SUBMISSION TO TREASURY

Protect safe lending laws

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57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 | **Fax** 02 9577 3377 | **Email** campaigns@choice.com.au | www.choice.com.au

The Australian Consumers' Association is a not-for-profit company limited by guarantee. ABN 72 000 281 925 ACN 000 281 925

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INTRODUCTION

Safe lending laws are an essential pillar of Australia's consumer protection framework.

Axing safe lending laws will cause lasting harm to people and the Australian community. It will tilt the balance of power firmly towards Australia's major banks and lenders.

This policy will lead to a debt disaster in Australia. Australia already has the second highest level of personal household debt in Australia.[1] 1.9 million people are already struggling with credit card debt.[2] Mortgage stress is at record levels. Over 40% of Australians are currently experiencing mortgage stress, with over 50% of Tasmanian mortgage holders experiencing mortgage stress.[3] Allowing unfettered lending by lenders will further only exacerbate household debt and financial hardship in households across Australia.

The Government's proposal contradicts the Banking Royal Commission's first recommendation.[4] After the scandals of the Royal Commission, the Australian community expects stronger and fairer financial services laws, not weaker laws. T It is clear the hard-fought lessons of the Global Financial Crisis and Banking Royal Commission have been forgotten.

This policy will hurt people. Lenders consistently show flagrant disregard for the financial wellbeing of people when lending money. Financial counsellors and community legal centres regularly assist people who have been sold by lenders into unaffordable or unsuitable debt. The impact of this is devastating. It affects people's livelihood, mental health, relationships, and sense of being in the world. Axing safe lending laws will simply be a green light for the banks to increase reckless lending in Australia and will hurt people.

CHOICE does not support the Government's proposal to axe safe lending laws. During a global pandemic and our first recession in three decades, banks need to take more, not less care.

[1] Australian Parliamentary Library, 2020, 'Monthly Statistical Bulletin - September 2020', p.18 https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/WUKX6/upload_binary/WUKX6.pdf;fileType=application/pdf

[2] ASIC 2018, REP 580 Credit card lending in Australia

[3] Digital Finance Analytics 2020, ' Household Financial Stress Reaches New High', October, https://digitalfinanceanalytics.com/blog/household-financial-stress-reaches-new-high/

[4] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, recommendation 1.

In November 2020, CHOICE asked people to share personal experiences of unfair lending by Australia's banks. Over 800 people responded with stories of predatory lending by banks and explained why safe lending laws are important. We have included these stories throughout the submission so that people have the opportunity to share in their own words the human impact of irresponsible lending.[5]

CHOICE is a signatory of the joint consumer submission to this consultation. However, in this submission, CHOICE wishes to shares people's personal experiences and highlight five glaring defects with the proposal:

- axing responsible lending laws will be harmful for our economic recovery;
- people will lose individual legal rights;
- protections against credit card selling will be scrapped;
- penalties for banks will be scrapped entirely or significantly watered down; and
- consumer protections for mortgage brokers will be weakened.

[5] Names with an asterix have been changed for privacy reasons.

Axing responsible lending laws will be harmful for our economic recovery

"Building an economy on borrowing is like building a wall by taking the bricks from the bottom and putting them on the top eventually it will fall down with a big crash."

Comment by Graham, WA

"Unfair lending practices hurt our society, and not just the borrower, because people who fall victim to exploitative lenders are frequently left crippled by debt and unable to afford a whole range of consumer goods that they need, and would purchase if they could afford to do so. This disadvantage may also extend to the borrower's family, especially to any children they may have. The effect of this situation on society and the economy is to concentrate money in the hands of those who do not need it, and to take it from those who do. This results in less money being spent on a whole range of consumer goods, and thus a slowing in the economy. It can also result in more government money needing to be spent on welfare."

Comment by Margaret, NSW

"Responsible lending will not harm the economy, it can only strengthen it as people will not get into unsustainable debt and threaten to bring down the economy by not being able to service the debt."

Comment by Matthew, NSW

Responsible lending laws were introduced in response to poor lending practices of the financial services marketplace prior to and during the Global Financial Crisis. These are important consumer protections that keep people safe from harmful lending.

Credit is flowing in Australia

Owner-occupier home lending is at record highs in Australia.[6] The latest ABS data shows that owner occupier home lending is at the highest level since records began in 2002 with total home loans commitments at $17.3 billion. This is . New first home owner loans rose to the highest level since October 2009.

[6] Australian Bureau of Statistics, November 2020, 'Lending Indicators', https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release

There is no access to credit issue in Australia. The Treasury, APRA and Australia's major banks have said there are no problems with access to credit in Australia. The Treasury's evidence to the Financial Services Royal Commission was that there was no evidence that existing responsible lending laws had "materially affected the availability of credit".[7] In October 2020, APRA testified before Senate Estimates that existing responsible lending laws were not materially affecting the flow of credit.[8]

Relaxing lending laws will weaken our economy.

Australia already has the second highest level of personal debt in the world and experiences a "debt overhang effect" which has slowed spending and economic growth. Nearly two million people are struggling with credit card debt.[9] Almost a third (28%) of all households are servicing a total debt that was three or more times their annualised disposable income.[10]

In 2019, the RBA found Australia has a "debt overhang" effect.[11] Across all mortgage borrowers, the RBA found that increased debt results in reduced household expenditure. They found that "evidence that indebted households reduce their spending by more than other households during adverse macroeconomic shocks."

In October 2020, investment bank UBS found there is "little benefit of repealing responsible lending laws" and it will increase financial stability risk.[12] UBS said that axing lending laws will "increase financial stability risk over the medium term given very highly leveraged Australian households and record low rates."[13] They found "few, if any stories from banks, non-bank lenders or mortgage brokers that credit has not been available."

Empirical evidence from the Global Financial Crisis has shown that high household debt contributes to prolonged recessions. When an economic shock hits, households with high household debt significantly cut back on spending to service existing loans. They are unable to contribute to economic growth and this weakens national recovery. The IMF found that "the experience of the Global Financial Crisis suggests that high household debt can be a source of financial vulnerability and leads to prolonged recessions."[14] A 2010 study by the Federal Reserve Bank of San Fransisco of 36 OECD countries found that growth in household debt is

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[7] Commonwealth Treasury, 2018, submission to Financial Services Royal Commission: Interim Report, p.34, https://financialservices.royalcommission.gov.au/Submissions/Documents/interim-report-submissions/POL.9100.0001.1059.pdf

[8] Commonwealth Australia 2020, 'Senate Economics Legislation Committee. Estimates', 27 October, transcript, p.78

[9] ASIC 2018, REP 580 Credit card lending in Australia

[10] Australian Bureau of Statistics, 2019, 'Household income and wealth, Australia', July, https://www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latest-release#articles

[11] Reserve Bank of Australia, 2019, 'The effect of mortgage debt on consumer spending: evidence from household-level data', July, https://www.rba.gov.au/publications/rdp/2019/2019-06.html

[12] UBS Global Research, 19 October 2020, 'Australian Banking Sector Update: UBS Evidence Lab inside - Will repealing Responsible Lending stimulate housing?', p.1 report available on request.

[13] UBS Global Research, p.1

[14] International Monetary Fund, 2017, 'Global Financial Stability Report October 2017: Is Growth at Risk?', Chapter 2, p.54, https://www.imf.org/en/Publications/GFSR/Issues/2017/09/27/global-financial-stability-report-october-2017

one of the best predictors in decline in household spending during a recession.[15] The Bank of England found during the Global Financial Crisis "households with big mortgages cut their spending six times more aggressively than households with no, or at least small, mortgages."[16]

Loan application times can be improved without axing consumer protections

Processing times for loan applications are operational challenges that can be solved by banks. Many lenders have offshored processing of mortgage applications. During COVID-19, Westpac admitted that mortgage applications that were carried out in India and Philippines contributed to long delays in applications.[17] ANZ also acknowledged operational challenges in processing applications during COVID-19.[18]

The roll out of Open Banking will likely fast track the process of mortgage application and approval. Open Banking came into effect on 1 July 2020, and the benefits for both consumers and lenders have not had a chance to materialise. As an example, Regional Australia Bank was one of the first Australian banks to use Open Banking technology. The bank is able to analyse over 3000 expenditure transactions in seconds.[19]

[15] R. Glick and K. Lansing, 2010, 'Global Household Leverage, House Prices, and Consumption', FRBSF Economic Letter, Federal Reserve Bank of San Francisco, https://www.frbsf.org/economic-research/publications/economic-letter/2010/january/global-household-leverage-house-prices-consumption/

[16] A. Brazier, 2017, ''Debt Strikes Back' or 'The Return of the Regulator'?, July, p.4, https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/debt-strikes-back-or-return-of-the-regulator.pdf?la=en&hash=DADC9209D8C64E623B1A2C2B9EF5F1B47A9C0080

[17] C Yeates, 2020 ''Response rates have been too slow': Westpac brings call centre jobs back to Australia', Sydney Morning Herald, July 29 https://www.smh.com.au/business/banking-and-finance/response-rates-have-been-too-slow-westpac-brings-call-centre-jobs-back-to-australia-20200729-p55gjp.html

[18] J Frost and J Thomson, 2020, 'ANZ hit by loan delays in rush to refinance', AFR, May 2020, https://www.afr.com/companies/financial-services/anz-hit-by-loan-delays-in-rush-to-refinance-20200520-p54una

[19] Finextra 2020, 'Regional Australia Bank uses Basiq to approve country's first Open Banking loan', 3 July, https://www.finextra.com/pressarticle/83158/regional-australia-bank-uses-basiq-to-approve-countrys-first-open-banking-loan

Credit card protections will be removed or significantly weakened

"'In 2010 and 2011, one of the big four banks allowed my son, Michael, to run up a number of credit card debts in excess of $50,000 [well above his expected yearly income of about $35,000] despite the fact that the bank was fully aware that his weekly income was no more than $675 per week. The bank at one stage rolled two credit card debts into a seven-year personal loan with an interest rate of 17.4% p.a. and still issued him with a further credit card.
My son was never informed of the financial implications of these arrangements, with the end result that he was bankrupted at a time when he and his partner were expecting a baby."

Story shared by Clive, NSW

"My daughter was pressured by bank staff to have a credit card when she went to open a bank account. There was no consideration for her age or ability to pay off a credit card (she was a student)."

Story shared by Tessa*, WA

"At the age of 18 (in 2013) I was invited by CBA to apply for a credit card, which I followed through with. Prior to laws prohibiting credit limit increases, I received a number of invitations sent to my phone - inviting me to increase my limit from an initial amount of $1,500 - to its eventual limit of $16,000 before I consolidated and closed the account. While I was fortunate enough to work in the credit industry and therefore did not use the entire amount made available to me, countless others have not been so lucky."

Story shared by Adam, QLD

"*After being offered unsolicited increases in credit card limits I ended up over $100,000 in debt and, after struggling for years to maintain payments, my only recourse was to enter bankruptcy. The stress associated to this time contributed to my having a significant stroke at a relatively early age (54). The idea that others could be placed in a similar position is disturbing.*"

Story shared by Nikita*, NSW

"My 81 year old mother who doesn't need a credit card was given one and was paying fees and late fees on top of those fees while she was in hospital."

Story shared by Marguerite*, NSW

"My son, who has Autism, was sent a letter offering a credit card. Had I not taken steps to stop him he could have run up a debt much larger than he could have serviced. The bank knew he had a disability as he had a fee free account because of it."

Story shared by Manuela*, South Australia

It's clear from these stories that lenders have a shameful track record of hawking credit cards to people, particularly to teenagers and people experiencing financial vulnerability.

The Government's policy will either significantly weaken or remove core consumer protections for credit cards. This policy will give a green light to lenders to sell credit cards to people, irrespective of whether it is suitable.

Credit cards are high-interest, high-fee and risky financial products. The interaction of balance transfer deals, annual fees, different interest rates for purchases and cash advances, interest-free periods and minimum repayment amounts make them extremely complex products. Banks need to be responsible in ensuring that cards sold are appropriate and will not place people in financial hardship or harm.

The Government's proposal creates a dangerous loophole, where bank-issued credit cards sold will not be subject to any responsible lending obligations. Credit cards issued by banks represent over 75% of cards sold in Australia.[20]

Banks stand to make significant profit by trapping people into a cycle of persistent credit card debt. Lenders profit when people can only afford to meet interest repayments and fail to pay down the principal. The law will exacerbate the issue of persistent credit card debt and place more households in financial hardship.

The Government's proposal also removes another important consumer protection for bank-issued credit cards. It scraps the important protection that determines that a credit card is unsuitable if a consumer could not repay credit limit within a reasonable time period, which is

[20]Productivity Commission, 2018, Competition in the Australian Financial System, Final Report, p.4

currently set at three years.[21] This was passed by the Federal Government in 2018 and the law only came into effect in 2019. This would significantly weaken consumer protection for people, and give more power to the major banks to market unsuitable credit cards.

Before this requirement was legislated, card issuers calculated a consumer's ability to repay based on the minimum repayment (such as 2% of the outstanding balance), not the full credit limit. In 2016, Treasury noted how credit card providers regularly sold cards to people based on meeting these minimum repayments and not on reasonable timeframes. They concluded that:

> "*Card issuers set minimum repayment amounts as a very small proportion of the outstanding balance, so that households making the minimum repayment will only pay off their balance over a very long period and incur very large interest costs. Making the higher repayments required to pay off their outstanding balance may be sufficient to cause financial distress for many consumers.*"[22]

[21] Treasury Laws Amendment (Banking Measures No. 1) Act 2018 (Cth)
[22] Treasury, 2016, 'Credit cards: improving consumer outcomes and enhancing competition', May, https://treasury.gov.au/sites/default/files/2019-03/C2016-024_Credit_card_reforms_CP.pdf

People will lose legal rights

"Our son was in a bad place at the time and the bank encouraged him to take a credit card which he had no way of using properly or the ability to pay it back. We advised them previously of his health and situation, not to approach him with offers such as this but they did it anyway. We ended up having to get the Financial Ombudsman onto the case to navigate our way through the problem which we managed to finally clear."

Story shared by Ian*, WA

Under the Government's proposal, people will lose legal rights.

In October 2020, the Commonwealth Bank of Australia was charged in the Federal Court for providing unsolicited credit limit increases to a problem gambler.[23] The borrower requested that the bank stop providing credit, yet the bank increased the credit limit to $35,000. Under the Government's proposal, it will be very challenging to bring individual claims such as this against lenders who lend unfairly to borrowers.

Consumers will likely lose the ability to take a bank to court or an ombudsman for an individual breach of lending laws.The new legislation focuses on lenders having adequate systems, processes and policies in place, rather than requiring individual loans to be suitable.[24] This firmly tips the balance of power into the hands of the banks.

It will be extremely challenging for an individual to prove that a bank had adequate "systems, processes and policies" in place for an individual breach of lending. It will be incumbent on the consumer to establish exactly what the 'system, process or policy' was at the time of offering the loan. Banks will not be forthright in providing these internal documents. Further, each time an advocate represents a consumer at AFCA, they will need to find the specific documents from the lender at that point in time. This is overly cumbersome and will likely disenfranchise many people from seeking redress.

[23] ASIC 2020, '20-263MR CBA ordered to pay $150,000 for credit limit increase provided to problem gambler: Royal Commission case study', 30 October, https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-263mr-cba-ordered-to-pay-150-000-for-credit-limit-increase-provided-to-problem-gambler-royal-commission-case-study/

[24] Prudential Standard APS 220 Credit Quality (APS 220)

It remains highly unlikely that an individual who has been sold an unsuitable loan will be able to seek compensation for a breach of the law. Under the existing law, a court has the power to compensate an individual if they suffer loss or damage as a result of another party's breach of a civil penalty provision in the Act.[25]

Under the current law, breaches of responsible lending obligations attract a civil penalty provision. However, the Government's proposal scraps civil penalty provisions for selling unsuitable or unaffordable loans. People will be unable to receive remedy or compensation for poor lending practices. This goes against community standards and expectations. In a recent November 2020 nationally representative survey, 82% of people think there should be compensation for people when they are wronged by financial institutions.[26]

It is extremely concerning that the Government is considering weakening people's legal rights and access to compensation when they are wronged.

[25] s178, *National Consumer Credit Protection Act 2009*

[26] Polling was completed as part of the Dynata's weekly "Omnipulse" omnibus.The fieldwork was conducted on 11-16 November, 2020. 1,014 people completed the survey and data was weighed to the latest ABS census data so results are nationally representative.

Consumer protections for mortgage brokers will be watered down

"Mortgage broker falsified home loan information resulting in 100% finance for purchase price and costs. The Mortgage Broker was advertised as a "wealth manager" for the (major) bank, including use of the bank's logo in advertising material. In another example my signature was fraudulently used on a personal loan by the same person who had long standing connections with bank manager at a smaller bank."

Story shared by Lilian, VIC

"...our broker did not advise the banks that my employment was highly likely to change from employed to unemployed submitted a loan application for $425k approx., submitted a loan application a couple years later that finance lawyers are of the opinion we could not afford. Gave financial recommendations, which had us take out a personal loan, and sell property. The bank never checked the accuracy of information nor did either parties [sic] consider our personal circumstances, instead used a formula, which clearly does not work for everyone. We are in a world of debt that we can`t afford. I don't know where Myself and my daughter will be living in the future because we may lose our house and literally live pay cheque to pay cheque on a part time employment basis."

Story shared by Nicole, QLD

"*My sister and I were granted a mortgage for a piece of land through a dodgy mortgage broker. They manipulated our documents so that only pay slips with overtime and highest amounts were used, not pay slips in order of date of issue. They also ensured that I was not included on the title of the land at the bequest of a third party who is not a part of the loan. So now I have a huge debt with nothing to show for it, which prevents me from applying for any other types of credit. Until the 'land-owner' and co-mortgagee decides to sell the land, I'm completely screwed.*"

Story shared by Sadio*, VIC

Axing responsible lending obligations for mortgage brokers will cause harm to people who use a broker.

The mortgage broking industry operates on a conflicted business model. Mortgage brokers have an incentive to recommend loans that will maximise their upfront and trail commission, irrespective of whether it is suitable. The Royal Commission identified this conflict of interest as a leading driver of misconduct. Commissioner Hayne found:

> "*The fact that the broker is paid only if a loan application succeeds stands as an obvious motive for that kind of conduct. It is in the broker's financial interests to have the lender approve the loan.*"[27]

Responsible lending obligations are an essential safeguard that ensures that brokers undertake adequate checks and balances to ensure they recommend appropriate loans to people. Brokers remain incentivised to falsify information on loan applications to earn commission. Broker fraud continues to remain a serious problem in the industry. An October 2020 UBS report found that 42% of loan applications through the broker channel misstated the mortgage application, compared with 22% through the bank's channel.[28] If responsible lending obligations for brokers were axed, we will likely see an increase in broker fraud, as there are less requirements for brokers to make detailed investigations and assessments of an applicant's financial situation.

The newly legislated best interests duty was designed to be a complementary legal obligation that operates alongside responsible lending obligations.The best interests duty has no explicit requirements for brokers to assess suitability or affordability of loans. This obligation was left to the responsible lending requirements of the broker. The Explanatory Memorandum for the best interest duty states,

> "*the best interests duty and the responsible lending obligations are separate obligations that operate alongside each other and apply every time credit assistance regulated by the Credit Act is provided by a mortgage broker.*"[29]

[27] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, p.65
[28] UBS Global Research, 19 October 2020, 'Australian Banking Sector Update: UBS Evidence Lab inside - Will repealing Responsible Lending stimulate housing?'
[29] Financial Sector Reform (Hayne Royal Commission Response) - Protecting Consumers (2019 Measures) Bill 2019, p.28

This is also codified in ASIC's Regulatory Guide which states that both obligations are "complementary".[30] According to the Regulatory Guide, responsible lending obligations require brokers "to make reasonable inquiries about the consumer's requirements and objectives, and make reasonable inquiries about the consumer's financial situation."[31]

Responsible lending obligations and the best interests duty are separate and complementary layers of consumer protection that protect people from poor conduct from a broker. Removing responsible lending obligations will take away a core protection that consumers have against poor conduct. It will undermine the effectiveness of the best interests duty. It will undermine the tangible, concrete steps that brokers have to satisfy to discharge their existing responsible lending obligations

[30] ASIC 2020, Regulatory Guide 273, Mortgage brokers: best interests duty, June, p.8 https://download.asic.gov.au/media/5641325/rg273-published-24-june-2020.pdf
[31] ASIC 2020, Regulatory Guide 273, Mortgage brokers: best interests duty, June, p.10 https://download.asic.gov.au/media/5641325/rg273-published-24-june-2020.pdf

Penalties for unfair lending will be significantly weakened or removed entirely

It is concerning that the Government proposes to water down or remove a number of criminal and civil penalties for breaches of lending obligations. The Australian community expects that institutions and executives are held to account when they do wrong by their customers. The Royal Commission showed clearly that financial institutions are only deterred from committing misconduct when penalties and enforcement are seen as onerous and more than the cost of doing business. Stripping penalties in effect is a green light for banks to break the law.

Under the current law, if a credit licensee provides a consumer with an unsuitable credit product, they have breached criminal and civil penalty provisions. These penalties are set to be scrapped entirely for bank lending. The proposed legislation has no new or additional penalties for breach of lending laws for banks.

The penalties associated with APRA's standards are significantly weaker than existing penalties under *National Consumer Credit Protection Act 2009*. Further, APRA is ill-placed to be a conduct regulator. Their priority is ensuring prudential stability, not prosecuting individual breaches of lending laws.

APRA's approach to enforcement was heavily criticised by the recent APRA Capability Review. They were criticised for a "behind the scenes" approach to regulation that was "out of step with public expectations of regulators following the Hayne Royal Commission."[32] The Panel concluded that,

> *"APRA's preference to engage with regulated entities behind the scenes limits its scope to deter poor outcomes"*[33]

It is worrying that APRA will have the authority to prosecute irresponsible lending, and that criminal and civil penalties for providing unsuitable loans will be removed. This swings the pendulum of power heavily towards the banks, at the expense of people.

[32] Treasury, 2019, 'Capability Review of the Australian Prudential Regulation Authority', p.2 https://treasury.gov.au/sites/default/files/2019-07/190715_APRA%20Capability%20Review.pdf

[33] Treasury, 2019, 'Capability Review of the Australian Prudential Regulation Authority', p.115 https://treasury.gov.au/sites/default/files/2019-07/190715_APRA%20Capability%20Review.pdf