CENTRE
of the ACT**

Consumer Policy Framework Inquiry
Productivity Commission
PO Box 80
Belconnen ACT 2616

24 May 2007

Also by email: consumer@pc.gov.au

Dear Commission,

Inquiry into Consumer Policy Framework

Thank you for the opportunity to participate in the Inquiry through this written submission.

The issues we raise in our submission will not address all questions raised in the Issues Paper but rather focus upon areas from which examples can be usefully drawn from our casework. As such, our comments focus on examples of poor regulation, on areas where competition has not produced consumer benefit evenly or at all, and the costs of a severely under resourced consumer advocacy, research and policy sector.

Again, we thank the Commission for the opportunity to provide this submission and we look forward to being appraised of the outcome of the Inquiry in due course.

Yours sincerely,

Amy Kilpatrick
Principal Solicitor

Encl.



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Care Inc.
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*Serving the
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Submission of the Consumer Law Centre of the ACT

to

The Productivity Commission Review of Australia's Consumer Policy Framework

May 2007

Our Service

The Consumer Law Centre of the ACT (CLCACT) is hosted by Care Inc. Financial Counselling Service. The CLCACT is accredited by the National Association of Community Legal Services.

Care Inc Financial Counselling Service has been the main provider of financial counselling and related services to low income and vulnerable consumers in the ACT since 1983. Those services include:

- Financial Counselling and information services (including an outreach service in Queanbeyan and a dedicated service for tenants and applicants of Housing ACT)
- Community Development and Education
- A No Interest Loans Program
- Participation in Policy Formation, Regulation and Law Reform

Like Care, the CLCACT works with some of the most financially and socially disenfranchised members of the ACT. The CLCACT provides free legal assistance, advice and advocacy for low and moderate income consumers, primarily in the areas of debt, consumer credit, telecommunications and utilities, as well as general fair trading and consumer protection.

Issues Identified By Our Clients

Clients of the CLCACT are regularly denied access to markets, including telecommunications and financial services. Further, when access is provided, it is often unsustainable in that it is more expensive and contains unfair terms.

This submission is informed by our direct contact with consumers and with reference to research generated through this work. We will not address all questions raised in the Issues Paper but rather focus upon areas from which examples can be usefully drawn from our casework. As such, this submission will focus comments on examples of poor regulation, on areas where competition has not produced consumer benefit evenly or at all, and the costs of a severely under resourced consumer advocacy, research and policy sector.

Below we address the Issues Paper by making reference to the page number upon which particular questions appear:

Issues Paper – page 14

Questions: What are the key rationales for government intervention to empower and protect consumers? What should be the balance between seeking to ensure that consumers' decisions properly reflect their preferences (empowerment) and proscribing particular outcomes (protection)?

Empowering consumers to become informed participants in increasingly complex markets and protecting them from abusive, unfair and unsafe practices and products are inseparable goals which should drive social and economic policy. Unfortunately, Commonwealth Government policy in recent years has focused on information disclosure as the means of empowering consumers while at the same time retreating from protecting consumers by withdrawing and misdirecting regulation. Examples of the failures to protect or empower consumers appropriately can be found in the telecommunication sector, fringe lending sector and in the home loan market. Each of these will be discussed further below.

Questions: What are the implications of developments in theory (e.g. behavioural economics) for consumer policy? Do they render some traditional views of the role for government in this area less relevant, or do they simply require more sophistication in the analytical framework and policy toolkit?

Our service is aware of developments in behavioral economics and supports policy and legislative initiatives to incorporate these developments into consumer protection and empowerment considerations. Current policy has focused on competition and market forces as an end in itself which has led to consumer detriment and financial risk in a number of areas. These issues are discussed further below. It is our submission that properly balanced consumer policy in Australia must consider consumer choice within the context of behavioral economics. This will enable greater sophistication in creating policy which better anticipates consumer responses.

It appears product and service design is also being driven by a greater understanding of consumer behaviour. For example, reverse mortgages and equity sharing models in the home loan market are products which play on emotional responses. They are also predicated on biased assumptions about the future, including that housing values will always rise. Regulatory responses to such products must therefore be equally sophisticated.

Issues Paper - page 15

Questions: What are the important costs of intervention? How significant are the hidden costs of intervention? How do these compare with the costs of not intervening?

Not intervening or reducing the breadth and type of intervention may on its face save costs and increase market activity. At the same time, other problems with unintended cost implications can arise. If there is no capacity or will to understand and respond appropriately those problems can escalate dramatically.

The impact of deregulation of the financial system, particularly in the home lending market provides an excellent example. New providers entered the market in large numbers in recent years. Many of the outcomes have been far from positive.

It was reported in 2005 by the Reserve Bank that non-deposit taking mortgage companies (often referred to as non-conforming lenders) write 4% of the value of new loans.¹ Data from Standard & Poors for 2007 states the non-conforming lenders' portion of the home loan market to be approximately **5.35%**, with a total of **\$41 billion** originating from these providers;² a dramatic increase from about ten years ago when the total value was reportedly nil. Further breakdown of the total figure indicates that \$34.5 billion is sourced for prime-lending with \$4.6 billion funding the sub-prime market³.

This shift in market share in mortgage lending from deposit taking institutions to non-deposit taking mortgage companies has reduced the proportion of home lending being examined by bank and government regulators. Many consumer advocacy services and consumer groups have made representations that the lending standards of non-deposit taking mortgage companies are inadequate and that too frequently, their loans are predatory. A recent case decided in the NSW Supreme Court likened one such home loan to "Ponzi lending"⁴ and made reference to the public policy issues involved with the growing proliferation of that type of loan. We support the public policy concerns expressed by his Honour Justice Patten in that case.

Concerned about the conduct of and quality of loans written by non-deposit taking mortgage companies, the CLCACT reported in 2006 on the growing number of actions taken by such lenders in the ACT Supreme Court for house repossession. Our report demonstrated that between 2002 and 2005, **68%** of actions seeking to foreclose on real property mortgages originated from the non-deposit taking mortgage companies. This suggests that loans with non-deposit taking lenders are failing at much higher rates than loans from traditional, prudentially supervised sources. This information is also an indication of the costs to the community of a failure to intervene in the residential mortgage market.

The potential costs of a lack of oversight of this market in Australia are still unfolding. It is useful however to consider impacts experienced in the United States where it has been reported that **2.2 million** Americans will lose their homes and **\$164 billion** in equity as a result of failed home loans written by non-deposit taking mortgage companies.⁵ The collapse of the non-deposit taking / sub-prime lending market has resulted in US Senate enquiries, identifying poor lending standards and poor federal government regulation as causes.

It is also worth considering how the dramatic shift in market activity has impacted problems in housing affordability generally. Consider for example recent comments by the Chair of the Federal Reserve in the United States and the Reserve Bank Governor of New Zealand.

¹ Reserve Bank of Australia, Financial Stability Review, March 2005 p.41

² Standard & Poor's Australian Securitisation News, Issue 281, 18 May 2007 at http://www2.standardandpoors.com/spf/pdf/fixedincome/Issue281_SecuritisationNews.pdf, pg. 3.

³ Standard & Poor's Australian Securitisation News, Issue 281, 18 May 2007 at http://www2.standardandpoors.com/spf/pdf/fixedincome/Issue281_SecuritisationNews.pdf, pg. 3.

⁴ Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook [2006] NSWSC 1104.

⁵ See; US Center for Responsible Lending report "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners" at <http://www.responsiblelending.org>.

Both have stated that a lowering of credit standards and the increased participation of non-deposit takers in the mortgage market are linked and of significant concern. Chair of the Federal Reserve Ben Bernanke, argued in March 2007 that widespread access to credit may have contributed to the chain of events leading to the explosion in home prices and the subsequent explosion of lenders that cater to the “sub-prime” market. He also indicated the need for a more sophisticated regulatory response by stating:

“recent problems in mortgage markets illustrate that an underlying assumption...that more lending equals better outcomes for local communities may not always hold.”⁶

In raising the potential for a regulatory response to poor lending standards and non-deposit taking mortgage companies, NZ Reserve Bank Governor Dr Alan Bollard stated:

“The banks are highly competitive, but while competition is to be encouraged, the low level of lending margins has contributed to ever increasing levels of household debt and upward pressures on house prices. [These factors] have impacts on financial stability and may therefore call for regulatory responses.”⁷

The explosion of non-deposit taking mortgage companies and a weakening of lending standards may have already delivered significant costs to the Australian community with housing affordability now at an all time low and the proliferation of lending products requiring little or no evidence of a borrower’s capacity to pay.

It is also concerning that there is a trend towards Australians withdrawing equity from their homes more rapidly than they are paying off their mortgage debt in contrast to previous decades.⁸ Further, Moody’s most recent financial report notes a rise in Australian RMBS delinquency rates over 2006, predicts a steady rise in 2007 and warns that “the changing composition of loan collateral, with an increasing number of products like low-doc and high LTV loans catering for weaker borrowers, may further elevate delinquency levels going forward.”⁹

Based upon these factors as well as reports of escalating numbers of actions for repossession¹⁰, these are signs that the concerns in the US and New Zealand market may be starting to surface here. Clearly, more detailed research is required to understand the costs to the community of the level of deregulation and/or the failure to intervene in the home loan market. In Australia, the lack of an adequately resourced and properly mandated national consumer body means that reporting of similar data is impossible. Unfortunately, no consumer service is specifically tasked to or resourced sufficiently to perform the national work required. Some consumer advocates have raised concerns of a systemic failure in this

⁶ Bernanke, Ben S. transcript of speech ‘The Community Reinvestment Act: Its Evolution and New Challenges’ at the Community Affairs Research Conference, Washington, D.C. 30 March 2007 at <http://www.federalreserve.gov/BoardDocs/Speeches/2007/20070330/default.htm>

⁷ NZ Reserve Bank Financial Stability Report, 9 May 2007, pg.3.

⁸ Reserve Bank of Australia, Bulletin – Survey on housing Equity Withdrawal and Injection, October 2005 at http://www.rba.gov.au/PublicationsAndResearch/Bulletin/bu_oct05/survey_housing.html

⁹ Moody’s Investors Services, International Structured Finance – Australia – Special Report: Australian RMBS Performance Review: Q4 2006, pg. 2

¹⁰ See above; B Wilmon and R Hartley “RBA Probes Housing Loan Stress Levels” The Financial Review, February 7, 2007 and N Khadem, “Mortgage Defaults On The Rise” THE AGE, May 21, 2007.

market through litigation and in the media. However, action of this type is reactive whereas appropriately targeted consumer policy could have been proactive in protecting consumers and the economy from a market evolution we may collectively come to regret.

Issues Paper - page 18

Questions: What interpretation of the terms vulnerable and disadvantaged should be applied for the purposes of consumer policy? Are the needs of vulnerable and disadvantaged consumers best met through generic approaches that provide scope for discretion in application, or through more targeted mechanisms?

In 2004, our service participated in Consumer Affairs Victoria's (CAV) discussion¹¹ exploring the meaning and implications of the terms vulnerable and disadvantaged consumers as follows:

...a disadvantaged consumer is one who can be identified by reference to personal characteristics (including age, lack of education, mental or physical incapacity etc), whereas a vulnerable consumer is one of a class most likely to react poorly to, or to suffer detriment as a result of engaging with a particular market or market segment.¹²

The CLCACT maintains the view that there are distinctions between disadvantage and vulnerability which ought to inform consumer policy. Currently, the experiences of these consumers highlight serious failures in markets to deliver fair or safe access to products, but all consumers are deserving of empowerment and protection through targeted mechanisms.

Harassment and coercion of low-income consumers by debt collectors is a frequent concern experienced by clients of our service. A recent joint initiative by ASIC and the ACCC to produce guidelines for consumers about their rights when being pursued for a debt and the corresponding guidelines for creditors is a good example of a campaign that empowers all consumers, but with particular relevance for those most frequently impacted, vulnerable and disadvantaged.

Another example of a pro-active regulatory approach was that taken by the ACT Legislative Assembly arising from concern about the impact of continuing credit products being issued to vulnerable and disadvantaged consumers who could not afford to pay without suffering hardship, the ACT Assembly inserted section 28A into the Fair Trading Act.

Section 28A requires credit providers to undertake a "satisfactory assessment process" prior to approving new credit or an increased credit limit on a card facility. This assessment process requires the credit provider to make reasonable inquiries about a consumer's income and expenses in order to inform itself about the consumer's capacity to repay. The Explanatory Memorandum to the Amendment states:

¹¹ Consumer Affairs Victoria, Discussion Paper – What do we mean by 'vulnerable' and 'disadvantaged' consumers?, Melbourne, March 2004.

¹² Tim Gough, Response to Consumer Affairs Victoria Discussion Paper "What do we mean by 'vulnerable and 'disadvantaged' consumers?", Consumer Law Centre of the ACT Canberra, 15 April 2004, pg 2.

These provisions are based in part on the uniform national Consumer Credit Code (the Code). Specifically, the intent of this amendment is drawn from section 70 which provides that credit contracts may be reopened by a court if the credit provider failed to take a number of steps before activating the contract...This Amending Bill would make it clear that creditors are obliged to diligently assess each debtor's or potential debtor's situation before approving credit or extension of credit limits. This would avoid the current situation where debtors caught in this trap have to initiate a court process in order to have the spirit and intent of the Consumer Credit Code applied to their credit contract. Lending institutions should be meeting the requirements of the Code in the first place.¹³

In our view, the ACT is not the only jurisdiction which could benefit from such a regulatory response. Especially in an atmosphere where credit card debt has skyrocketed from 7.6 billion in March 1997 to 39.5 billion in March 2007¹⁴ and the level of household debt to annual income has been estimated to be 160% (an increase of 69% from 10 years ago)¹⁵.

For example, it is noted that in 2005, American Express issued Gold Cards to Aboriginal Australians living in remote communities of north Queensland earning incomes from CDEP programs¹⁶. American Express issued these cards to a disadvantaged group of consumers without assessing capacity to pay which led to significant debts being accrued. Legislation like that implemented by the ACT may have protected these disadvantaged consumers from the unfair credit cards offered as well as protecting other people in Queensland.

A further example of a generic regulatory intervention which would assist all consumers in the financial market whilst targeting vulnerable and disadvantaged consumers could include the introduction of a Commonwealth usury limit on all credit contracts. Such a usury limit should cap interest rates inclusive of fees and charges regardless of the payment term. It is noted that the ACT and NSW have recognized the need for such a generic approach, introducing a 48% usury limit, to curb predatory short-term or “pay-day” lending. The impact of failing to introduce similar limits in other jurisdictions has resulted in usurious rates of interest being charged, especially in the short-term lending market. The lack of consistency across jurisdictions is a cause of significant consumer detriment.

By way of example: a client of our service presented with several credit contracts and a promissory note with various “pay-day” lenders in South Australia. The interest rates applied ranged from 230% to 855% plus additional fees and charges. The same contracts in the ACT would have been illegal and may have resulted in the revocation of the credit provider's license.

However, development of effective policy and regulation also requires energy to monitor and enforce compliance where appropriate. Based on our clients' experience, the regulatory response of agencies to complaints made by consumers is patchy at best. Responses when

¹³ The Legislative Assembly for the Australian Capital Territory, Fair Trading Amendment Bill 2002 – Explanatory Memorandum

¹⁴ Reserve Bank of Australia, Credit and Charge Card Statistics – C1 at <http://www.rba.gov.au/Statistics/Bulletin/C01hist.xls>

¹⁵ AMP Capital Investors, reported in Australian Financial Review “Bank Regulator Warns on Bad Loans” 19 March 2007.

¹⁶ As reported in the The Age “AMEX defends issuing Gold Cards to poor” 16 December 2005 at <http://www.theage.com.au/articles/2005/12/16/1134676423423.html>

they do occur seem to rarely assist the individual concerned, but rather feed into a closed bureaucratic process. Better *protection* should correspond with attempts to *empower*. Theoretical rights that are not accessible in practice are pointless. In this regard, it is noted that the US State of New Mexico introduced a targeted regulatory response to sub-prime, high cost home loans by mandating financial counseling as a prerequisite to the approval of such loans.¹⁷

Questions: What are the examples of policies that are very ineffective in targeting vulnerable and disadvantaged consumers? Are there instances where a desire to protect these groups has imposed significant net costs on the wider community?

Perhaps the best example of ineffective consumer policy regulation for all consumers is telecommunications. The Universal Service Obligations relating to persons suffering life-threatening illnesses and the Australian Telecommunications Industry Forum Code (ACIF) on Credit Management are perhaps the only policies specifically targeted to vulnerable and disadvantaged consumers. The Codes are lengthy, disjointed and ineffective. It is the experience of this service that implications for a breach or multiple breaches of a Code or several codes seems to result in no sanction on the service provider. The Codes mentioned are registered under the Telecommunications Act and are therefore theoretically enforceable. There is no evidence however that the enforcement option is likely or credible.

Issues Paper - page 20 & 21

Question: Are the current dispute resolution mechanisms and arbitration processes, including consumer tribunals readily accessible and effective?

CLCACT has daily contact with internal and external dispute resolution services across various industry sectors. Based upon this experience we have formed the view that the level of professionalism associated with a particular company's internal dispute mechanism is closely linked with its membership of a respected external dispute resolution service (an exception is telecommunications which is discussed above).

Currently, there are a myriad of external industry specific external dispute resolution schemes. The effectiveness of many is questionable. The recent review and restructure of the Credit Ombudsman Service Limited is a good example of an EDR service responding to consumer and industry concerns about the lack of consistency, inefficient structures and accessibility. We submit the guiding principals in dispute resolution ought to include:

1. Free access for consumers
2. Visibility
3. Ease of access
4. Informality of communications
5. Consistency
6. Mandatory adherence to Codes of Practice with breach resulting in sanctions
7. Independence of decision makers
8. Significant consumer participation at management and board level

¹⁷*Home Loan Protection Act [58-21A-1 to 58-21A-14 New Mexico Statutes Annotated 1978].*

In terms of access to Courts and Tribunals, the costs of enforcing consumer rights under the Consumer Credit Codes, is passed to affected individuals. With the consumers impacted most likely to be those on low incomes costs are falling frequently on Legal Aid Commissions and Community Legal Centres. Given the limited availability to such services and the complex legal nature of litigation, real access to justice is a significant concern.

Issues Paper - page 22

Questions: Would there be benefits from government support for a consumer advocacy body and would they outweigh the funding and other costs involved? Should such a body's role be limited to advocacy, or should it also be responsible for bringing forward consumer complaints? Do consumer advocacy bodies adequately represent the interests of all consumers? If not, what other means could be used to elicit the views of consumers? Is there a need for greater research into consumer and market behaviour to inform policy development? If so, who should be responsible for carrying out and resourcing such work?

The lack of an appropriately resourced and independent national consumer policy research and advocacy body has led to a lack of detailed qualitative and quantitative analysis in all areas of economic reform that have impacted consumers over the past 11 years. This has resulted in significant consumer detriment in the area of consumer credit and telecommunications in particular as described above. There will be costs involved in bridging the gaps across the current siloed and disjointed regulatory landscape. However the costs of failing to act may far outweigh the costs of action.

In our view, there is a demonstrated need for a national consumer council and legal centre responsible for policy, research and advocacy across a range of consumer issues. There are models internationally from which the government could draw upon to suit our particular circumstances in Australia.