Phase Two of the National Consumer Credit Reforms: Consumer Leases and Enhancements to the National Credit Code

Regulation Impact Statement

June 2011

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GLOSSARY

Term	Definition
ACL	Australian credit licence
ADI	Authorised Deposit-taking Institution
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
COAG	Council of Australian Governments
Code	National Credit Code. This is Schedule 1 to the *National Consumer Credit Protection Act 2009*
Credit Act	*National Consumer Credit Protection Act 2009*
EDR scheme	External dispute resolution scheme
RIS	Regulation Impact Statement
UCCC	Uniform Consumer Credit Code

Executive Summary

In 2008, the Council of Australian Governments (COAG) agreed to transfer responsibility for the regulation of consumer credit from the States and Territories to the Commonwealth under a two phase implementation plan.

Phase One of the National Consumer Credit Protection Reforms

Phase One of the National Consumer Credit Protection Reforms substantially commenced on 1 July 2010, through requirements introduced by the *National Consumer Credit Protection Act 2009* (Credit Act). The main features of Phase One were that it introduced:

- a comprehensive licensing regime for all providers of consumer credit and credit related brokering and intermediaries in the industry;
- responsible lending conduct requirements on all licensees to not provide credit products and services that are unsuitable, either because they do not meet the consumers' requirements or because the consumer does not have the capacity to meet the repayments, either at all or only with substantial hardship;
- improved sanctions and enhanced enforcement powers for the sole national regulator the Australian Securities and Investments Commission (ASIC);
- expanded redress for consumer protection through universal external dispute resolution membership for licensees, streamlined court arrangements, and remedies for consumers for licensee misconduct; and
- a largely replicated version of the key state-based legislation, the Uniform Consumer Credit Code (UCCC), as the National Credit Code (Code).

Phase Two of the National Consumer Credit Protection Reforms

At its meeting of 19 April 2010, COAG endorsed a two part implementation plan for Phase Two of the credit reforms, under which there is a longer timeframe to consider more complex topics (such as the need to regulate the provision of credit to small business or lending for investment purposes).

Part One consists of:

- changes to the obligations applying to consumer leases;
- enhancements to particular provisions of the Code;
- extending the regulation of credit for personal use;
- small-amount short-term lending; and
- improvements to the regulation of reverse mortgages and credit cards.

It is intended that legislation to give effect to part one will be in place in 2011, and for part two by mid-2012 at the latest. This Regulation Impact Statement (RIS) considers reforms in relation to the first two topics.

In August 2010, the Government announced election commitments in relation to the regulation of credit cards under the *Fairer, Simpler Banking* policy, and to the regulation of equity release products under the *Delivering for Seniors* policy. These commitments will be implemented in Part One of Phase Two of the credit reforms, and have been addressed in separate Regulatory Impact Statements (RISs). The reforms in relation to credit cards have are being progressed through the introduction of the *National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011*, introduced into the House of Representatives on 24 March 2011.

The following summary analyses the reasons for pursuing reforms in relation to consumer leases and enhancements to the Code.

Consumer Leases

There are significant differences in the application of the Credit Act to credit contracts and to consumer leases. This disparity results in the following problems for consumers:

- The lesser obligations applying to consumer leases regulated under the Credit Act has created opportunities for regulatory arbitrage, and contributes to consumers being misled before entering into a contract.
  - Different regulatory outcomes arise according to whether or not the consumer will be able to own goods at the end of a lease. This creates a tension for lessors between seeking to avoid regulation (by utilising a lease for this purpose), and not discouraging customers (who may only enter into a contract where they believe they will own the goods at the end of the contract). This causes an inherent structural tendency for consumers to be either actively mislead or not fully informed.
- There are information asymmetries in relation to:
  - whether or not the consumer will have ownership of the goods at the end of the contract, and consequently on the impact this legal distinction will have on the consumer's rights under the contract (as there are no statutory obligations for lessors to disclose this information); and
  - the capacity of consumers to determine the cost of a consumer lease relative to a credit contract.
- Classes of consumers who are particularly vulnerable may be targeted by fringe operators who use leases to finance the provision of goods because of the absence of regulation, and offer leases on terms where the benefit is minimal relative to the costs incurred.
  - Consumers may be particularly susceptible where they are on pensions or low incomes, and have few or no other alternative sources of finance.

- Consumers have more difficulty in obtaining redress (because they either have fewer statutory rights where they enter into a consumer leases rather than a credit product, or because the type of lease is completely unregulated by the Credit Act).

It is proposed to address these problems by:

- amending the Credit Act to ensure greater regulatory consistency between leases and credit contracts (including developing options for allowing more effective comparison on price and disclosing whether or not the consumer will own the goods); and
- using existing financial literacy programs to deliver specific information to consumers in relation to the uses of leases as a means of acquiring goods.

These reforms would make a significant difference for consumers in that:

- Consumers will be able to make more effective purchasing decisions, as they will be able to more readily compare the costs of entering into a consumer lease with the cost of entering into a credit contracts, and be better informed about whether or not they own the goods at the end of the contract.
- Consumers will have greater access to remedies in the event they suffer loss or damage.
- Vulnerable consumers will be at less risk of being targeted by fringe operators as those operators will need to hold an Australian credit licence, and therefore meet the standards of conduct applicable to licensees (or else cease offering these products). Fringe operators have been associated with problems such as the use of pressure selling tactics; failure to deliver leased goods or delivery of goods other than those specified in the lease; and the use of itinerant, untrained labour with poor levels of compliance.

These reforms would have the following impact on industry:

- Lessors who currently offer consumer leases (a product already regulated by the Credit Act) would incur relatively low compliance costs. They would find themselves able to compete more effectively with providers of exempt leases, but, in turn, would no longer have the benefit of their current competitive advantages relative to credit contracts (and may have to reduce the cost of their products in order to maintain their market share).
- Lessors who currently offer products unregulated by the Credit Act would incur higher compliance costs, and it could be expected some would cease offering these products (particularly those fringe operators who operate without any business infrastructure).
- Credit providers who offer regulated products that are more competitive than leases may increase market share due to greater transparency in pricing, and the enhanced capacity of consumers to assess the relative merits of competing products. These providers will not incur any new compliance costs.

Enhancements to the National Consumer Credit Protection Regime

During the course of Phase One of the National Consumer Credit Protection reforms, concerns were raised by various stakeholders about possible improvements to specific provisions in the State-based UCCC, which have been replicated in the National Credit Code.[1] It was agreed these issues would be considered during Phase Two of the credit reforms and were the topic of Chapter 7 of the Green Paper.

The following issues have been identified in relation to the operation of the Code where the UCCC did not adequately address problems for consumers:

- The provisions enabling borrowers to request a variation of their credit contracts or consumer leases on the grounds of financial hardship (whether before or after enforcement action) are highly prescriptive, and subject to a restriction in that they only apply to persons who have borrowed up to $500,000. This restricts the capacity of borrowers to obtain a variation, even where they only need a variation to address a short-term change in their circumstances.

- There is no general remedy provided for unjust conduct by brokers or other intermediaries (as the Code only provides a remedy where there has been unjust conduct by lenders). This creates a gap as consumers otherwise need to rely on general prohibitions that may not always provide a remedy where they have suffered loss because of the conduct of a broker.

- The Code does not prohibit or restrict the use of particular words or phrases. In the credit context, some words or phrases have an emotional resonance with consumers (for example, 'impartial' or 'interest free'). Consumers may be more susceptible to entering into contracts where brokers or lenders have used these terms in advertising, even where they may not be strictly correct or are subsequently qualified, and where therefore the contract is inconsistent with the use of these words.

- The Code only contains a partial prohibition against door-to-door canvassing of credit. The prohibition does not apply where goods are being sold on credit or provided through a lease. Given the range of alternative distribution channels available today, door-to-door selling in this way is largely associated with targeting of vulnerable consumers, and often with high-pressure or manipulative sales tactics.

It is proposed to address these problems by:

- simplifying the procedures for consumers to obtain a variation of the repayments under their contract due to financial hardship, removing the restriction so that a consumer can rely on the statutory procedures irrespective of the amount they have borrowed, and provide borrowers with an additional opportunity to rectify defaults prior to their lender being able to take enforcement action;

- extending the existing remedy for consumers for unjust conduct by lenders to also include conduct by brokers and intermediaries;

[1] The Code (and the UCCC before it) regulates credit provided to natural persons for personal, domestic and household purposes. From 1 July 2010, the Code also regulates credit provided to natural persons for investment in residential investment property.

- prohibiting lenders and lessors from selling goods and services on finance through unsolicited door-to-door canvassing; and
- restricting the capacity of lenders and brokers to use certain words or phrases (for example, claiming to be 'independent' where they receive commissions).

It is expected that consumers will benefit from these changes as:

- they will have a reduced the risk of default in the event of a short-term change to their financial circumstances. Therefore, they will not need to refinance (incurring transaction costs) or risk losing security for the debt.;
- they will have an enhanced capacity to make brokers and intermediaries accountable for unjust conduct;
- they will be at less risk of entering into contracts for the supply of goods as a result of high-pressure or manipulative sales tactics, or without actively seeking out credit for financing the purchase of goods; and
- they will be at less risk of being misled by advertising claims.

It is expected that these changes will have the following impact on industry:

- Greater and simplified capacity to seek hardship variations:
  - For those lenders who have voluntarily adopted a code of conduct with similar obligations and are already fully complying with the code – the change to their business would be minimal; and
  - For those lenders who are not signatories to such a code, or who are complying inconsistently with it – the introduction of these obligations in law would introduce greater accountability and responsibility for non-compliance, and could be expected to result in greater internal changes to their practices to ensure they were now meeting these requirements.
- Introduction of a remedy for unjust conduct by providers of credit services:
  - It would have no impact on credit providers or lessors.
  - It is not expected brokers or intermediaries would incur additional costs directly, except for a relatively small class of brokers who deliberately and consistently engage in unfair or unjust conduct.
- Prohibition on door-to-door canvassing: A relatively small number of businesses who engage in unsolicited selling practices may need to change their business practices (noting that only 67 persons who had applied for an ACL with ASIC by 31 December 2010 nominated their function as 'Door-to-Door or Phone Sales').
- Restricted use of specified terms: The only class of providers who would be affected would be those who currently use any of these terms, who would need to decide between ceasing to use a restricted term or changing their business model so that they meet the conditions to be able to use it.

CONSULTATION

The Government has conducted extensive consultations in the consideration of issues under Phase Two of the credit reforms through the following consultation groups:

- The primary vehicle for consultation with stakeholders was the Industry and Consumer Representatives Consultation Group (ICRCG). Its membership comprised of representatives of the banking, financial services, mortgage and finance brokers industries, consumer credit legal services, consumer advocates, ASIC, and the Department of the Treasury. All major industry bodies are on this group, and are able to disseminate information to their members and provide their feedback.

- Consultation with this group has generally occurred on a monthly basis. Between January 2010 and October 2010, 7 meetings were held in relation to the Phase Two reforms. The usual structure for these meetings was for Commonwealth Treasury staff to circulate papers on Phase Two topics, with the topics then discussed in detail at the meetings. This format allowed members of the group to provide comments and feedback at all stages of the development of options canvassed in this RIS, and also enabled differences in views to be explored in detail. This structure enabled prompt and detailed exploration of issues with stakeholders and was important in the refinement and development of different options.

- The **Financial Services and Credit Reform Implementation Taskforce** (FSCRIT), comprises representatives from State and Territory departments and agencies, ASIC and the Department of the Treasury. Its main role in relation to Phase Two is to ensure proposals are developed in accordance with the COAG timetable. FSCRIT consultations have been conducted on a monthly or bimonthly basis, according to need.

A full membership list of each of the consultation groups is provided at **Attachment A**.

In addition, to ensure a broader level of public consultation, the Government released the **Green Paper** ***National Credit Reform - Enhancing confidence and fairness in Australia's credit law*** in July 2010. The Green Paper set out a range of options in relation to each of the Phase Two topics. It enabled interested parties to provide their views directly to the Government. Approximately 60 submissions were received, enabling the Government to more fully assess the impact of the options canvassed in the Green Paper in developing its reforms (as noted in this RIS in relation to particular topics). To facilitate consultation with small businesses, the Green Paper was also released on the Australian Government business consultation website.

Draft chapters of the Phase Two Green Paper were also circulated to the ICRCG, ERCWG and FSCRIT for their comment.

IMPLEMENTATION

Phase Two of the Credit Reforms will be implemented by legislation to be introduced in the 2011 and 2012 sittings of Parliament. Regulations to support the legislation may also be made. ASIC will continue to act as the national regulator of consumer credit and will be responsible for administering and monitoring compliance with the Credit Reforms.

Changes to deliver financial literacy messages to consumers will need to be developed through those programs. Some of these changes will be contingent on the passage of the legislation to implement the reforms; for example, the ASIC website already has information in relation to consumer leases, but the reforms will enable consistent, simpler and more effective information and messages to be provided. These messages could also include information about possible alternative sources of funding in certain circumstances, such as Centrelink products and non-commercial microfinance schemes.

The Government will continue to consult with stakeholders regarding implementation timeframes and transitional issues, particularly through the ICRCG and ERCWG groups (as regular meetings of these groups will continue). In addition, the Commonwealth Treasury also has well developed links with ASIC and industry bodies that ensure complex issues can be identified early, allowing prompt responses to be provided. The effectiveness of these relationships was demonstrated throughout Phase One, where a range of transitional and implementation issues were able to be addressed in relatively short periods of time, resulting in both the registration and licensing processes working smoothly for industry players.

REVIEW

The terms of the National Credit Law Agreement agreed by the Commonwealth and all States and Territories in 2009, require the Commonwealth to commence a review of the operation of the National Credit Law, no later than two years from commencement.

Regulation of Consumer Leases

Background

Differences in the way a lease (a hiring of goods) is structured will determine whether or not it is regulated by the Credit Act, and, if so, the extent of the regulation. There are two threshold requirements that must be met in order for the Code to apply to a lease:

- The hired goods must be used predominantly for personal, domestic or household purposes.
- The total amount payable by the consumer exceeds the cash price of the goods.

Assuming these requirements the different categories of leases and their regulatory treatment can be summarised as follows:

- Leases deemed to be a sale by instalments: This occurs if the person who hires the goods has a right or obligation to purchase the goods, and where the total amount payable exceeds the cash price of the goods. The lessor is required to meet all of the disclosure and conduct requirements that apply to credit contracts; the rationale being that this type of lease will have the same commercial outcome as a sale of goods by instalments, in that the only difference is whether the consumer will have ownership of the goods at the beginning of the finance contract, or at its end.
  - This RIS will not examine leases that are deemed to be sale by instalments as they do not present consumers with the problems or risk of harm that can arise in relation to consumer leases and exempt leases.
- Consumer leases: The hiring of goods is a consumer lease where the person who hires the goods does not have a right or obligation to purchase the goods and where the total amount payable exceeds the cash price and the lease is not exempt. Part 11 of the Code regulates consumer leases and sets out requirements, including disclosure requirements, which are significantly less extensive than the analogous obligations applying to credit contracts.
  - For example, if a car is rented for six months and the total amount of rental payments is less than the cash price of the car, the lease will not be regulated under the Code. Alternatively, if a television is hired for 36 months and the total rent payable is more than the cash price of these goods, the transaction will be a consumer lease.
- Exempt leases: Notwithstanding that some specific categories of leases may otherwise meet the criteria above they have been exempted from the Credit Act, under section 171 of the Code. The categories of exempt leases are leases for 4 months or less, leases for an indefinite period and employment-related leases. The discussion below primarily concentrates on leases that are exempt because they run for an indefinite period, or where the initial term is for a fixed period of less than 4 months in order to take advantage of the exemption, but both the lessor and the consumer anticipate that the contract will be rolled over on a regular basis.

The following table summarises the different types of leases, and their regulatory outcomes.

Characteristics of Lease	Regulatory Outcome
1. Consumer has a right or obligation to purchase the leased goods at the end of the contract. 2. The total amount payable by the consumer exceeds the cash price of the goods (that is, the reasonable market value).	Deemed to be a sale of the goods over time pursuant to section 9 of the Code, and the provider must meet the same requirements as a person offering credit contracts. The cost to the consumer is the amount by which the total amount payable exceeds the cash price.
1. Consumer has no right or obligation to purchase the leased goods at the end of the contract. 2. The contract is for a fixed period of more than 4 months. 3. The total amount payable by the consumer exceeds the cash price of the goods (that is, the reasonable market value).	Regulated as a consumer lease under Part 11 of the Code. More limited disclosure and conduct obligations apply to the lessor relative to leases deemed to be a sale of goods.
1. Consumer has no right or obligation to purchase the leased goods at the end of the contract. 2. The contract is for an indefinite period, or for an initial term of less than four months. 3. The total amount payable by the consumer exceeds the cash price of the goods (that is, the reasonable market value).	Exempted from regulation under the Code by subsection 171(2).

There are two different types of retail outlets that offer consumer leases:

- In mainstream retail outlets, including national or multi-store operations that only provide household goods through consumer leases.
- Smaller retail outlets, often with only a single store, that largely rely on local custom.

As at July 2010 52 entities had registered with ASIC as providing consumer leases Nearly all of the 52 entities who registered with ASIC as providing leases would fall into the last category, as there are only four major lessors.

In addition, industry sources estimate that exempt lessors have 20 per cent of the market share (based on the number of contracts rather than the value of those contracts).

There are a number of situations where leases are regularly used:

- In mainstream retail outlets, where consumers may be offered a choice for financing goods between credit contracts, particularly continuing credit contracts, and consumer leases.
- Smaller retail outlets where the consumer is only given the choice of financing the acquisition of goods through consumer. These goods include refrigerators, washing machines and other household electrical goods. These leases are often used to finance the provision of goods to lower income consumers (particularly those who are unable to afford to pay either through cash or the use of credit cards).
- Consumer leases and exempt leases have been used by a number of different operators in door-to-door marketing of household goods to indigenous communities, particularly in rural New South Wales and the Northern Territory.
- Some car dealerships offer consumer leases rather than credit contracts as a means of consumers obtaining possession of a motor vehicle.

A significant number of lessors bundle the leased goods with other services. These services include:

- Warranties for the service or repair of the leased goods;
- Products that address the risk of the goods being stolen while they are in the possession of the lessee.
- Products similar to unemployment or disability insurance, where the lessee's liability to make rental payments may be extinguished or reduced if they become disabled or unemployed).

These products are typically automatically included in the agreement; that is, the consumer is not charged a separate cost for them and the consumer has no choice whether or not to accept them. It is therefore not possible to assess the price being charged to the consumer relative to the value of the services being provided.

Problem Identification

Introduction

The differences in regulatory treatment between credit contracts and consumer and exempt leases can cause the following problems for consumers:

- The current regulatory differences between credit contracts, consumer leases and exempt leases create an information asymmetry in relation to:
  - The terms of the contract, and, in particular, whether or not the consumer has the right to own the goods, and the consequences this has in respect of their rights under the contract; and
  - The cost of the contract (with consumers unable to assess the cost of a lease except in dollar terms).

- Fringe operators may use the absence of regulation to exploit the vulnerabilities of particular classes of consumers (particularly Indigenous communities). They are more likely to use leases for an indefinite term, where the benefit to the consumer is minimal relative to the costs incurred (as the consumer must pay for the goods as long as they retain possession, even where they are household items such as beds or tables).

- Consumers have more difficulty in obtaining redress (whether because they have lesser rights attaching to consumer leases rather than a credit product, or because the Code does not apply at all).

Some of the analysis below is based on a 2007 report into consumer leases by the Micah Law Centre, titled 'A loan in lease clothing: problems identified with instalment based rent/purchase contracts for household goods' (Micah Report).[2] The Micah Report states that the research for the study is based on the direct experience of consumers from 20 case studies sourced from community legal centres and financial counselling services, and from reviews of the operation of lessors in retail outlets in Melbourne.

Information asymmetry in relation to terms of the contract

Leases differ from credit contracts in that the consumer does not have a right to retain ownership of the goods at the end of the contract. Consumers are therefore only paying for the use of the goods during the period of the contract rather than the cost of purchasing them outright over time.

Where the consumer does not have a right or obligation to purchase the hired goods and the lease is regulated by the Code the following obligations apply:

- they are under no statutory requirement to specifically inform the consumer that under the lease the consumer will not own the goods; and

- the lessor is only required to provide a copy of the contract document to the consumer after they enter into the contract, and, therefore, after they make a purchasing decision. The consumer may therefore only be informed that they are only renting the goods when they receive a copy of the contract, and when this information does not need to be highlighted in the contract.

Persons offering leases for an indefinite period are under no statutory obligations as to how they inform consumers about the fact that the payments they make will not result in them owning the goods.

As noted in the above table in the background section, the distinction between a sale by instalments and a consumer lease is based on a technical distinction, as to whether or not the contract gives the consumer the right or obligation to purchase the goods at the end of the term of the contract. In practice therefore financiers can elect to avoid the higher level of regulation imposed on credit contracts by not giving the consumer the right or obligation to purchase the leased goods.

This dynamic has created two problems for consumers. The first is that consumers will enter into leases because of a regulatory preference of the provider, and will do so in situations

[2] The Micah Law Centre is a not-for-profit outreach law firm in Victoria, established to provide advice and advocacy for disadvantaged individuals and groups.

where it is reasonable to expect that the consumer's purpose is to own the goods at the end of the contract.

There are two situations where consumers will prefer to own the goods at the end of the contract, according to:

- The nature of the goods being supplied – the goods are of a type where they usually are used by consumers for a period longer than the term of the (for example, beds or tables, or fridges where the term of the contract may only be a period of three years or less, but where the consumer has paid more than the cash value of the goods).

- The financial circumstances of the consumer – low-income consumers are more likely, because of their financial constraints, to want to continue using the goods at the end of the term, rather than wanting to upgrade to newer or replacement goods. This particularly applies to contracts under which they lease cars for periods such as three years, without having an asset at the end of the contract that they can continue using or can trade in order to be able to upgrade.

The use of a lease is therefore an economically inefficient way of the consumer having these goods in these circumstances. Generally these consumers would not need to use leases if they were either able to access other mainstream options to pay the relatively modest amounts necessary to own the items outright, particularly either by purchasing the goods for cash, or obtain credit through other retailers utilising the widespread 'interest free' options that they can facilitate. Conversely, the smaller retail outlets have a niche market and have broad assessment criteria that that allows leases to be approved to consumers can often be pensioners or Centrelink recipients.[3]

Low-income consumers are more likely to use leases to acquire goods because they do not meet the eligibility criteria of lenders who offer credit contracts. However, this class of persons is also more likely to be renting cheap or basic household goods where it is more reasonable to expect them to want to own the goods at the end of the contract (rather than return them or continue paying for them). There is therefore a systemic risk of these consumers being misled or not properly informed, and entering into lease contracts where they believe they will be able to own the goods.[4]

The second problem that arises for consumers from the use of leases relative to credit contracts is that they receive fewer statutory protections. Consumers are generally unable to make informed choices when choosing between these products as they neither appreciate both the differences between the two types of products and the differences in regulation.

The key areas in which there are differences are:

- The lessor may not be liable for misrepresentations by a third party at the point of supply of the goods – this is particularly important given, as noted above, the structural risk of the consumer being misled prior to entering into the contract.

[3] Micah Report, page 12.

[4] Consumer advocates consistently identify individual case studies that demonstrate this dynamic in operation, from situations where retailers were actively misled about the nature of the contract they were entering into to examples of consumers being unaware that they would have to keep making payments once the contract had expired if they wanted to retain possession of the goods.

- The consumer may be charged significant sums of money in order to retain possession of the goods once the contract has expired (either a one-off payment or continued payments until the goods are returned) – with the consumer not having ownership after meeting the payments specified in the lease contract.

- The consumer does not receive any benefit for early payments – as the contract is a rental agreement the consumer does not receive any financial advantage from making payments in addition to the regular repayments (unlike a credit contract where the amount of interest payable is reduced), nor do they receive any statements or information from the lessor that would alert them to this adverse consequence.

The problems identified above are exacerbated where exempt or indefinite term leases are used. The extent of the use of this model is significant, and is estimated at 20 per cent of the total lease market. The adverse financial consequences to consumers where they enter into such a lease believing they will own the goods are greater, as in effect they are required to make payments for an indefinite period, as long as they retain possession of the goods. There is no 'trigger' to alert consumers to this, unlike consumer leases where payments cease at the end of the term of the contract; consumer groups have reported instances of lessees making payments for items such as beds or tables for five to eight years under these types of leases, and paying several times the market value of the goods.

Lessors who currently provide exempt leases also do not have to comply with the responsible lending obligations (as these requirements only apply to lessors where they enter into leases regulated by the Credit Act). As a result, these lessors do not need to undertake credit checks or test the capacity of the consumer to meet the payments due under the contract. Consumers are therefore at greater risk of defaulting, and being liable for additional costs and charges.

Where the consumers are in remote or regional areas, and have entered into the lease as a result of a visit by the lessor to their locality they face an additional difficulty. In practice, returning the goods to the lessor will be impractical, with the result that consumers are required to maintain payments even if the goods are no longer required or perhaps even working.

Information asymmetry in relation to price

The following disclosure requirements in relation to the cost of their products apply to lessors:

- If they are providing consumer leases:
  - The only disclosure the lessor is required to make is the cost in dollar terms of each repayment, and the total amount of the repayments.
  - The lessor is not required to separately disclose charges for other services (such as warranties for the service or repair of the leased goods or quasi-insurance products, where the lessee's liability to make rental payments may be extinguished or reduced if they become disabled or unemployed). .
  - The information about the cost in dollar terms only needs to be included in the contract (not in any pre-contractual document) and the lessor is not required to provide the contract to the consumer before they enter into it except for the

purposes of signing it (or, therefore, make their purchasing decision) but only within 14 days of the consumer entering into the lease.

- If they are providing exempt leases – the timing and content of disclosure is unregulated.

By comparison credit providers are required to provide pre-contractual disclosure of a range of matters relevant to the consumer's decision, including an interest rate and information in relation to fees and charges payable under the contract. They are also required to use a comparison rate (calculated according to a uniform formula) when advertising the cost of their products, to ensure consumers compare the cost based on the same assumptions. Credit providers are also required to disclose the amount of credit being provided; this means that a credit provider cannot bundle services with goods in the same way, and the cost of the services would be reflected in the annual percentage rate.[5]

These differences in the content and timing of disclosure in relation to cost result in an information asymmetry between lessors and consumers. This creates two distinct problems for consumers:

- A cost of finance can be charged that is so high it would be discouraging or prohibitive to consumers if disclosed in a way comparable to an interest rate.
- Consumers can be encouraged to use leases because of the availability of services bundled with the goods, without the cost of those services being separately disclosed (or, in some cases, promoted as free).
- Consumers cannot readily compare the cost of different finance options, and may choose more expensive finance arrangements, or may be steered towards them by suppliers of goods where their conduct is influenced by commission payments.

These problems arise because the lessor is only required to disclose the total amount to be repaid in dollar terms. In order to assess the cost of making payments over time relative to purchasing the item for cash the consumer needs to undertake a two-step process. They initially need to determine the cash price of the goods, and then assess the amount being charged in excess of that figure and the time they are being given to pay it.

Neither of these steps may be straightforward. Determining the cash price of the goods according to the advertised or nominated price by the retailer may not reflect or be broadly consistent with their market value.[6] Assessing the cost of paying over time is an even more complex calculation.

The bundling of additional services with the leased goods, and their promotion as benefits, can also make it harder for the consumer to assess the overall cost of the package they are being presented with. This practice reduces the likelihood of the consumer declining to proceed with the transaction because the overall cost is high relative to the market value of the goods.

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[5] The requirement is in subsection 17(3) of the Code.

[6] For example, a small number of dealers inflate the value of cars to make the cost of finance seem low.

These limitations mean that consumers are unable to make informed judgements before entering into a consumer lease, and the absence of such disclosure means that consumers are less likely to reject finance where the cost is high and to seek alternative cheaper finance.

The impact of this information asymmetry in practice is demonstrated by the charges levied by some lessors; consumers can pay amounts for the use of goods at a cost equivalent or greater than interest rates in excess of 40 per cent (if the cost of the lease was calculated as if the transaction was a credit contract).[7] The following table, which summarises information from the Micah report, sets out the total amount payable under the lease by consumers for three common household items, and the equivalent interest rate.

Goods and Cash Value	Cost charged by lessor (interest rate)
81cm LCD TV ($1600)	$2800 over 36 months (41%)
260L Fridge ($700)	$1552 over 36 months (62%)
Washing machine ($598)	$2020 over 36 months (109%)

These interest rates are consistent with the experience of ASIC which has also identified lessors providing finance at rates at over 40 per cent, particularly in relation to leases of goods to remote Indigenous communities.

By contrast, there are no providers offering credit contracts for the purchaser of goods who regularly charge consumers interest in excess of 40 per cent. It is considered that the ability of some lessors to provide finance at this cost is evidence of a non-competitive market, primarily because consumers are unable to readily discern the cost of the finance, and therefore are prevented from making more efficient purchasing decisions.

Consumer Credit Legal Centre (NSW) has also identified the use of consumer leases in one business model in order to avoid the UCCC disclosure requirements in relation to the cost of credit. This model was utilised by a financier that, in 2008, had over 30 staff, and over $10 million of finance. This model had the following features:

- the consumer would sell goods they owned to the lessor, and receive a lump sum equivalent to their financial needs (rather than the cash value of the goods);
- the lessor would then lease these goods to the consumer and receive payments over a period of time greater than the sum paid to the consumers; and
- complex documentation was used that disguised the nature of the transaction to the consumer.

[7] The interest rate would be higher where the consumer also has to pay an additional amount to buy the goods at the end of the contract.

While this model is not indicative of practices in the mainstream it is consistent with these practices in the sense that the use of a lease avoids a need for the more detailed disclosure requirements attaching to credit contracts, and increases

The second situation in which consumers are disadvantaged is where they may choose more expensive finance arrangements because they cannot readily compare the cost of different finance options. This risk is particularly likely to arise where an intermediary has arrangements with financiers so that they can offer consumers either a credit contract or consumer lease. The lack of any requirement to disclose costs in a comparable way can allow the lessor to pay higher commissions to the intermediary to promote their product to consumers , even though it may be more expensive (in part because the consumer is paying for the cost of these commissions through the charges on the finance product). This channelling of consumers by intermediaries to higher cost products is known as 'reverse competition' where competition among providers for access to distribution channels can drive up the price paid by the consumer.

It is accepted that there are situations in which a consumer will prefer a lease for reasons other than cost (for example, other features of the contract that may result in a higher price). However, this demonstrates the need for an informed discussion to allow the consumer to assess the competing features of the products, including the cost of other features that may attach to a lease.

The risk of consequent financial detriment to the consumer is that they will pay a higher amount for the goods. This amount will vary according to the cost of credit under a consumer lease relative to a credit contract.

The precise extent of steering as a result of reverse competition is not measurable in any way, and is therefore unknown. However, it has been identified as a significant concern in a number of the submissions to the Green Paper, suggesting the commission-driven nature of the conduct means the problem is structural in nature. Where consumers are therefore paying higher amounts to finance goods through a lease, when they would be eligible for alternative forms of cheaper credit, the current regulatory arrangements are lessening competition in markets for the supply of goods.

Consumers who enter into indefinite leases are particularly disadvantaged in respect of cost, as the cost is potentially both greater than that for a fixed term contract, and not readily comparable with other finance options. Consumers are required to keep making payments for as long as they retain possession of the goods. This can be for a period that can be open-ended.

Use of leases in targeting vulnerable communities

Both consumer leases and exempt leases have been utilised by door-to-door traders marketing goods in Indigenous communities. The analysis below is based on information obtained by ASIC and on the reported experience of some consumers.[8]

Some operators target these communities in that they only, or almost only, solicit consumers in areas with high Indigenous populations. This practice means they do not have a model in which they need to compete on price or service with mainstream providers, and rely on

[8] See *Unconscionable Conduct and Aboriginal and Torres Strait Islander Consumers* Research Report, by Indigenous Consumer Assistance Network Ltd.

sales only to a relatively vulnerable group. They are therefore not subject to the same competitive pressures as mainstream providers.

The communities are commonly located in remote or regional Australia, and its members usually have very few alternatives for finance, or, therefore, for obtaining even basic household goods, such as beds or tables. Individual borrowers are commonly in receipt of Centrelink payments and the operator relies on payment through direct debit arrangements that are rarely cancelled in practice. As a result, the operator will continue to receive payments notwithstanding that it may result in financial hardship for the consumer.

Further, irrespective of whether a consumer lease or an indefinite lease is used, it will usually be the case that the lessor can continue charging the consumer for hire of the goods until the goods are returned. This can be difficult or impractical for consumers in remote areas. In this situation the lessor has a financial incentive not to advise the consumer, before they enter into the contract, that they will not own the goods or that they will have to keep making payments while they have possession. If the consumer was advised of these matters upfront they would be more likely not to enter into the contract, either at all or on those terms.

The conduct of these types of operators has been associated with the following problems: the use of pressure selling tactics; incomplete or incorrect documentation (including contracts with no specified terms for the repayments); failure to deliver goods or delivery of goods other than those specified in the lease; failure to service damaged items; and the use of itinerant, untrained agents with poor levels of compliance.

Consumers suffer financial harm in that:

- They enter into contracts as a result of high pressure tactics;
- They can pay significantly more, particularly where they are required to make ongoing payments because it is not practical to return the goods;
- They are paying for goods they have not received or that are different from those they are contracted for.

The broader problems resulting from unconscionable or exploitative conduct are an indirect consequence of the use of leases in that operators deliberately elect to use a product which does not require them to meet the entry standards to hold an Australian credit licence (ACL), and where ASIC is unable to ban them from providing those products, irrespective of the nature of the conduct they engage in. They also gain commercial advantages from using leases, as outlined in more detail previously; for example, they do not need to disclose an interest rate (this is particularly relevant where the cost is high enough to discourage purchasers if they were informed of the cost); and there are fewer or no statutory obligations (for example, where exempt leases are utilised the lessor does not need to be licensed or be a member of an EDR scheme, or assess the borrower’s capacity to meet repayments without substantial hardship).

Inadequate remedies

As noted above, consumers may enter into leases without necessarily appreciating the differences between leases and other forms of credit. There are particular risks that consumers will only become aware of problems at the end of the lease or after they have been making payments for a significant period of time. Consumer are only likely to identify problems at this time when they realise or are informed, contrary to their expectations, that they will only be able to keep the goods if they make additional payments.

Where this is the case, or where consumers have suffered financial loss in relation to a consumer lease or an exempt lease, the Code currently provides fewer and less adequate remedies to assist them in seeking compensation, compared to a credit contract.

Consumers also have fewer remedies against the conduct of an intermediary if they obtain goods by way of a consumer lease rather than a sale by instalment. This is because under the Code, some of the provisions in relation to liability apply only to credit contracts (for example, the remedy for false and misleading representations in sections 128 and 154).

Lessors who only provide exempt leases are completely unregulated by the Credit Act. In addition to the gaps identified in relation to consumer leases, they also are not required to be a member of an EDR scheme. As a result, consumers can experience significant difficulty in resolving complaints unless they take court action. This is often not a viable option, particularly for low-income consumers.

This lack of accountability can encourage lower standards of conduct and supervision on the part of lessors, as they can deny liability for misconduct by third parties who have arranged the lease with the consumer, or do not even need to respond to complaints unless the consumer instigates court proceedings.

Objectives of Government action

- To reduce the occurrence of the detriment suffered by consumers that, to a large extent, is unnecessary and avoidable.
- To improve consumer choice by ensuring that they are provided with relevant information in a form and manner that increases their capacity be able to make comparisons between consumer leases and other functionally similar products.
- To achieve consistency in the regulation of products that are different in form but which have similar commercial outcomes, and further competition between providers of these products.
- To minimise the impact of any changes on industry, and reduce the regulatory burden resulting from any such changes.

Options

Option 1: Maintain the status quo

Under this option, no changes would be made to the regulation of consumer leases, sale by instalments and exempt leases under the Code.

This option would also take into account the potential impact that the introduction of new obligations (in respect of licensing and responsible lending) under the Credit Act would have on persons who offer consumer leases (but not those who offer exempt leases).

Impact Analysis

There will be no changes to existing practices.

This option would meet the fourth objective. It would only partially meet the first objective to the extent that the introduction of responsible lending obligations and licensing requirements under the Credit Act reduce the occurrence of the detriment suffered by consumers from consumer leases. However, this in turn may simply result in a greater use of exempt leases (particularly leases for an indefinite period) to avoid these legal responsibilities completely rather than changing their business models to comply with them. This risk is greatest with fringe operators.

The risk of continuing consumer detriment appears significant given that the differences and gaps in the current regulatory framework have been in existence since the commencement of the UCCC in 1996 and have been utilised by some operators to facilitate outcomes that benefit them but result in financial harm to consumers. Some providers have demonstrated a specific election to provide finance through leases because of the competitive advantages, which suggests this position is unlikely to change in the absence of regulatory intervention.

To the extent that consumers who hire goods via consumer leases are generally low income consumers with fewer choices, the impact of poor financial decisions is more pronounced. It is important for persons on limited incomes to be able to make more suitable choices when entering into arrangements to hire goods. This is especially so given that low-income consumers generally have fewer finance choices available for the purchase of basic household items. They are therefore less able to bear or adjust to relatively low levels of loss, which therefore have the capacity to cause significant financial hardship.

In summary, there are no advantages to consumers under this proposal, while lessors will continue to benefit, particularly through being able to charge higher prices because of the lack of competition.

Option 2: Regulate consumer leases and exempt leases in a way that acknowledges the functional similarity of these products to credit contracts

This option would result in:

- New obligations being imposed on consumer leases; and
- Leases for an indefinite period being regulated by the Code.

Consumer leases

Under this option the following two categories of new obligations would apply to consumer leases:

- extending to leases existing and well understood requirements in the Code that currently only apply to credit contracts, either in their current from where these are applicable to consumer leases and where their introduction would address the problems identified above, or in a modified way where the different structure of leases requires this (particularly in relation to the ownership of goods); and
- introducing new obligations to allow for disclosure of the cost of finance in a way that allows for comparison with credit contracts.

The obligations in the Code that, under the first proposal above, would be applied to leases include:

- the provisions in the Code applying to mortgages and guarantees where the lessee's obligations under the lease are supported by a mortgage (over goods or property other than the leased goods) or guarantees;
- requirements in relation to variations to consumer lease contracts (other than those providing for hardship variations, as these obligations already apply);
- requirements in respect of providing statements of account (including enabling a consumer to dispute the contents of these statements) and in relation to enforcement practices (including regulating enforcement expenses); and
- extending the liability of a lessor for conduct by an intermediary at the point of sale.

Disclosure obligations would be introduced that are likely to assist consumers in making a better judgement about consumer lease products before deciding whether to use them. These obligations would include:

- providing for a high impact short form disclosure of key information about the contract prior to the contract being entered into (with the details of this requirement to be developed in a further RIS discussing disclosure in respect of all products regulated by the Credit Act);
- disclosure of the cost of a lease using consistent assumptions that enable a comparison to be made with credit contracts;
- disclosure of the amount in dollar terms required to be paid for each dollar of the market value of the hired goods (which would enable consumers to assess the amount they are paying relative to purchasing the goods for cash or using an interest free option, where this is available); and
- disclosure of the cost of services provided with the lease, to enable consumers to make informed decisions of each element of a bundled transaction.

This RIS also identified an issue in relation to the lack of comparative disclosure where an intermediary has arrangements with financiers so that they can offer consumers either a credit contract or consumer lease. This issue may be further addressed in a RIS that considers the role of these point of sale intermediaries in detail.

Leases for an indefinite term

Section 171(1) currently exempts leases that are for an indefinite period or that have a fixed term of less than 4 months. This option would result in the removal of these exemptions, so that these categories of leases become regulated as consumer leases under the Credit Act. Persons who currently only offer these types of leases would therefore need to meet all the obligations under the Credit Act, including meeting the requirements to hold an ACL, and also meeting the responsible lending obligations.

Impact Analysis

Consumers

Consumers would particularly benefit from being able to more readily compare the costs of entering into a consumer lease and a sale by instalments and other credit contracts, and make more effective purchasing decisions. They would also benefit from a reduction in cost, where lessors lower their prices because of the need to meet enhanced competition from persons offering credit contracts;`

They would also benefit from:

- greater regulation of indefinite leases, which may result in these products only being offered where they meet the consumer's needs, rather than as a way of committing the consumer to making indefinite payments;
- exclusion of players who engage in regular misconduct from the industry; and
- having greater access to remedies in the event they suffer loss or damage, and this in turn could be expected to promote better standards of conduct by the lessor (to reduce the costs associated with responding to complaints, particularly complaints to an EDR scheme).

Consumers who currently obtain goods through unregulated providers are likely to have continued access to some goods through lessors who are currently regulated by the Credit Act. The application of the responsible lending requirements, and the need to ensure consumers have the capacity to meet repayments, may mean that they are unable to access the same volume or quality of goods. That is, as a result of those reforms, those consumers who are on low incomes or unable to access other forms of credit, are still likely to be able to obtain goods through leases, but that either:

- the goods they can lease would be lower in value; or
- the total cost would be reduced, because the individual repayments would be lower.

The risk of the consumer defaulting, and incurring consequent costs, will be reduced, as a result.

Lessors offering regulated products

Lessors would incur increased costs, as discussed in detail below. However, consumers will have a better capacity to understand the relative costs of different products and therefore lessors may not be able to pass on any increase in costs where, as a result of the reforms, the lessor will need to compete with cheaper credit contracts.

The impact on those lessors who are already required to comply with the Credit Act would be relatively low, as they are already required to comply with the Act (including the licensing and responsible lending obligations). The main changes would be:

- introduction of new pre-contractual disclosure requirements – these may result in one off costs of between $10,000 and $20,000 for the lessor to change their existing documents so that they comply with the new requirements; and
- changes to their internal procedures in order to comply with obligations in the Credit Act – these costs would not be significant in that the substantive nature of these obligations is well understood as they have been in force in relation to credit contracts, through the UCCC, since 1996.

Lessors offering unregulated products

Those lessors providing unregulated products would need to decide whether to exit the market or apply for an Australian credit licence (ACL). It could be expected that the majority of these would decide to leave the industry, as the use of exempt leases is particularly prevalent among those who are targeting vulnerable consumers and have no interest in establishing a broader or mainstream presence, or therefore in meeting the range of legal obligations associated with holding an ACL. If they cease offering leases they could still be rsubject to limited egulation while they are receiving payments under existing leases (adapting the existing regulatory approach in the Credit Regulations 2009 for lenders who choose not to apply for an ACL following the commencement of the Credit Act).

The lessors who decide to seek a licence will incur costs in relation to entry requirements, ongoing conduct standards and responsible lending conduct obligations. If the lessor sought legal advice for this purpose they could expect to incur costs of $60,000 to $180,000 in order to be 'regulator-ready'. The cost would vary according to factors such as the range and type of products being provided and the extent to which existing procedures need to be changed.

A lessor would also incur costs to third parties as follows:

- Costs payable to ASIC in connection with the licence, that is, an application fee, and an annual fee.[9] For lessors, the amount of the fee is based on the amount of rental payments under contracts arranged and can range from $450 to $21,000 (although most lessors are likely to be at the lower end of the scale).[10]

- EDR membership: application fee $165 - $220; membership fee (calculated according to membership type and the size and nature of business) and complaint fees.[11]

Lessors would also incur costs in changing their practices in order to ensure they are complying with the new obligations. While there would be one off costs in documenting these new practices and training staff, there would be little difference in ongoing costs once the new procedures have been introduced, as they would be replacing existing practices.

Providers of credit contracts and government

Credit providers who offer regulated products more competitive to leases may increase their market share due to greater transparency in pricing. These providers will not incur additional compliance costs.

The amount of revenue generated for government by fees associated with, in all likelihood, a small number of lessors applying for an ACL is unquantifiable but insignificant.

In summary, this option would have the following costs and benefits:

- Lessors who currently offer consumer leases (a product already regulated by the Credit Act) would incur some compliance costs in relation to changes in documentation; however, these would be significantly lower than the costs they have incurred in

[9] See ASIC Info Sheet 108 How much does a credit licence cost?

[10] National Consumer Credit Protection (Fees) Regulations 2010, Schedule 1, item 1.1

[11] See http://www.cosl.com.au/Member-Fees;
http://www.fos.org.au/centric/home_page/members/apply_for_membership.jsp

obtaining an ACL or complying with the responsible lending obligations. They would find themselves able to compete more effectively with providers of exempt leases, but, in turn, would no longer have the benefit of their current competitive advantages relative to credit contracts (and may have to reduce the cost of their products in order to maintain their market share).

- Lessors who currently offer products unregulated by the Credit Act would incur significant costs as they would need to meet the standards and obligations applying to all licensees. It could be expected some would cease offering these products (particularly those fringe operators who operate without any business infrastructure).

- Credit providers who operate business models in which their products compete with credit contracts would no longer be at a competitive disadvantage and, where their products were cheaper than consumer leases, could be expected to benefit through increased market share.

- Consumers would benefit in a range of different ways, principally through being able to select the cheapest finance option, and also through better protections from fringe operators. These changes would particularly benefit low-income consumers.

Option 3: Use financial literacy programs and materials to educate consumers as to the differences between credit contracts, regulated leases and unregulated leases

This option would see existing education or financial literacy programs used to provide lease-specific information to consumers, to encourage better decision-making by consumers in relation to the use of credit contracts, regulated leases and unregulated leases. It is noted that ASIC already has information comparing leases and other forms of credit on its website, but that this option contemplates more extensive and targeted information, delivered through additional mechanisms.

It could include the dissemination of information through existing financial literacy avenues, including school programs and government websites. The differences between these products are, as set out above, largely based on technical features of the contracts between the financier and the consumer, and the educational materials would therefore need to reflect this.

This approach would not prevent persons from offering consumer leases or exempt leases on the same terms as is currently the case, until any education campaign changed consumer behaviour sufficiently to require them to reassess their products.

Impact Analysis

Consumers

It is unlikely that an education campaign would have an immediate impact on consumer behaviour as the use of leases is linked to a desire by the consumer to obtain goods. In these circumstances the consumer's initial concern is on selecting these goods from a retailer, and then responding to the finance options presented by the retailer. The difference between leases and credit contracts, as presented in the abstract, will not necessarily assist a consumer to identify whether the form of finance they are being offered is a lease or a credit contract.

An education campaign would therefore also need to assist consumers to be assertive in their dealings with the providers of goods, and to specifically inquire what form of finance would be used. This restricts the extent to which an education campaign will be effective, particularly where consumers may have limited choices available to them and are offered a lease as the only source of finance (on a 'take it or leave it' basis).

This option would have no immediate impact on providers of leases or on their competitors. It may have a limited impact over time, as consumers adjust behaviour in response to a greater awareness of the consequences of different choices. This long-time benefit would, however, depend on continued education programmes to inform each new generation of consumers.

This approach would be unlikely to meet the government's objectives, other than the fourth objective.

In summary, this option would have the following costs and benefits:

- Lessors would not incur any costs, except as over time consumer decision-making changed to indicate a preference for credit contracts over consumer leases.
- Some consumers, who assimilate the messages of the education campaign, would either avoid leases or enter into lease contracts with a better understanding of how they work. Consumers who do not respond to these messages or who do not have alternative finance choices available to them would continue to be at risk of suffering the financial disadvantages identified in this RIS.
- Credit products who operate business models in which their products compete with credit contracts would continue to be at a competitive disadvantage.

CONSULTATION

The Government has conducted extensive consultations in the consideration of enhancements to the regulation of consumer leases via the Green Paper and the Industry and Consumer Representatives Consultation Group.

In addition, the Government has formed a specialist group on this topic, given the technical issues associated with leases. This group comprises lessors (represented directly rather than through an industry body), consumer representatives with significant experience in the area, the FOS (because of its experience with complaints in respect of leases) and providers of credit contracts. The level of expertise within this group has resulted in a frank and detailed analysis and exchange of information that has informed this RIS and is expected to assist in the implementation of the proposals.

The views of stakeholders are set out below.

Consumer and legal representatives

The option of applying the protections provided to consumers using credit contracts under the Credit Act to users of consumer leases is supported by a range of consumer and legal group stakeholders, including the Brotherhood of St Laurence, Consumer Action Law Centre, National Legal Aid, and the Wesley Community Legal Service. In particular, these stakeholders agree that providing consumers with disclosure regarding the cost of the consumer lease and being provided with enhanced disclosure that improves the consumers' ability to compare the cost of a consumer lease with a credit contract are key necessary reforms.

These groups also agree that the different levels of regulation applying to credit contracts and consumer leases creates regulatory arbitrage and is allowing lease providers to reduce disclosure and other requirements under the Code by structuring their products as a lease, rather than a credit contract.

Industry representatives and professional bodies

Several industry and professional body representatives including GE Capital, the Mortgage & Finance Association of Australia and Min-it Software have expressed various concerns regarding practices under current regulation including competitive bias and regulatory arbitrage. These stakeholders agree that greater regulation of consumer leases is required.

Several industry and professional body representatives including Flexigroup, the Australian Finance Conference and the Finance Brokers Association of Australia consider that there is insufficient evidence to determine that additional regulation of consumer leases is warranted.

To the extent they acknowledge there may be regulation their primary concern is that leases are not regulated in a way in which ownership of the goods passes to the consumer. This approach has not been contemplated in this RIS.

Dispute resolution provider

The Financial Ombudsman Service considers that consumer leases should be subject to the same disclosure requirements as sales by instalments and credit contracts.

RECOMMENDED OPTION

Options 2 and 3 are the preferred options. It is considered the combination of these two options will operate in a complementary way to deliver both benefits to consumers both in the short-term and the medium-term.

Enhancements to the National Consumer Credit Protection Regime

Background

During Phase One of the National Consumer Credit Protection reforms, stakeholders raised concerns about certain aspects of the UCCC which have been replicated in the Code.[12]

It was agreed that improvements to the Code would be considered during Phase Two of the credit reforms and were the topic of Chapter 7 of the Green Paper. The following issues have been identified:

- The provisions allowing borrowers to request a variation of their credit contract on the grounds of financial hardship (whether before or after enforcement action) are highly prescriptive, and subject to a restriction in that they only apply to persons who have borrowed up to $500,000. This restricts the capacity of borrowers to obtain a variation, even where they only need a variation to address a short-term change in their circumstances. Three different aspects of this topic are considered below.

- There is no general remedy provided for unjust conduct by brokers or other intermediaries (as the Code only provides a remedy where there has been unjust conduct by lenders). This creates a gap as consumers otherwise need to rely on general prohibitions that may not always provide a remedy where they have suffered loss because of the conduct of a broker.

- The Code does not prohibit or restrict the use of particular words or phrases. In the credit context, some words or phrases have an emotional resonance with consumers (for example, 'impartial' or 'interest free'). Consumers may be more susceptible to entering into contracts where brokers or lenders have used these terms in advertising, even where they may not be strictly correct or are subsequently qualified, and where therefore the contract is inconsistent with the use of these words.

- The Code only contains a partial prohibition against door-to-door canvassing of credit. The prohibition does not apply where goods are being sold on credit or provided through a lease. Given the range of alternative distribution channels available today, door-to-door selling in this way is largely associated with targeting of vulnerable consumers, and often with high-pressure or manipulative sales tactics.

Issue One - Types of hardship variations that can be requested

Background

Rights of Borrowers under the National Credit Code

Under the Code borrowers have a statutory right to request certain variations to their contract where they are unable reasonably, due to illness, unemployment or other

[12] The Code (and the UCCC before it) regulates credit provided to natural persons for personal, domestic and household purposes. From 1 July 2010, the Code also regulates credit provided to natural persons for investment in residential investment property.

reasonable cause to meet their obligations where the value of their contract is under the monetary threshold.[13] This right is subject to a number of limitations, primarily that the borrower must specifically ask their credit provider to change the contract in one of the three following ways:

- extending the period of the contract, and reducing repayments accordingly;
- a repayment holiday (without extending the period of the contract); or
- a repayment holiday and extending the period of the contract.

If the borrower formulates the request in some other way (for example, they simply ask for a variation without putting forward any proposal of their own) this will not be a 'request' within the meaning of the Code, and therefore the credit provider is under no statutory obligation to respond in accordance with the Code.

The wording of the current provision therefore focuses attention on a relatively narrow set of options for varying the contract, rather than directing the parties involved to consider the substantive issue, namely whether a variation (of any type) would resolve the borrower's situation and void them defaulting, while still being able to repay the amount borrowed.

In relation to a request that falls within one of the three categories above, a lender must a respond in writing within 21 days, and set out the reasons for denying the request (if this is the outcome). A request can be legitimately denied where the credit provider does not reasonably expect the consumer to be able to meet their obligations despite a variation.

A debtor can apply to the court to change the contract if the credit provider refuses a hardship request. If successful, a court has power to order a variation as described above.[14] Consumers may also apply to the credit provider's external dispute resolution (EDR) scheme to reconsider a request for a hardship variation.

Changes to a contract can also be negotiated by agreement between the parties.[15] There are no limitations on what variations can be made under this provision. However, if a request to amend a contract which is made outside of the hardship provision in the Code is refused by the credit provider, the consumer has no statutory recourse to a court (or EDR) for review. These variations are therefore within the discretion of the credit provider.

Some credit providers have elected to become signatories to a voluntary industry code.[16] These types of codes include requirements that signatories will assist consumers in financial hardship beyond meeting the statutory obligations required by the Code. While there is no statutory recourse to a court for review, the jurisdiction of EDR schemes can include monitoring compliance with industry codes.

In April 2009 the Treasurer announced an agreement between the Government and the four major banks, to assist borrowers who are experiencing financial difficulty as a result of the global financial crisis by temporarily adopting expanded principles on hardship. By June 2009, all 144 retail banks, building societies and credit unions had agreed to adopt the

[13] Section 72 of the Code
[14] Section 74 of the Code
[15] Section 71 of the Code
[16] Such as the Australian Bankers' Association Code of Banking Practice, the Mutual Banking Code of Practice and the Mortgage & Finance Association of Australia Code of Practice.

expanded principles. Under the expanded principles, these institutions work with borrowers, irrespective of the value of their loan, to determine the most appropriate assistance option. In practice, nearly all of these institutions were already signatories to a voluntary code containing similar obligations, and this agreement therefore did not significantly change the way in which they operated. However, there are differences in approach between lenders in relation to compliance with these voluntary obligations (as discussed in detail below).

In the discussion of this issue below the term 'credit' is used to refer to both credit contracts and consumer leases.

Levels of debt and financial hardship in Australia

Between March 2000 and March 2010, total outstanding consumer credit (owner-occupied housing credit and other personal credit) increased from $277.2 billion to $913.5 billion. This equates to an average annual growth rate of 12.7 per cent. Total outstanding credit in the economy, which includes consumer credit, grew at an average rate of 11.1 per cent over the same period.[17]

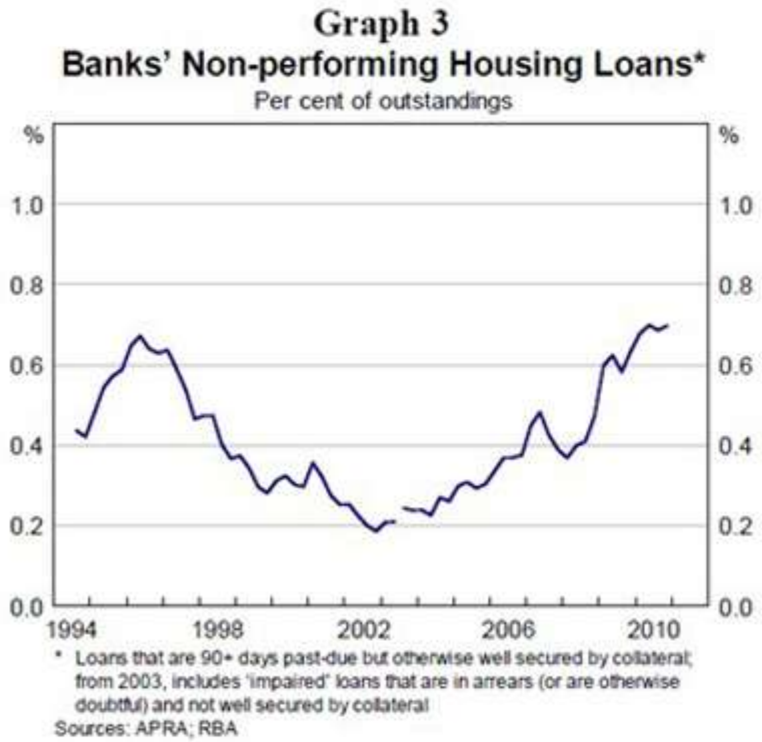
The growth in the volume of consumer credit has also resulted in an increase in the level of debt stress amongst Australian households (exacerbated in the last two years by the global financial crisis). This has resulted in a greater number of borrowers at risk of defaulting under their credit contracts, and an increase in the number who need or are seeking variations to their credit contracts on the grounds of financial hardship.[18] The Treasurer's announcement from April 2009 was a reflection of this situation.

During 2008-09 there were 6,731 new disputes relating to credit lodged with the Financial Ombudsman Service (FOS), an ASIC-approved EDR scheme. This was 'up 36% on the previous financial year and reflects the deteriorating economic condition of 2008–2009 and the hardship experienced by many consumers'.[19]

The Credit Ombudsman Service Ltd (COSL), another ASIC approved EDR scheme, reported that 'enquiries increased by 21% in 2008/2009' while 'complaints increased by 19% in 2008/2009'. 'Issues relating [to] financial hardship alone accounted for a significant 22% of all enquires and complaints we received. Applications for a variation to a credit contract on grounds of financial hardship are likely to increase further in the next financial year.'[20]

The following graph shows the percentage of home loan provided by banks in arrears by greater than 90 days between 1994 and 2010.[21] Although the arrears rate is low in percentage terms, it remains elevated in historical terms (with this trend consistent with that for home loans provided by lenders other than banks). The need for a hardship variation is most pronounced in relation to mortgages as, first, this debt is likely to be a borrower's largest commitment (and therefore the one they will have most difficulty in meeting), and, second, the consequences of default are greater relative to other debts (including potentially loss of the family home).

[17] *Reserve Bank of Australia, Financial Aggregates, March 2010.*
[18] www.vedaadvantage.com/news-and-media/article.dot?id=509973; www.couriermail.com.au/money/banking/families-gripped-by-financial-hardship/story-e6freqox-1225767439923; http://www.rba.gov.au/speeches/2010/sp-ag-300310.html
[19] FOS 2008-09 Annual Review
[20] COSL Annual Report 2009
[21] Financial Stability Report, March 2011 Reserve Bank of Australia



Problem Identification

The discussion above indicates that borrowers only have a right to seek a variation to address short-term hardship on relatively narrow grounds, and where their request conforms to precise legal requirements. This creates a risk of two distinct problems for borrowers:

- the lender may refuse to consider a variation of their contract because the borrower's request did not conform to the requirements under the Code; or

- lenders may only provide a variation that is one of the three options set out in the Code, when a different response would more effectively address the borrower's situation.

In both cases the consequence for the borrower is the same, namely that they may default under their credit contract and face enforcement action when, in some situations, this could have been avoided.

There is evidence from a number of different sources that some lenders are not properly meeting the obligations in their voluntary code in relation to hardship, and that they are only complying with the requirements in the Credit Act. They therefore have practices which mean they do not actively seeking to resolve, in a broader way, the position of borrowers who are in financial hardship.

The first source is a Bulletin issued by FOS in March 2007 which set out its concerns that some member banks were not complying with the requirement in the Code of Banking Practice to actively inform customers in financial difficulty about the hardship provisions of the UCCC (rather than only responding to requests made in accordance with the UCCC).[22] FOS stated that: 'It has become apparent that across a number of banks the material provided to customers and the internal processes applied focus almost entirely on the matters arising under section 66 of the UCCC and do not pay adequate regard to the fact that financial difficulty could arise from circumstances other than illness, unemployment or another cause; and the ways in which a subscribing bank may respond to those circumstances are potentially broader than by the express changes described in section 66'.

Secondly, in 2009, ASIC conducted a review of hardship practices by 15 major lenders. The key relevant findings in the report were that:

- One lender would only consider an application made in accordance with the statutory requirements, and that otherwise it would not offer any assistance. All the other lenders did not differentiate in their responses.
- Lenders preferred to provide a similar response irrespective of the borrower's situation; typically this was short term assistance such as a three month payment moratorium. This response did not require an assessment of the consumer's circumstances and needs and then varying the contract to match those needs.
- Lenders generally have a far wider range of options for responding to hardship than those set out in the Code, but in practice tend to provide a much narrower range of options.

The results of the ASIC survey also raise an inference that the FOS Bulletin did not result in all lenders reviewing their level of compliance with a voluntary code to ensure they were meeting its standards of conduct.

Further, both EDR schemes, FOS and COSL, have reported high rates of negotiating variations between lenders and borrowers where the lender initially refused a request for a variation. In its Green Paper submission FOS noted that over 80 per cent of disputes in the period 1 January to 20 July 2010 were resolved successfully, with agreements made on grounds not necessarily available under the Code. COSL reported a similar experience, and also noted in their Green Paper submission that their experience was that negotiated agreements often involved variations outside the Code.

The outcome of complaints to EDR schemes clearly indicates that a significant percentage of lenders are rejecting applications for hardship when in fact the consumer is in a position to continue making payments under a variation to their contract. It suggests that lenders are taking a narrow or technical view of whether to provide a variation, rather than considering the overall position of the borrower.

Finally, it is also noted that fringe or predatory lenders who provide 'equity stripping' loans have no interest in providing hardship variations, and could be expected to rely on any legal technicalities to avoid doing so. This is because the intention of these lenders is to maximise the debt incurred by the borrower in as short a period as possible, and particularly through default or penalty interest and enforcement expenses. While only representing a very small segment of the market these lenders cause significant losses to individual consumers.

[22] Banking and Finance Bulletin 53, Customers in financial difficulty – Code of Banking Practice and UCCC Obligations (March 2007).

It would generally be expected that it would be in the interests of lenders to provide a hardship variation where appropriate, as it would be preferable for the contract to remain on foot and for the lender to receive ongoing payments without the costs of enforcement action. Both the ASIC report and the experience of both FOS and COSL indicate that this is not always the case. Possible reasons for this include:

- Compliance procedures are developed to meet the requirements imposed by the law, rather than being applied more flexibly (notwithstanding that this may be in the interests of the lender).

- It is administratively simpler for lenders to adopt a standard response to requests for hardship (such as providing a three month moratorium) rather than assessing each application on its merits.

- Another reason may be that some lenders, particularly smaller lenders, are reluctant to defer payments, and prefer to receive payments as early as possible.

It is also noted that not all borrowers who have an application for a variation rejected will pursue a complaint to an EDR scheme, and that there will be a percentage of borrowers therefore who end up facing enforcement action or selling their home, when they would be very likely (given the FOS resolution rate of 80 per cent) to avoid this outcome if they did complain.

Objective of Government Action

The objective of government action is to support sufficient flexibility in the hardship variation provisions to enable the most mutually beneficial outcomes for lenders and consumers.

Options

Option 1.1 Maintain the status quo

Under this option, the existing limited range of variations that can be requested under the hardship provisions will be maintained. This presupposes that the existing mechanisms for requesting variations to contracts when consumers find themselves in financial hardship are already sufficiently flexible.

Impact Analysis

Under this option, there would be no additional impacts on consumers or credit providers. Some consumers would therefore continue to be disadvantaged, particularly by losing the opportunity to retain possession of their homes where the lender, adopting a strict but legally correct approach to hardship variations, refused to change the terms of the contract even where doing so would result in the borrower being able to make repayments.

Option 1.2 Broaden the types of variations that can be requested

Under this option the types of variations that can be requested will be broadened. Rather than establish additional prescriptive types of variations, it is proposed that the provision be written as a principles based right to request a variation when experiencing hardship, which should only be granted where the debtor reasonably expects to be able to comply with their obligations, as altered. Credit providers would not be obliged to agree to a variation that sees them receiving a lower amount than would otherwise be due under the contract.

This approach would be driven by an underlying policy objective that, as far as possible, borrowers who can meet their financial obligations through a variation, should be assisted to seek such changes to their contract through a flexible response adapted to their individual circumstances.

Impact Analysis

Consumers

Consumers will benefit from the additional flexibility in the types of variations they can request, and their requests will not be declined for technical reasons, thereby increasing their ability to keep their contract on foot or recover from default. The most substantial benefit will accrue to those borrowers who are able to remain in their own homes, and who will avoid significant costs (particularly enforcement costs and legal expenses) and consequent social dislocation.

Avoiding default means that consumers will not be liable for default fees and charges and enforcement expenses which would otherwise be incurred by their credit provider. In addition, it would avoid a default listing being placed on their credit file, which could see them unable to obtain additional credit or having to pay a higher price for it.

It is expected that a number of requests will also be resolver quicker (based on the experience of the extent to which requests for hardship variations that are initially rejected by the credit provider are then resolved through the intervention of an EDR scheme). Consumers will benefit from the likelihood that requests are resolved quicker and have improved confidence that reasonable variations are likely to be made.

If the options in the statutory right were broader, there would be improved reviewability of lender's decision through internal mechanisms and external oversight, as compared to the current reliance on changes by agreement.

Consumers whose financial position is irretrievable would still face enforcement action, as is currently the case.

Credit Providers who are not signatories to a code of conduct

This class of lenders are likely to incur additional compliance costs in changing the way in which they respond to requests for hardship variations, as they are not already covered by industry codes (noting that some may nevertheless already currently adopt a flexible response to hardship).

The cost of a lender reviewing one aspect of their systems in relation to hardship variations is likely to be quite low, given that it is estimated that it could cost a lender currently unregulated by the Act as little as $60,000 to comply with the Code in its entirety.

These costs could also be partially offset by a better performance of their overall lending portfolio, with reduced enforcement expenses and fewer bad debts. Notwithstanding that these advantages could be expected to encourage all lenders to already act in this way, it is noted that this is not the case (as discussed above).

In addition, it is likely that over time more hardship disputes would be resolved internally, as lenders adapted to the new requirements and became more effective in identifying and providing the appropriate response to an individual's circumstances. This would result in minor savings for credit providers, as EDR schemes charge a fee for each dispute received.

Credit Providers who are signatories to a code of conduct

This option has a more limited impact on those lenders who are signatories to a code of conduct in which they have voluntarily agreed to be more responsive in their dealings with consumers who are in financial hardship, irrespective of the value of the credit contract. This would include all ADIs, and would cover the majority of credit contracts.

The nature of the impact would be:

- For those lenders already fully complying with the code – the change to their business would be minimal; and

- For those lenders not complying with the code, or complying inconsistently (as suggested by the ASIC report and the FOS bulletin) – the introduction of these obligations in law would introduce greater accountability and responsibility for non-compliance, and could be expected to result in greater internal changes to their practices to ensure they were now meeting these requirements.

In relation to those lenders who are ADIs, APRA has advised that there may be more loans which, because of delays in repayment or variation in terms, may need to be classified as impaired (and therefore provisioned). However, to the extent the terms of a loan are renegotiated under hardship provisions (which should not be done in circumstances where an inevitable default by the customer is probable) there would be no impact on the estimated future cash flows of the financial asset and therefore no impairment charge. The impact of broadening the statutory grounds on which a variation could be sought would therefore be expected to have a minimal impact on APRA-regulated entities.

This option could be expected to have the following costs and benefits:

- A significant percentage of consumers who currently have requests for hardship variations refused would be provided with changes to their contract that avoid them going into default, or enable them to remedy a default in a relatively straightforward way.

- Lenders would incur minimal compliance costs, and could be expected to have lower default rates overall (noting that these costs may vary according to whether or not the lender was a signatory to a code of conduct with similar obligations, and, where it was a signatory, whether or not the lender was already meeting the standards of conduct in that code).

Stakeholder views

This option was supported by EDR schemes, consumer groups and some lenders in their Green Paper submissions. Expanding the types of variations available provides greater flexibility and access to review thereby increasing the potential to stay out of default. It also addresses the concern that consumers' requests could be declined for technical rather than substantive reasons.

Although MFAA, ABA and ABACUS did not support any further regulatory intervention in their Green Paper submissions, they noted that adopting this recommendation codifies their codes of practice and should have only a minimal impact on their members.

APRA has considered the prudential implications for the proposed expansion of the circumstances under which borrowers can ask lenders to vary loans under the hardship provisions. They acknowledge that the effect of the broadened ambit of the provisions means that there may be more loans which, because of delays in repayment or variation in terms, may need to be classified as impaired (and therefore provisioned). However, APRA does not believe the proposals raise significant prudential concerns as:

- the proposals only give consumers a right to request a variation, as opposed to a right to a variation;
- a credit provider will not be obliged to provide a variation that sees them receiving a lower amount than would otherwise be due under the contract; and
- a variation should continue to be granted only where it is expected the consumer will be able to meet their obligations after the variation.

Recommended option

Option 1.2, broadening the types of variations that can be requested, is the recommended option. Avoiding a narrow or prescriptive approach to hardship variations will assist consumers and lenders to negotiate the most beneficial outcome. It would remove unnecessary inflexibility from the statutory right to request a variation and increase access to independent review of the lender's decision. A variation would be provided according to whether or not the borrower can meet their liability to the lender through the variation, rather than whether the request meets relatively technical procedural requirements.

As this recommendation codifies leading industry codes of conduct and EDR rules, it should have minimal compliance cost implications for lender while delivering significant protections to consumers (in terms of greater flexibility in keeping contracts on foot).

Issue Two — Changing the monetary threshold above which a consumer does not have a statutory right to request a hardship variation or postponement of enforcement proceedings

Background

The right of borrowers to seek a variation of their credit contract under the Code is subject to a constraint, in that it is only applies to borrowers where the maximum amount of credit available under the contract did not exceed a prescribed figure.

The way in which this figure was determined has changed as follows since the introduction of the UCCC:

- In 1996, when the UCCC first came into force, the statutory right for consumers to request a variation to their contract only applied to contracts under $125,000.[23]
- Changes to the State regulations between November 2004 and July 2005 resulted in the introduction of a floating threshold linked to equal to 110 per cent of the average loan size for the purchase of new owner occupied dwellings in New South Wales. The threshold changes monthly, and has varied significantly, from $295,790 (Aug-Sept 2005) to $387,420 (Sept-Oct 2010). Since July 2009, the threshold for these contracts has

[23] In 1962 the Molomby Committee recommended that consumers be given a statutory right to seek changes on the basis of hardship for secured debts. Such rights have been included in various hire-purchase and credit Acts since then.

been around $350,000. This threshold continues to be relevant for pre-1 July 2010 contracts only.

- As part of Phase 1 of the national credit reforms, the threshold for contracts entered into after 1 July 2010 was increased to $500,000 (or higher as specified in regulations).[24] This threshold is not indexed, and as a result it can be expected that over time an increasing number of credit contracts will be over the threshold

This threshold is also relevant to the right to request a postponement of enforcement proceedings (discussed below in Issue Three).[25]

This discussion only applies to contracts entered into after 1 July 2010. For constitutional reasons, the basis for calculating the threshold for contracts entered prior to 1 July 2010 cannot be altered.

Problem Identification

The existence of a monetary threshold (of any amount) necessarily creates a class of borrowers who will be denied access to a statutory right to seek a variation. This creates a risk for these borrowers that the lender may refuse to provide a variation of their contract, even where the variation would allow the borrower to avoid defaulting. Where these persons are in short-term financial difficulties, their options are then limited to refinancing (with transaction costs, and assuming that a new lender is prepared to lend to the borrower), or facing enforcement action (and consequent costs).

The evidence of lender conduct set out in detail in Issue One above indicates that some lenders:

- take a technical approach to responding to requests for hardship variations, and will only assess them in accordance with the law, resulting in requests in respect of loans over $500,000 being rejected;

- respond to requests in a formal rather than substantive way, for example, by providing a short term moratorium (which may only exacerbate the problem for the consumer after this period, when the amount outstanding has increased and their underlying financial situation has not changed); and

- reject requests for hardship variations when, following complaint to an EDR scheme, a repayment scheme is negotiated that enables the consumer is meet their obligations under the contract.

Loans which exceed the threshold would generally be home loans secured by a mortgage, and, in the majority of cases, the lender would be an ADI or RFC. The number of contracts which exceed the threshold are concentrated in high cost metropolitan areas and are expected to increase in line with increasing house prices. There is no evidence to suggest that these consumers differ in some way from persons who borrow less than $500,000; while they may earn more money in order to be able to service a higher level of repayments there is no clear distinction between the two classes of borrowers.

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[24] http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/036.htm&pageID=003&min=njs&Year=2009&DocType=0

[25] Section 94 of the Code

Table 1 shows that, based on a mortgage of 95 per cent[26] of the median sale price of all dwellings (strata and non-strata) in certain Sydney metropolitan areas as at December 2009, the value of a significant number of consumers' home loans could exceed the current $500,000 monetary threshold.

Table 1: Housing New South Wales, A8. Median Sales Prices - Greater Metropolitan Region by statistical sub-divisions/postcodes – December 2009.[27]

Location	95% median sale price	% annual change	Location	95% median sale price	% annual change
Inner Sydney	$551,000	16%	Lower Northern Sydney	$665,000	26.4%
Eastern Suburbs	$760,000	26.4%	Central Northern Sydney	$643,150	15.7%
St George-Sutherland	$519,650	20.2%	Northern Beaches	$752,400	18.2%
Inner Western Sydney	$584,250	25%			

Similarly, Table 2 shows that based on a mortgage of 95 per cent of the median sale price of houses in metropolitan Melbourne, the value of consumers' home loans could exceed the current threshold.

Table 2: Real Estate Institute of Victoria, Metropolitan Melbourne Median Prices. [28]

Dwelling type	95% median sale price	median sale price Jun Qtr 2010	% change Jun-09 to Jun-10
Houses	$531,050	$559,000	26.8%

Although the average loan size remains well below the current threshold, it is expected that the number of loans in excess of $500,000 will increase, as house prices increase. Based on data from the Australian Bureau of Statistics, Treasury estimates that more than 35,000 home loans in excess of $500,000 are written each year, and that the total number of such loans on foot will increase with each year (as more loans of this type will be provided than are discharged).[29] It is not known how many of these loans are varied or default because the consumer experiences financial hardship.

Objective of Government Action

The objective of government action is to support access to the hardship variation provisions to enable the most mutually beneficial outcomes for lenders and consumers.

[26] Many credit providers will lend up to 95 per cent of the value of a residential property when secured by a first mortgage ge.

[27] http://www.housing.nsw.gov.au/NR/rdonlyres/C56898FB-D99E-4013-835A-B88188793AA7/0/Sales_Metro_PcodeSSD_2009q4.pdf

[28] http://www.reiv.com.au/home/inside.asp?ID=1048&nav1=1226&nav2=165&nav3=1048

[29] Australian Bureau of Statistics *Survey of Income and Housing 2007-08* and *5609.0 Housing Finance, Australia Tables 9a and 12*, August 2010.

Options

Option 2.1 Maintain the status quo

Under this option, the existing monetary threshold above which a consumer does not have a statutory right to request a hardship variation of $500,000 would be maintained. Consumers with contracts in excess of the threshold would continue to lack access to the statutory right to request hardship variation and to have that decision reviewed. Those consumers would need to rely on other mechanisms to obtain hardship variations, such as industry codes (where they apply).

Impact Analysis

Under this option, there would be no additional impacts on consumers or business. Some consumers would continue to lose the opportunity to retain possession of their homes where the lender refused to vary the terms of the contract even where doing so would result in the borrower being able to make repayments. The number of consumers in this category would increase over time as the value of contracts increases relative to the threshold.

Option 2.2 Increase the threshold under which a consumer has a statutory right to request a hardship variation

Under this option, a threshold would be maintained but would be increased. Possible models for this approach would be:

- to increase the threshold to a fixed figure such as $1 million;
- to adopt a new higher floating figure (for example, using a figure equal to 110 per cent of the average loan size for the purchase of new owner occupied dwellings in inner Sydney, rather than greater New South Wales); or
- to set increments after certain periods of time (for example, increased by $10,000 every year or $50,000 every three years).

Further consultation on the method of determining the appropriate level of the threshold would need to be undertaken. Possible methods of increasing the threshold include annual indexation or linking to movements in the median house price. In certain market conditions (eg deflation) use of these methods would result in the threshold decreasing unless expressly preserved.

For example, if the hardship threshold was linked to equal to 110 per cent of the average loan size for the purchase of new owner occupied dwellings in Inner Sydney (rather than greater New South Wales as it was prior to 1 July 2010) the threshold would have been $638,000 in December 2009 (as opposed to $364,210). If the hardship threshold was linked to equal to 110 per cent of the average loan size for the purchase of new owner occupied houses in metropolitan Melbourne the threshold would be approximately $614,900 in June 2010, rather than $361,790 (based on the old threshold).

Although some consumers would gain access to the statutory right to request variations, others would continue to be excluded and have to rely on other mechanisms to request hardship variations.

This option would need to be justified either by evidence that above the threshold:

- consumers are assumed to possess a level of financial literacy or sophistication that means they do not need statutory rights – however, there is no evidence this is the case, given the majority of the loans of this value are for a primary place of residence rather than part of an investment strategy.[30]

- lenders are at greater risk in respect of high value loans – as noted in Issue One, APRA did not identify any such risks in respect of this type of lending generally.

Regular adjustments to the threshold may lead to uncertainty about coverage and increase the monitoring and compliance cost for those businesses who maintain different procedures for contracts on the basis of whether or not they were below the threshold.

Impact Analysis

Consumers

Some consumers will gain statutory access to the right to request variation to their contract, increasing their ability to keep their contract on foot or recover from default. Any additional compliance cost incurred by lenders may be passed on to consumers.

A limited number of consumers are likely to be confused about whether or not they have a statutory right to request a hardship variation (particularly where their loan exceeds the threshold by a small amount), and may seek a remedy when they have no such right.

Credit Providers who are not signatories to a code of conduct

This class of lenders are likely to incur additional compliance costs in changing the way in which they respond to requests for hardship variations above the threshold (noting that some may nevertheless already currently adopt a flexible response to hardship).

These costs are likely to be quite low, and could also be partially offset by, first, a better performance of their overall lending portfolio, and, second, simpler and consistent internal procedures.

Credit Providers who are signatories to a code of conduct

This option has a more limited impact on those lenders who are signatories to a code of conduct in which they have voluntarily agreed to be more responsive in their dealings with consumers who are in financial hardship, irrespective of the value of the credit contract. This would include all ADIs, and would cover the majority of credit contracts.

In summary, this option could be expected to have the following costs and benefits:

- Fewer consumers who enter into contracts under the increased threshold would go into default and lose their home (because they would be able to use the statutory right to request a hardship variation to be provided with changes to their contract that avoid this outcome).

- Lenders would incur minimal compliance costs, and could be expected to have lower default rates overall.

[30] Note: contracts for credit for investment other than in residential properties are currently not regulated by the Credit Act. The need to regulate other loans for investment purposes is being considered separately during Phase 2.

Option 2.3 Remove the threshold under which a consumer has a statutory right to request a hardship variation

Under this option, the threshold would be removed, and all consumers would have a statutory right to request a hardship variation.

Impact Analysis

Consumers

All consumers will have statutory access to the right to request variation to their contract, thereby increasing their ability to keep their contract on foot or recover from default. Additional compliance cost incurred by lenders may be passed on to consumers.

Credit Providers

This option would have the same impact on credit providers as Option 2.2, except that lenders would incur slightly lower compliance costs in that:

- They would not need to monitor the monetary threshold; and
- They can apply internally consistent procedures across all contracts, eliminating the need for different processes.

This option could be expected to have the following costs and benefits:

- Even fewer consumers than under Option 2.2 would go into default and lose their home (because they would be able to use the statutory right to request a hardship variation to be provided with changes to their contract that avoid this outcome).
- Lenders would incur minimal compliance costs, and could be expected to have lower default rates overall.

Stakeholder views

Removing the threshold was supported by EDR schemes, consumer groups and some lenders in their Green Paper submissions. Consumer groups supported increasing the threshold as an alternative (if removing the threshold altogether was not recommended).

Although MFAA, ABA and ABACUS did not support any further regulatory intervention in their Green Paper submissions, adopting this recommendation codifies their codes of practice and should have minimal impact on their members.

APRA did not believe this proposal raised significant prudential concerns. The reasons are the same as discussed above in relation to Issue One above, namely that:

- the proposals only give consumers a right to request a variation, as opposed to a right to a variation;
- a credit provider will not be obliged to provide a variation that sees them receiving a lower amount than would otherwise be due under the contract; and
- a variation should continue to be granted only where it is expected the consumer will be able to meet their obligations after the variation.

Recommended option

Option 2.3, removing the threshold, is the recommended option. This would not mean that a borrower has an automatic right to a variation, but rather a right to request one. Lenders would not be required to agree to receive less than what they are rightfully owed, and a variation should only be granted where it is reasonably expected that the borrower could discharge their obligations.

As this recommendation codifies leading industry codes of conduct and EDR rules, it should have minimal compliance cost implications for lenders while delivering significant benefits (in the form of increased protection and access to review for consumers and the likelihood additional contracts would be kept out of default) to consumers with have large debts who are experiencing difficulty in making their repayments.

ISSUE THREE - ENHANCEMENTS TO THE POSTPONEMENT OF ENFORCEMENT PROVISIONS

Background

A credit provider can generally commence proceedings where a consumer is in default and the credit provider has served the borrower a notice specifying the nature of the default, and allowing them an opportunity to rectify the default.[31] The notice contains information on the hardship variation and stay of enforcement provisions and EDR contact details.

The Code does not require credit providers to specifically consider whether the consumer could continue to meet their obligations if their contract were varied before commencing enforcement proceedings. However, some industry codes of conduct and the rules of both FOS and COSL[32] prohibit lenders from commencing or continuing enforcement proceedings once they have received, and are considering, a request for a hardship variation.

In this context, enforcement proceedings include taking legal action; repossession (unless the security is at risk); listing of a default on a consumer's credit file; and selling the debt or otherwise assigning any right to recover the debt.

Problem Identification

Some borrowers do not seek solutions to their financial hardship by actively approaching their lender prior to going into default, and the lender commencing enforcement action (by sending them a notice under Section 80 of the Code). Nevertheless, some of these borrowers would still satisfy the requirements for a hardship variation by being able to repay their liability to the credit provider (notwithstanding that the debt has increased in size relative to if they had sought the variation earlier).

Consumer advocates suggest that a significant number of borrowers do not approach their lender to seek a hardship variation until the credit provider has commenced enforcement action. The reasons for this include:

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[31] Section 88 of the Code

[32] COSL, *Position Statement Issue 2: Financial Hardship*, May 2010; FOS, *The Financial Ombudsman Circular Newsletter*, Edition 3, Update 1, August 2010.

- Consumers are not always aware themselves of their right to seek a variation until they seek out advice from a third party, and a percentage of consumers only seek this advice when faced with enforcement action.

- Consumers who may be aware of this right nevertheless believe that telling their credit provider they are in financial difficulties will precipitate enforcement action (irrespective of whether this is true or not).

Where the borrower makes a request the Code currently does not prevent lenders from commencing enforcement action. Therefore, some lenders may commence enforcement proceedings before giving proper consideration to consumer's ability to remedy the default, such as responding to their request for a hardship variation, or proactively making enquires with the consumer to determine the source of the problem and whether it can be resolved without resorting to formal enforcement proceedings.

There is evidence that the scale of the problem is significant. Firstly, COSL, in its submission to the Green Paper, stated that in more than 90% of the complaints it receives from borrowers seeking hardship variations the borrower has either been served with a default notice or legal proceedings have commenced. This number does not represent all borrowers who have had hardship applications rejected as not all these persons will pursue their complaint to an EDR scheme.

It is noted that the COSL membership includes the overwhelming majority of non-ADI lenders, micro lenders, promoters of non-bank residential lending programmes, aggregators and mortgage managers.

Secondly, a recent survey of homeowners facing enforcement action found that 'Nearly half the respondents initiated attempts with their lenders to [re-schedule mortgage repayments in order to deal with mounting arrears and forestall possession or forced sale] but only 4 per cent were successful.'[33]Where credit providers initiate court action it is likely they will have incurred legal costs (and may continue to do so while any hardship variation or request for a stay is being considered). Under court rules the borrower would usually be liable for these costs, which increase their debt. In some cases, these costs could have been avoided by consideration of such measures earlier.

Objective of Government Action

The objective of government action is to support sufficient flexibility in the hardship variation provisions to enable the most mutually beneficial outcomes for lenders and consumers.

Options

Option 3.1 Maintain the status quo

Under this option, the current arrangements regarding when enforcement proceedings can be commenced, would be maintained.

Measures implemented in Phase 1 of the credit reforms should assist in raising awareness about the existence of the right to request hardship variations and stays of enforcement and

[33] Berry, Dalton & Nelson, *Mortgage Default in Australia: Nature, Causes and Social and Economic Impacts*, March 2010, p.4 AHURI Final Report No. 145. Melbourne: Australian Housing and Urban Research Institute, RMIT Research Centre.

encourage consumers to be more proactive in approaching their lender when they experience difficulty. In addition, improved access to independent review by EDR should raise the quality of decisions made by lenders.

Impact Analysis

Under this option, there would be no additional impacts on consumers or business.

Option 3.2 Requiring lenders to consider whether a hardship variation is appropriate before commencing enforcement proceedings

Under this option, credit providers would be required to specifically consider whether a variation should be given to a defaulting borrower before commencing enforcement proceedings. This would require a lender to contact any defaulting consumers to establish the cause of the default and then assess whether a variation should be provided (in order to keep otherwise viable contracts on foot and avoid incurring unnecessary enforcement expenses).

Requiring lenders to initiate consideration addresses the risk that consumers did not apply because they did not know or were hesitant to raise the issue with their lender. Enforcement proceedings should only be commenced when other options are exhausted; exceptions would apply where, for example, security is at risk or it is clear that the contract cannot be completed satisfactorily,

Impact Analysis

Consumers

Requiring lenders to initiate consideration of a variation before commencing enforcement action may reduce the incidence of avoidable and costly enforcement action. However, there is a risk that inappropriate variations may granted, leading to further financial hardship and worse outcomes.

There is also a risk that the implementation of this proposal could encourage credit providers to consider commencing proceedings earlier, to compensate for any perceived risk of delay which may arise as a result of the time required to consider a variation.

There is also a risk that delaying enforcement proceedings which eventually proceed could result in borrower being liable for a much greater debt as a result of a greater shortfall. Where such provisions are used as a delay tactic to artificially extend the period before enforcement action, neither the consumer nor lender would ultimately benefit.

Credit Providers

As this proposal goes beyond what is currently contained in industry codes and the rules of EDR schemes, it is likely to have significant impacts on credit providers, in terms of the cost and time required to contact all defaulting consumers to determine the cause of default and the appropriateness of a variation.

These costs may be partially offset by savings in avoidable enforcement expenses and reduced number of defaults that are written off as bad debts. However, it is expected that the cost would exceed those savings, as it is likely that a variation would not be provided in most cases, including where the lender could not make contact the borrower or could not obtain sufficient information about the borrower's financial situation to be able to assess the application. The costs of contacting borrowers individually (possibly on multiple occasions) and seeking a level of detail, through documentary evidence of the borrowers' circumstances, are likely to considerable. Where a variation was not provided these contracts would proceed to enforcement.

This option could be expected to have the following costs and benefits:

- Some consumers who are facing enforcement action would be provided with changes to their contract that avoid them going into default.
- Lenders would incur significant compliance costs in contacting all borrowers who have defaulted, and where enforcement action is being considered. This may result in lenders passing on these costs to all consumers (through higher interest charges).

Option 3.3 Require lenders to finalise consideration of any outstanding requests for a variation before commencing enforcement proceedings

Under this option, credit providers would not be able to progress enforcement proceedings until they had considered a consumer's request. Making this an upfront requirement in the law, rather than relying on industry codes or only having it apply to cases which are taken to EDR, would provide certainty and encourage confidence in the process.

Where the request was refused, credit providers would be required to allow the borrower time (for example, 10 working days) to consider the response and take further action (for example, request review from an EDR scheme, seek other sources of credit or sell assets).

There would need to be restrictions about the number of applications a consumer could make, in order to avoid the risk that multiple applications of little or no merit were made, simply to delay enforcement action.

Impact Analysis

Consumers

Requiring lenders to determine a request for hardship before commencing enforcement action is likely to reduce the incidence of avoidable enforcement action. It will particularly assist the following classes of consumers:

- Borrowers who are hesitant or reluctant to confront their financial problems. These persons may only seek assistance when they are confronted with the prospect of enforcement action, through the lender sending them a default notice.
- Borrowers who pursue hardship variations because the introduction of a statutory right gives them greater awareness of, and confidence in pursuing, their rights.

There is a risk that delaying enforcement proceedings which eventually proceed could result in some borrowers becoming liable for a larger debt as a result of a greater period during which repayments may not be made.

Credit Providers

Additional compliance costs are expected to be minimal, as this proposal would only affect credit providers in relation to a smaller class of borrowers relative to Option 3.2 (those borrowers in default who have lodged a hardship variation rather than all borrowers in default where enforcement action is being considered). These costs may be offset by savings in avoidable enforcement expenses and reduced number of defaults that are written off as bad debts.

The evidence from COSL suggests the impact is likely to be higher on lenders who are not ADIs.

This option could be expected to have the following costs and benefits:

- A percentage of those consumers who have defaulted and would otherwise face enforcement action would be provided with changes to their contract that avoid them going into default.

- Lenders would incur minimal compliance costs, and could be expected to have slightly lower default rates.

Stakeholder views

Consumer groups supported Option 3.2. However, a majority of lenders responded that without access to information about the totality of a consumer's financial situation at the time of the default or an indication on the consumer's willingness to meet their obligations, a lender would not be able to properly consider the appropriateness or feasibility of a variation.

FOS suggested it was appropriate for lenders to attempt to contact consumers to determine the reason for default, and if possible consider if a variation would be appropriate, before commencing recovery action.

There was support for Option 3.3 from NFSF, EDR schemes and consumer groups. ABA, ABACUS, MFAA and FBAA did not support additional regulatory action.

Recommended option

Option 3.3 is the recommended option. Where a consumer has exercised their right to request a variation, they should be given the opportunity to have it properly considered before the lender commences enforcement action. A beneficial outcome is mostly likely to be achieved when both parties are willingly and actively participating in the process.

However, consumers would be prevented from forestalling enforcement by regularly applying for hardship variations where their circumstances have not changed and it is unlikely to result in a beneficial outcome.

Issue Four – Provision of a general remedy for misconduct by providers of credit services

Background

The implementation of Phase One of the credit reforms has maintained in the Code the right for consumers to be able to have a credit contract, consumer lease, mortgage or guarantee reopened on the grounds that it is unjust. This provides a general remedy beyond those existing in other legislation. A remedy of this type in respect of credit contracts has been long-standing, and previously been included in money-lending legislation. The remedy has recognised the desirability of industry-specific protections that encourage higher standards of conduct by credit providers.

However, the Credit Act does not provide any equivalent general remedy in relation to providers of credit services. There are two classes of such persons, those who provide credit assistance by arranging or suggesting a particular or identified contract (and are therefore required to comply with the responsible lending requirements in Chapter 3 of the Credit Act), and other intermediaries who only play a lesser role in the provision of credit or leases.

The Credit Act currently only provides a consumer with a remedy where a person has breached a specific provision of the Act, and the consumer has suffered loss or damage as a result.[34] This means that the ability of consumers to obtain a remedy under the Credit Act varies according to the function of the person they are dealing with, as follows:

- Where the person provides credit assistance – they are subject to a number of specific obligations in Chapter 3 of the Credit Act (including obligations to ensure the contracts they arrange or suggest are not unsuitable, and disclosure requirements, particularly in relation to fees and commissions) and will be liable to consumers for breaches of these requirements, but not otherwise.

- Where the person does not provide credit assistance – they are not subject to specific obligations under the Credit Act in respect of their dealings with consumers and as they are under no requirements, they therefore cannot breach them.

Following the introduction of the Commonwealth legislation consumers in New South Wales, Victoria and Western Australia who use the services of brokers no longer have rights that they previously enjoyed under State legislation in relation to the conduct of brokers. For example, in New South Wales, Section 4J of the Consumer Credit Administration Act 1995 (NSW) (the Administration Act) provided consumers with a remedy for unjust conduct in relation to contracts regulated by the UCCC. Section 3 defined unjust conduct as conduct that:

(a) is unfair, dishonest or fraudulent, or

(b) consists of anything done or omitted to be done in breach of contract, whether or not proceedings in respect of the breach have been brought, or

(c) consists of a contravention of any consumer credit legislation.

The legislation in force at a State level has been effective in regulating the conduct of brokers in a way that reduces the risk of adverse conduct that can cause harm to consumers. For example, the New South Wales Office of Fair Trading considers that the Administration Act was effective in reducing the level of disputes between consumers and brokers in relation to fees, but that these types of problems continued to occur where the contract was unregulated by the UCCC, and the Administration Act therefore did not apply.

Problem Identification

There are two related problems for consumers:

- Existing remedies under the Credit Act and other Commonwealth legislation do not adequately address common situations where consumers are at risk of financial detriment from brokers and other intermediaries.

[34] Section 178 of the Credit Act.

- In New South Wales, Victoria and Western Australia the situation is exacerbated in that consumers have suffered a loss of rights in their dealings with brokers, from the repeal of legislation regulating their conduct.

The absence of any remedy means that consumers will be unable to obtain a remedy against a provider of credit services where they have not breached other legislation (such as the ASIC Act).[35] There are a number of relatively common situations where consumers are at risk of loss or detriment from conduct of brokers that is either unjust or unfair without other remedies being available. These practices are largely adopted by persons who operate on the fringes of the industry, and who are conscious of the limits of existing regulation. This class of persons will deliberately seek to avoid infringing specific statutory obligations by techniques such as:

- using a number of different parties, to make it harder to attribute fault to any single party;
- exploiting technical gaps in legislation (in the credit context, by constructing their business in such a way that they do not provide credit assistance and are therefore subject to a lower level of regulation);
- formal compliance with the law (for example, providing necessary disclosure but that is designed not to alert consumers to particular risks); or
- making the consumer sign documents that contain false statements or information (for example, verifying that they understand a particular transaction or consequences), that make it harder for the consumer to then deny the version of events recorded in those documents.

The first situation where this type of conduct is likely to occur is in 'equity stripping' scenarios. Currently, the responsible lending provisions in the Credit Act impose an obligation on a broker who provides credit assistance (typically, by suggesting the particular credit contract) to assess the capacity of the borrower to meet repayments. However, this requirement does not extend to other persons involved in the transaction who do not provide credit assistance; for example, in some equity stripping practices three or four parties may be involved each of whom charges a separate and large fee to the consumer. National Legal Aid specifically referred to this situation in its response to the Green Paper and stated: 'Equity stripping, without any consequences for third parties who have financially benefited from such practices, … is of significant concern.'

A second area of concern is fees charged by intermediaries who do not provide credit assistance.[36] The Credit Act does not include any specific requirements regulating the way in which these persons disclose or charge fees. It is noted that COSL (the EDR scheme that the majority of brokers belong to) has identified disputes about fees as a significant source of complaints in its recent Annual Reports of Operations; in 2008-09 227 complaints (or 22 per

[35] Consumers who suffer loss in relation to a credit contract because of the conduct of a broker will usually not have any recourse against lenders in these circumstances, as lenders will generally not be responsible or accountable for the conduct of these third parties.

[36] The disclosure of fees charged by persons providing credit assistance is now regulated by Chapter 3 of the Credit Act, with these fees needing to be disclosed both in a quote and a proposal document.

cent) were about fees, and in 2009-10 244 complaints (or 19 per cent) were about fees. There is therefore considerable potential for ongoing disputes about fees (for example, about the amount or the circumstances in which a person is liable to pay those fees).

A third situation is where intermediaries charge fees or earn commission, where the cost to the consumer may be inflated to cover payments to the broker (directly or indirectly). For example, the broker may also be involved in the sale of real property and fix the price of the property according to the maximum amount the consumer can borrow, in order to earn a higher commission from the sale of the property.

This practice is illustrated by the facts in the decision of the NSW Supreme Court in *Investmentsource Corporation Pty Ltd v Knox Street Apartments Pty Ltd & Others* [2002] NSWSC 710. The case concerned the marketing and promotion of inner city units by a Henry Kaye company, Investmentsource Corporation Pty Ltd (Investmentsource). Henry Kaye held wealth creation seminars in which he encouraged consumers to purchase these units and that Investmentsource assisted consumers to arrange finance.

Separately, Investmentsource had negotiated with the owner of the units to obtain exclusive rights to market them. Investmentsource had negotiated to receive a commission from the owner for the sale of each unit; the amount of commission received by Investmentsource was not fixed but was the amount by which the purchase price exceeded a minimum sale price set by the owner. There was no evidence that the consumers were told about these arrangements and it can be presumed that they were unlikely to have agreed to purchase the units if this was the case.

Investmentsource sold 31 units and earned commission of $1,330,589. This equates to a profit of $42,922 on each sale through inflation of the property price. Assuming that the consumers borrowed money to finance the purchase of a unit with a loan at an interest rate of 6.5% and that the liability was discharged over a period of 15 years, the additional interest paid by a consumer on the sum of $42,922 would be $24,379.41. The total loss to consumers, through paying a higher cost for the properties, can be estimated as $2,086,343.70 ([$42,922 + $24,379.41] x 31).

The extent of these practices is not precisely known. However, given that brokers and intermediaries can earn significant financial benefits from these practices they are likely to create a continuing incentive for persons to continue to engage in this type of conduct.

Objective of Government Action

The objectives of government action are to improve public confidence in the conduct of brokers and intermediaries by providing consumers with appropriate access to remedies in relation to loss or damage from misconduct by credit service providers.

Options

Option 4.1 Maintain the status quo

Under this option there would be no change to the current remedies available to consumers for loss or damage suffered as a result of conduct by brokers and intermediaries in relation to credit contracts, consumer leases, mortgages and guarantees.

Consumers would need to seek remedies for loss or damage under the existing, and more limited, provisions of the Credit Act (where applicable) or other legislation. Consumers in

NSW, Victoria and Western Australia would have lost protections by comparison with the remedies which were available under legislation such as the *Consumer Credit Administration Act 1995* (NSW).

Impact Analysis

Under this option, there would be no additional or new impacts on business. Consumers in NSW, Victoria and Western Australia would find their rights reduced when engaging the services of brokers.

Option 4.2 Provide a general remedy against providers of credit services by extending the existing remedy for unjust conduct

The existing remedy allows an unjust contract to be reopened, but usually only allows for orders to be made against the credit provider, rather than third parties. This would entail a change to the procedural aspects of the existing provisions, to enable an application to be brought against a broader range of parties (so that the consumer can obtain redress against both brokers and lenders, either individually or jointly).

Changing the existing nature of the remedy in this way would mean that misconduct by a third party may enable the consumer to obtain a remedy which would allow the court to rewrite the terms of a credit contract or lease (irrespective of whether the conduct was known to the lender).

Impact Analysis

Consumers

Consumers will be able to obtain a remedy that is currently not available where they have suffered loss or damage as a result of unjust conduct by a person providing credit services. They may also benefit from improved standards of conduct by providers of credit services, where they change their practices to mitigate the risk of engaging in unjust conduct.

In some situations the unjust conduct by the provider of credit services causes loss or damage that results in the consumer defaulting on the payments due under their contract. Where this is the case, enhancing the capacity of the consumer to seek compensation may mean they can use the money awarded to them from a broker to rectify this default, and thereby avoid enforcement action by the credit provider or lessor.

Credit Providers or Lessors

Some risk averse financiers may no longer arrange transactions involving third parties where they assess there is a high risk of unjust conduct that could result in the contract being reopened (to avoid incurring additional compliance costs in monitoring this risk). Alternatively they may increase the cost of credit charged to the borrower to cover this contingent risk. However, this is unlikely to involve significant new costs as it is considered most financiers would already be undertaking these assessments for other reasons (for example, reputational risk).

Credit Service Providers

Providers of credit services may need to review their practices to identify situations where they are at risk of engaging in unjust conduct, and make appropriate changes after identifying any areas where they consider their conduct both may be unjust or unfair and may cause loss to consumers. For example, brokers who earn commissions from related transactions may need to take extra steps to disclose to consumers their commercial arrangements with third parties other than lenders.[37] Brokers who previously operated in NSW would not need to do so, as it is generally expected that they would have already undertaken this task in order to address similar risks under the Consumer Credit Administration Act 1995.

Some brokers may therefore incur additional compliance costs as a result of this review. These costs are unlikely to be significant for those who have reviewed their practices prior to applying for an Australian credit licence (or in making any changes required under their professional indemnity insurance). These costs may need to be absorbed internally where the person providing credit services does not charge borrowers a fee.

There is a small class of brokers who are likely to incur more substantial costs, namely those brokers operating on the fringes who deliberate engage in conduct that may be unjust (for example, brokers who charge fees in ways that may be unfair or who earn secret commissions). It is not possible to assess the impact on these persons solely in terms of compliance costs as there is a threshold question as to whether or not they are prepared to risk non-compliance with the requirements of the Credit Act in order to gain additional financial benefits. In practice therefore they will need to decide whether to exit the industry rather than change their overall business model.

In summary this option would result in the following costs and benefits:

- Some lenders may charge consumers higher costs or may reduce the extent to which they use broker distribution channels.

- It is not expected brokers or intermediaries would incur additional costs directly, except for a relatively small class of brokers who deliberately and consistently engage in unfair or unjust conduct.

- Consumers would have a higher level of protection, and greater access to remedies, particularly when using the services of those fringe brokers, but may be charged higher costs by some lenders.

Option 4.3 Provide a specific remedy against providers of credit services

This option would see a new and separate remedy created for unfair conduct by providers of credit services. The consumer would only be able to seek a remedy against a provider of credit services, and this remedy would be separate to the existing remedy in the Credit Code available against credit providers or lessors in relation to the credit contract. The consumer's rights would be limited to remedies from the provider of credit services, and would therefore not result in any adjustment of the rights of the consumer under any credit contract or consumer lease to which they are a party.

Impact Analysis

Consumers

The impact on consumers would be largely equivalent to that under Option 4.2. Some consumers may incur costs of time and money because they initially pursue a complaint against the lender when the remedy should have been pursued against the broker. This is not expected to have a significant impact on consumers as:

[37] The requirements to disclose commissions from lenders are specifically addressed in the Credit Act.

- where the complaint is made to an EDR scheme – these schemes already have in place procedures to efficiently identify and resolve this issue. As there are only two such schemes, the EDR scheme would either treat the complaint against the lender as a complaint against the broker (where they are a member of the same scheme), or refer the complaint to the other EDR scheme under existing protocols.

- where compensation is sought through court action – the consumer's lawyers could be expected to accurately identify the person against whom a remedy should be sought, so that the problem would not arise.

The costs to the consumer can therefore be expected to be minimal, and are balanced in that these costs are only incurred because the consumer is seeking a remedy which would otherwise not be available.

Credit Providers or Lessors
This option would not affect credit providers or lessors, as their rights under existing contracts would not be affected. It would see a more efficient allocation of responsibility where the appropriate person is accountable for conduct that causes loss or damage, rather than third parties being made liable.

Credit Service Providers
The impact on providers of credit services would be equivalent to that under Option 4.2, in that some of these providers may consider it necessary to review their practices and identify any areas of their conduct where they may be at risk of claims. The costs are not quantifiable as they will vary according to the size, market and existing practices of the provider.

Again, however, the main class of brokers who would be affected is those who are targeting vulnerable consumers in systematic ways through unfair or unjust conduct in a systemic way and therefore causing financial harm to a relatively large number of consumers. These persons would need to decide whether to cease these practices or face a greater risk of liability.

In summary this option would result in the following costs and benefits:

- It would have no impact on credit providers or lessors.

- It is not expected brokers or intermediaries would incur additional costs directly, except for a relatively small class of brokers who deliberately and consistently engage in unfair or unjust conduct.

- Consumers would have a higher level of protection, and greater access to remedies, particularly when using the services of those fringe brokers.

Stakeholder views

The status quo was supported by the ABA and the FBAA.

The ABA, the MFAA and the AFC specifically opposed Option 4.2 on the basis that lenders and their contracts should not be affected by the misconduct of a third party. The MFAA's key concern was that under Option 4.2 the credit contract could be set aside or varied because of the conduct of the broker. This could encourage lenders not to distribute through brokers, and the result would be a reduction in competition and the assistance for borrowers. The MFAA was however quite comfortable about brokers being liable for their own conduct under Option 4.3.

Option 4.3 was supported by the NFSF, COSL, CALC, CCLC (NSW) and National Legal Aid. CCLC (NSW) and National Legal Aid saw the introduction of a remedy of this type as particularly significant in relation to equity stripping practices (where a number of legal actions they have been involved in have failed because brokers avoid liability through invoking technical restrictions in the scope of other remedies.

In its Green Paper submission, COSL stated that the creation of a new and separate remedy for unjust conduct by providers of credit services would allow the remedy to be specifically tailored to address the role of third parties who are not the credit provider or lessor, and would allow relief to be attributed to the appropriate person.

Recommended option

The recommended option is option 4.3, that is, providing a general broad remedy against providers of credit services. The creation of a separate remedy would allow the remedy to be specifically designed to address the role of third parties who are not the credit provider or lessor. It would also avoid any impact on credit providers or lessors.

The model in the Consumer Credit Administration Act 1995 (NSW) could be largely utilised, to ensure consistency with a known standard of conduct. The result would be to introduce a general remedy for 'unfair conduct', rather than a remedy being available only within the precise terms of other legal concepts (for example, conduct that is unfair may not be unconscionable, as the latter concept requires demonstrating that the borrower's decision and judgement is adversely affected).

Implementation

It is proposed to implement this reform as follows:

- The remedy for unjust conduct would be modelled on the existing approach in the Administration Act. This has been in force for a number of years, and would therefore provide greater certainty as to when conduct will or will not infringe such a provision. Some of the contingent elements developed for the remedy in the draft Finance Brokers Bill also need to be included in the remedy (for example, where they provide clarity about the circumstances in which the remedy applies).

- The court would be given broad powers to provide relief similar to those available for unjust conduct under the Credit Act, including by awarding compensation for loss or damage or relieving the consumer of liability under any contract with the provider of credit services.

- As a technical issue, the remedy would not extend to a situation where a credit provider or lessor was acting as a provider of credit services in respect of their own products., and would therefore have an appropriate limitation to this effect (similar in effect to those in sections 112 and 135 of the Credit Act where lenders and lessors have been exempted from other requirements, in relation to their own products).

Implementing the reform in this way would principally address the conduct of fringe operators who deliberately construct transactions in ways that cause financial harm or loss to consumers, principally through:

- charging excessive or disguised fees;
- earning inflated profits through transactions related to the credit contract or lease (particularly the sale of other products or services); and
- being involved, directly or indirectly, in equity stripping arrangements or other situations where the credit provider or lessor can be misled as to the financial position of the consumer.

These persons would be at greater risk of having to compensate consumers.

ISSUE FIVE - RESTRICTING THE USE OF CERTAIN WORDS OR EXPRESSIONS

Background

Under the financial services regime, sections 923A and 923B of the *Corporations Act 2001* (Corporations Act) restrict the use of the words independent, impartial or unbiased, and other words or expressions, for example insurance broker or stockbroker, unless the person holds appropriate authorisations under their Australian financial services licence. The Credit Act does not include any equivalent provision restricting the use of certain words or expressions by persons engaging in credit activities.

Problem Identification

A small number of key words or phrases can have an emotive force, and a power to connect with or engage consumers. Allowing the unrestricted use of these terms raises the prospect of consumers being misled, either deliberately or inadvertently. This risk has been identified as arising in respect of the following particular terms.

'Pre-approved'. This term has been used in the context of lenders sending out applications for new credit cards or offers to increase the credit limit on an existing credit contract. The Consumer Action Law Centre conducted a review of the terms of these invitations. It found that the use of the phrase 'pre-approved' conveyed to the consumer a message that the lender endorsed the increase in credit limit, and was an effective means of encouraging the consumer to apply.[38] The risk is that consumers will therefore increase their credit limit unnecessarily, and will do so partly in the belief that the lender considers this is a sensible or appropriate course of action (rather than the lender being motivated by their own commercial interests).[39]

'Independent, impartial or unbiased'. These terms can be extremely influential in attracting consumers who are seeking assistance from a broker who will not choose products on the basis of commissions. The risk for consumers is that they will be placed in a credit contract that may be more expensive than other products because the broker will earn commissions in respect of that product. ASIC has previously had to use its powers under the ASIC Act powers to prevent brokers from using these terms in a way that was misleading (but only

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[38] Harrison, Paul and Massi, Marta 2008, *Congratulations, you're pre-approved! : an analysis of credit limit upselling letters* Consumer Action Law Centre, Melbourne.

[39] The responsible lending obligations in Chapter 3 do not address this risk directly.

after promotional materials had been published given the limitations in the way that Act regulates this type of conduct)[40].

It is proposed that this term would be restricted in a way similar to the analogous requirement applying to holders of an Australian financial services licence (AFSL) under the Corporations Act. ; this would mean that there can be no confusion as to whether ‘independent’ means the broker will never receive commissions, or whether this is a general approach subject to qualifications or exceptions.

It would also avoid brokers being able to use these terms when they have entered into volume bonus agreements, where the broker is under a financial incentive to meet targets, and where the consumer is at risk of being placed in a product that may be slightly more expensive as a result. For example, a difference of 0.5 per cent in the interest rate on a home loan of $175,000 can result in the consumer paying an additional $15,547 over the life of the contract.

Limiting the use of these terms will therefore also be important in encouraging the development of brokers who do operate using an independent (or non-commission based) business model. They can have greater certainty that the use of these terms cannot be appropriated or abused by brokers who will receive commissions (and therefore limit the effectiveness of their capacity to promote themselves).

AFSL holders are already subject to restrictions in relation to the use of the words ‘independent, impartial and unbiased’ in the financial services context, and this would ensure consistency in the way in which they describe themselves, where they hold both an AFSL and an ACL.

‘Reverse mortgage’. The term ‘reverse mortgage’ currently has some popular currency, but can be used to refer to a broad range of products with different characteristics. As discussed in detail in the RIS for equity release products it is proposed to introduce a technical definition of ‘reverse mortgages’ in the Credit Act, and to require lenders offering this class of products to meet a number of specific requirements (for example, having a statutory guarantee of no negative equity).

It is intended to assist the class of potential borrowers to more readily identify products with these characteristics by limiting the use of this term. In the absence of such a restriction there is a risk that consumers will be attracted to other providers and may enter into contracts that are less suitable for their needs (for example, where they must repay a lump sum at a fixed point in time, and therefore face the risk of having to sell the family home involuntarily rather than at a time of their choosing).[41]

The risks are exacerbated because of the characteristics of the class of borrowers likely to use these products, in that they tend to be more vulnerable and have a limited understanding of how these contracts work (as a result of factors such as poor financial literacy skills, lack of income and reduced capacity due to health problems).[42]

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[40] Press Release 05-36: *ASIC acts against misleading and deceptive advertising*, 24 February 2005.

[41] ASIC has identified this risk previously with providers using the term ‘reverse mortgages’ to promote lines of credit.

[42] These factors are discussed in more detail in the RIS prepared in relation to the regulation of equity release products.

This approach will enable these borrowers, over time, to more easily identify the products that provide offer appropriate protections, and protect them from advertising materials that would otherwise use the term 'reverse mortgage' to attract them, when the product has fewer or none of these protections.

'Financial counselling/financial counsellor'. These terms are typically used to describe persons who are funded by government or on a not-for-profit basis, and who have been accredited by their professional association as meeting appropriate standards of training and competency (by holding particular qualifications such as a diploma and, in some States, meeting work experience requirements). However, there is no restriction on the use of these terms, and they can be used by other persons. This includes commercial businesses that can use these terms to attract consumers who by definition are likely to be in financial difficulties with limited income.

There are two significant differences between these commercial enterprises and government or not-for-profit services. First, they are free, and, secondly the assistance provided by government funded financial counsellors involves a more thorough and patient relationship with the consumer as it includes:

- A detailed assessment of their overall financial position.
- Identifying all possible options to address their problems (both external options – negotiating with creditors, and internal options – changes to lifestyle and budget).
- Ongoing support to the client in implementation of these options (which is particularly important where changes to their use of money and behaviour are required).

The terms financial counselling or financial counsellors are currently used by a number of commercial fee-charging businesses, particularly in webpages. Typically these businesses provide a more restrictive range of services (for example, they may only assist with arranging Part IX bankruptcy agreements) so that consumers who approach them may only be offered this solution; by comparison, a financial counsellor will spend time analysing all the different aspects of the consumer's financial problems and then identify the most appropriate response.

There is also a risk that these persons may not perform their services with adequate levels of skill, as they do not need to meet any accreditation requirements and there are therefore no controls over their competency levels.

For example, ASIC is aware of one operator who would make requests for hardship variations without obtaining the necessary documentary evidence from borrowers to support their claims, and where those applications were therefore routinely dismissed. Borrowers who have used the services of this person are in a worse position financially as they have not only incurred costs charged by the business, but the size of the debt owed to their lender has increased during these failed negotiations, reducing their scope to negotiate a variation once the appropriate evidence of future income had been obtained

There is a significant number of consumers who may be affected, given that financial counsellors see a maximum of 100,000 clients a year.

It is noted that the use of certain words or phrases may be misleading or deceptive or contain false and misleading representations, depending on the context in which the statement is made, and therefore infringe the prohibitions in sections 12DA and 12DB of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). Under this provision, consumers may recover loss or damage. ASIC has standing to take these actions, and may intervene in proceedings brought by consumers.

The existing remedies for misleading or deceptive conduct or making false and misleading representations are inadequate to address this situation for two reasons:

- They do not address situations where a phrase does not have an accepted or specific meaning (for example, reverse mortgage or financial counsellor). In these situations the use of the phrase in other contexts will not be misleading or deceptive (as this can only arise because of confusion between an accepted meaning – where one exists – and the actual way in which it is used).

- They do not act as an automatic prohibition in all circumstances. A person may still use these terms in a way that is false or misleading (either inadvertently or because of their effectiveness), and continue to use them until challenged by ASIC. They may also be able to raise technical defences, or use qualifications or contexts that may create ambiguity as to whether a matter is misleading or deceptive, so that ASIC would have to prove that the use of words is misleading or deceptive in court on a case by case basis.

Objective of Government Action

The objective of government action is to mitigate the risk of consumer detriment caused by the use of certain potentially misleading words or expressions in relation to credit.

Options

Option 5.1 Maintain the status quo

Under this option, no specific restrictions on the use of certain words and expressions would be introduced, and consumers would rely on the existing prohibition on false and misleading conduct and remedies available under the ASIC Act.

Impact Analysis

Under this option, there would be no additional impacts on consumers or business.

Option 5.2 Restrict the use of certain words or expressions

Under this option the use of the terms described above would be restricted so a person could only use them in situations which met particular criteria:

- *'Pre-approved'* would not be able to be used in invitations to apply for credit or a consumer lease, or to increase an existing credit limit where the lender has not received an application form or conducted an initial assessment of the borrower's eligibility.

- *'Independent, impartial or unbiased'* would only be able to be used by brokers and intermediaries where they exclusively operate a model in which they do not receive any remuneration from commissions (but including where all commissions are rebated to the borrower).

- *'Reverse mortgage'* would be limited in use to describe products that are consistent with the definition to be introduced in the Credit Act.

- *'Financial counselling/financial counsellor'* and other similar phrases would be used to describe persons who are funded by government or on a not-for-profit basis, and who are accredited by the relevant professional association. The approach would be based on the existing definition used to exempt this class of persons from the need to hold an ACL in the *National Consumer Credit Protection Regulations 2009*.

Impact Analysis

Consumers

Persons would be unable to use the restricted term inappropriately, and consumers would therefore benefit as follows:

- *'Pre-approved':* They are unlikely to apply for credit unnecessarily, and more likely to make informed choices about credit according to their needs, rather than responding to invitations for credit. This is particularly relevant to credit cards where the consumer can incur higher interest charges than on other credit products.

- *'Independent, impartial or unbiased':* Consumers would be able to more clearly identify and select those brokers who are not remunerated by way of commission. Where they use brokers who do receive commissions they would also be at less risk of being confused about whether or not they are acting independently, and therefore of entering into a contract where the cost of the credit was more expensive than other contracts (because the product selection was influenced by the payment of commissions).

- *'Reverse mortgage':* Consumers, especially elderly or retired borrowers, would be at less risk of entering into contracts that are less suitable for their needs than reverse mortgages (for example, because they do not include a no negative equity guarantee).

- *'Financial counselling/financial counsellor':* Borrowers in financial difficulties would be less likely to be attracted to use the services of persons who will charge them for their services, and where there are no requirements in respect of their skill or competency levels. These consumers may otherwise find themselves both liable to pay fees and in further financial distress.

Credit Providers and Credit Services Providers

The only class of providers who would be affected would be those who currently use any of these terms, or who propose to do so in the near future. Credit providers and lessors do not use the terms *'Independent, impartial or unbiased'* or *'Financial counselling/financial counsellor'*, as these are used by either brokers or persons seeking to attract persons in financial hardship.

Some businesses are therefore likely to consider whether, rather than ceasing to use a restricted term, they should change their business model so that they meet the conditions to be able to use it. They would presumably only do so where there was a commercial or financial advantage to them taking this course of action.

It is not expected this cost would be significant as it is intended the reform would be quite specific and unambiguous about when the terms can be used.

This measure would enhance competition by promoting an even playing field, where one party cannot unfairly attract more customers by misrepresenting themselves.

In summary this option would result in the following costs and benefits:

- It would have a small impact on a relatively small number of persons or businesses. These persons would incur low one-off costs in changing their marketing or promotional materials, and may incur more substantial costs where they relied on these terms to a significant extent to attract customers.
- Consumers would be at less risk of being confused or misled by advertising, and could be expected to make better decisions about which service or lender to use. This has the potential to save them money, as discussed above (for example, by not paying for financial counselling services).

Stakeholder views

The status quo was supported by the ABA and AFC, who claimed that the prohibition on false and misleading conduct under the ASIC Act was sufficient. The MFAA claimed there was no evidence of misuse to justify further regulation.

The FBAA noted that it had not received negative feedback as to the misuse of certain words or expressions. It also stated that the restriction on the term 'pre-approved' is consistent with existing practices, in that its members can only use the term 'pre-approved' where a formal approval in principle by the lender has actually occurred and any conditions specified by the lender have been met.

FOS recommended the use of 'ombudsman' be restricted.

Consumer groups supported the proposals in the Green Paper.

The Australian Financial Counselling and Credit Reform Association (AFCCRA), the peak body for government and not-for-profit financial counsellors, supported the restricted use of the terms *'Financial counselling/financial counsellor'*, and provided a range of examples where the terms were currently used by commercial businesses.

Recommended option

Option 5.2, restricting the use of a limited number of terms, is the recommended option. It is considered this option will reduce, in a number of key areas, the potential for confusion and therefore improve consumer choice in relation to both credit and credit services. The reforms could be expected to provide them with financial benefits by reducing the extent to which:

- they take up invitations for credit that are not necessary (particularly in respect of credit cards where higher interest rates can be charged relative to other mainstream credit products).
- enter into more expensive credit contracts where the broker was remunerated by commission.
- enter into contracts that do not contain the statutory protections that will apply to reverse mortgages.

- use fee-charging alternatives where financial counselling services would be more appropriate, and where the lack of any training or competency levels for those alternative services may exacerbate existing level of financial hardship or distress.

The financial impact on persons engaging in credit activities is minimal in that, first, it does not affect all persons but only a relatively small class, and, second, the compliance costs are not significant. Given the outcomes for consumers above, the cost-benefit analysis supports this reform.

ISSUE SIX - CANVASSING OF CONSUMER CREDIT AT HOME

Problem Identification

The detailed analysis below is based on two substantial studies of the psychology of door-to-door selling. The first report is a 2010 Australian research project by Deakin University and Consumer Action Law Centre, '*Shutting the gates*'[43] ('CALC Report'), which examined the sale of educational software programs door to door. The report is particularly relevant as it includes information from interviews with former salespersons, who articulated the way in which they would use the nature of the home environment to manipulate the consumer into agreeing to the purchase.

The second report is a 2004 English study prepared by the University of Sussex for the Office of Fair Trading, '*Psychology of buying and selling in the home*'[44] ('OFT Report'). It is considered to be relevant to the Australian market given the similar cultural and behavioural dynamics in Australia and the United Kingdom.

In this RIS the term 'unsolicited selling' is used to describe selling arising from both door-to-door canvassing by the salesperson and from situations where the consumer is initially approached by telephone and an appointment in the consumer's home is arranged, including scenarios where the consumer has provided their contact details for another purpose (for example, from entering a competition[45] or by misrepresenting that the purpose of the visit was not to sell the item but to give the consumer a chance to win it for free).[46]

Overview

There are significant differences for a consumer between the sales interaction in a standard retail environment and one in their own home:

- The consumer has not expressed an interest in the goods or services, and must be convinced that they have a need for them in the course of the visit, in order for a sale to be secured. The salesperson is driven by a greater need to sell to the consumer they are dealing with relative to a person in retail premises who can rely on a regular supply of potential customers.

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[43] Consumer Action Legal Centre and Deakin University, *''Shutting the Gates: An analysis of the psychology of in-home sales of educational software*", March 2010

[44] University of Sussex for Office of Fair Trading, *"Psychology of buying and selling in the home, Annexure F of the doorstop selling report"*, May 2004

[45] Consumer Action Legal Centre, 4

[46] ACCC News Release, *'Door to door sellers must clean up act after ACCC action against Craftmatic'*, 19 June 2009 (reporting the results of of court action by the ACCC against Craftmatic Australia Pty Ltd (Craftmatic), in which Craftmatic admitted that its in-home sales process had subjected senior citizens to unfair tactics and pressure to buy a bed, which could cost up to $15,000).

- The fact the transaction is being negotiated in the consumer's home makes them susceptible to psychological manipulation in a number of ways that are not present in a traditional retail sales context (or only present to a lesser degree). These can range from implicit factors (for example, people tend to treat persons invited into their home as guests, making it an environment for reciprocity, that is, responding more positively to requests[47]) to overt tactics (for example, the salesperson can tell the consumer they need to 'sign the contract now', as they will not be visiting this area again).

- The consumer is usually unable to compare the cost of alternative or similar goods or services, except by asking the salesperson to leave and return later. The limitations in making comparisons are exacerbated where either the goods are unique so that exactly the same product cannot be purchased elsewhere, or the goods are complex or unfamiliar so that consumers have more difficulty relying on their previous experience of knowledge of the goods.

- The consumer may also be unable to access alternative or cheaper sources of finance. This is a particular issue for low-income consumers who, should they decide to purchase the goods or services, do not have a credit card or cash available and must depend on the finance offered by the retailer (irrespective of the cost of this option).

- The consumer cannot simply walk away from the transaction by leaving the retail store. Instead they have to ask the salesperson to leave, and depend on them complying with that request. This requires a level of assertiveness by the consumer, and also establishes a dynamic in which the salesperson can manipulate this situation (for example, by deflecting the request or indicating they intend to finish their presentation).

The different dynamic in the relationship between the consumer and the supplier where the transaction is being negotiated in the home of the consumer means that the consumer may enter into a contract as a result of the operation of factors rather than being based on the price or quality of the goods or services being offered, or the terms of any finance arrangement.

It can be expected that retailers would target consumers where their sales practices are more likely to be effective, and where therefore the consumers are more susceptible to manipulation, and who are more likely to ultimately acquiesce to a purchase. This class of consumers can be broadly defined as persons who are either on low incomes or are otherwise at a disadvantage in their dealings with the retailer. The correlation between unsolicited selling practices and the targeting of more vulnerable consumers has been identified in a number of reports as follows:

- A 2002 National Competition Policy review of the NSW Door-to-Door Sales Act 1967 found direct selling practices were directed towards and were more effective in respect of vulnerable groups in society, including the elderly (especially older women living alone), consumers with poor understanding of English and the disadvantaged. Many direct selling firms were also found to target particular suburbs or areas, including those with a high percentage of public housing.[48]

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[47] Office of Fair Trading, 9

[48] National Competition Policy Review: *Fair Trading Act 1987 and the NSW Door-to-Door Sales Act 1967*, p. 49. http://www.fairtrading.nsw.gov.au/pdfs/About_us/ftadtdreport.pdf

- The Financial Counselling Resource Centre undertook a study in 2009, based on 81 case studies from current and recent clients involving electricity, gas and water issues. 49 It found door-to-door marketing techniques to be the largest source of consumer detriment for low income consumers, including the vulnerable such as newly arrived immigrants, people with language or literacy difficulties, those experiencing mental health issues and the disabled.

- The CALC report found a statistically significant relationship between the consumer entering into a contract and their level of education; door-to-door selling is more likely to be effective the less educated the consumer was.[50] Given the relationship between education and earning power, it also follows that low-income consumers are more likely to enter into these contracts.

The proportion of sales that can be made to more vulnerable consumers is higher for the following reasons:

- They are may be less likely to have access to other ways of purchasing items, for instance online retail sales.[51]
  They are less likely to be resistant to sales tactics (either because they are less assertive or confident, or have less commercial sophistication) and may have less knowledge about alternative and cheaper options.

State regulatory agencies report relatively high and consistent levels of complaints in relation to unsolicited selling, reflecting the risks for consumers inherent in this type of conduct. The December 2009 RIS prepared for the Australian consumer law reported the following levels of complaint:[52]

- over the previous two financial years, CAV received 1,056 complaints and enquiries about unsolicited selling;

- over the previous three financial years, NSW Fair Trading received 2,015 complaints and 3,229 enquiries about door-to-door selling and telephone sales;

- over the previous two financial years, the South Australian OCBA received 872 complaints and enquiries annually about unsolicited selling generally; and

- the Queensland OFT received over 125 enquiries per month, on average, about door-to-door sales.

A. Psychological factors present in door-to-door sales

Consumers tend to interact differently with a salesperson when they are present in their own home, compared to the interaction in a store. Consumers can experience a different range of psychological factors that are more likely to prompt behavioural responses that result in them being more likely to buy the goods or services being offered. The nature of

49 FCRC (2009) *Still an Unfair Deal? Reassessing the impacts of energy reform and deregulation on low income and vulnerable consumers*, see http://www.fcrc.org.au/files/YIDOUVF93M/FCRC_Still_an_Unfair_Deal_-_FINAL_REPORT.pdf. While the study is based on the selling of services other than credit it is still relevant because of the analogies between the two services (in that both involve regular payments over time).

50 Consumer Action Legal Centre, 92
51 Consumer Action Legal Centre, 92
52 Page 12

these factors means that consumers cannot readily identify or address the factors triggering particular reactions or prompting them to act in a particular way.

The CALC Report summarised the effect of these factors as follows: 'while the macro-objective of the whole process is the purchase, each phase of the process is structured to achieve a micro-objective. The sale process should be seen as a succession of progressive steps, which incrementally seek a larger commitment from the consumer, as such, the sum of psychological effects (rather than a single factor) will influence the consumer's response and reaction.'[53]

There are seven significant behavioural tendencies commonly present in the door to door context (that are not present in a retail sales environment, or only present to a much lesser degree).

1. **Consistency and commitment.** People are strongly motivated to appear consistent due to a tendency to believe that their behaviour is correct where it is consistent with a prior commitment,[54] and a fear that if they act inconsistently with previous behaviour they will present themselves as either two-faced or confused.[55] Studies show that an initial commitment to a baseline (often irrefutable) proposition will lead them to incrementally agree to a request that is presented as consistent with that proposition.[56] This is particularly significant in the door-to-door context, in that once a consumer has agreed to the salesperson entering their home they will consider it is either inconsistent or rude to ask them to leave, at least without hearing their presentation. This technique is also used to gain the consumer's consent to a visit where the approach is made by way of telephone, described as a 'foot in the door'. For example, one method is to disguise the effect of the initial approach along the following lines: 'Thank you for answering our short survey. We note your interest in your children's education and would like to make an appointment to speak to you about it'.

   This technique is exemplified by sellers of educational software for the children of the consumer. The baseline agreement will be obtained through seeking affirmative responses to propositions such as: 'So education is important to you then? It sounds like, as a parent, you want to provide as much opportunity as you can to reach [your children's] potentia1?'[57]. The salesperson will then seek further agreements with statements that make it progressively more inconsistent and psychologically difficult for the consumer to ultimately refuse to buy the product, as it will imply they are parents who are unconcerned about their children's future, when they have previously agreed they are. One salesperson of an educational software product described this process as follows: 'the sales routine ... was often described as a sheep paddock, where you would go around shutting the gates as you went through your routine. So that at the end, the only gate left open was to buy'.[58] The sale would then be concluded by the salesperson not giving the consumer a choice as to whether or not they want to sign the contract but rather by presenting it as a consistent and inevitable outcome of the earlier discussions, through framing the request as '...so if you could just sign here?'.[59]

[53] Consumer Action Legal Centre, 100
[54] Consumer Action Legal Centre, 34
[55] Office of Fair Trading, 19
[56] Office of Fair Trading, 19
[57] Consumer Action Legal Centre, 43 (take from actual sales script)
[58] Consumer Action Legal Centre, 117
[59] Office of Fair Trading, 20, Consumer Action Legal Centre, 41

2. **Reciprocity:** This is a norm leading people to feel the need to repay a favour, gift or concession. [60] A concern about being viewed as a 'freeloader' leads to a deep sense of unease when feeling indebted, and the need to demonstrate in a clear way their recognition of the generous nature of the person offering the gift by a similar response to 'equal the score'.[61]

   In the door-to-door context the need to reciprocate can arise simply through the visit of the salesperson; persons who have purchased items via doorstep selling have stated that they felt indebted to the seller for the time had spent with them[62]. The provision of small gifts, samples or price reductions are techniques that a seller can use to further engage this norm[63]. The OFT Report found gift-giving to be the most common theme in consumer accounts about behaviour of sales representatives, with one salesperson telling OFT that gift-giving 'works quite nicely because then you get an emotional attachment and the client is then obligated to you'.[64]

3. **Scarcity, the endowment effect and anticipated regret**: Making a product or service appear scarce has been shown to have two behavioural effects. Firstly it enhances the perceived value of the product, with its scarcity providing visible social proof that other people think the product is valuable.[65] Secondly it can induce fear or a sense of anticipated regret if the consumer will be unable to choose the product in the future.[66] The mere fact of being prompted to imagine ownership may also lead to the consumer experiencing a sense of pre-emptive loss in forgoing the product.[67]

   This characteristic of human behaviour is known as the endowment effect. It is an inherent feature of door-to-door selling in that the availability of the product is dependent on the presence of the salesperson in the consumer's home. The salesperson can then deliberately heighten its effect by statements that emphasise the limited availability of the product; for example, that the deal is only available 'right now – during this visit'[68]. These types of comments can encourage a consumer to anticipate the possible regret they may feel if they do not accept the offer.

   The sales script for one provider of educational software programs trained salespersons to use the following statements: 'In each area we take no more than 100 enrolments. Just like a school, once we reach our 100 quota, we close enrolments and move to the next area'.[69] Techniques such as these are designed to both preempt responses that the

[60] This heuristic exists in every know society that has been investigated. A Gouldner, *"The norm of reciprocity: a preliminary statement"*¸American Psychology Review 1960, 25 in Consumer Action Legal Centre, 45
[61] Office of Fair Trading, 16 – 17
[62] Consumer Action Legal Centre, 46
[63] Cialdini (2001, 29) reports the "incredible success of a company called Amway, whose door-to-door sellers had an 'unbelievable increase in sales' when they left a free collection of Amway products... in the consumer's home." Office of Fair Trading, 17
[64] Office of Fair Trading, 59
[65] R Cialdini, "*Influence: Science and Practice*" (1st Ed) 1985 in Consumer Action Legal Centre 36, 65
[66] Office of Fair Trading, 22 -23
[67] Office of Fair Trading, Page 22- 23

[68] For example, Craftmatic would offer reluctant or hesitant consumers a number of discounts that were described as being 'special discounts' only available to limited consumers and only available that day. In reality, the discounts were offered to every consumer who resisted the sales process. ACCC News Release, *'Door to door sellers must clean up act after ACCC action against Craftmatic'*, 19 June 2009

[69] Example of sales script "*In each area we take no more than 100 enrolments. Just like a school, once we reach our 100 quote, we close enrolments and move to the next area*". Consumer Action Legal Centre, 65

consumer will 'think about it', and create a sense of urgency, through potential loss of access to the product, that can be entirely controlled by the salesperson.

4. **Anxiety:** Individuals who are more anxious by nature are more likely to be influenced by appropriate prompts in their decision-making.[70] They are also more likely to make decisions in favour of an option perceived to address that anxiety.[71] The creation and alleviation of anxiety is therefore an important aspect of door-to-door selling, with products more likely to be promoted successfully where they have characteristics that allow for this dynamic to be articulated by the salesperson in their presentation.

   Three of the most common products marketed door-to-door in the last decade – security alarm systems, water filters and educational software – all had features that enabled the salesperson to initially engage the consumer by discussing matters likely to make them anxious. These examples illustrate that the pressure created by anxiety is not simply an incidental feature of door-to-door selling but is a constant aspect because of its power to induce consensus from an otherwise reluctant purchaser. A salesperson of education products succinctly expressed this approach: 'the first half of the presentation was to generate anxiety; the second half was to solve the anxiety'. [72]

   Security alarm systems were a product that could be readily marketed through techniques designed to elicit a sense of fear in the consumer. Selling practices consistently sought to personalise the potential sense of harm the consumer was at risk at through, first, statistics about the level of violent crime in their local area, and, second, visual images (both through photos and DVDs) of persons after they had been attacked.

   Water filters have been actively marketed on the basis of the health risks resulting from drinking unfiltered water. Marketing tactics can include the salesperson 'testing' tap water to reveal that it is polluted or contaminated; referring to government initiatives to give a false legitimacy to claims about the nature and extent of problems; and suggesting that impure water is responsible for causing a range of illnesses (from skin problems to cancer and deformities in babies[73]).

   Educational software programs for children are promoted on the basis that otherwise the borrowers' children will fall behind in school, and that their education will be compromised, seeking to trigger a parent's natural desire for their children not to be disadvantaged. One of the techniques used in some presentations was to have the children undertake a ranking assessment on a program provided by the salesperson, with the difficulty of the assessment deliberately understated by the salesperson. The effectiveness of the sales techniques that can be employed with these types of programs has resulted in a recent proliferation of these types of schemes, and in consequent warnings in every Australian jurisdiction.[74]

[70] Consumer Action Legal Centre, 37

[71] R. Raghunathan and M Pham, *'All negative moods are not equal: motivational influences of anxiety and sadness in decision making'* , Organizational Behaviour and Human Decision Processes, 1999, 79 in Consumer Action Legal Centre, 68

[72] Consumer Action Legal Centre, 110

[73] Consumer Affairs Victoria, Consumer Alert, *'Salespeople playing dirty tricks with clean water*', 13/02/2003 and Brisbane Times, "*Qld 'cancer water' company fined*", 04/05/2009

[74] Consumer alerts have been issued by every State and Territory fair trading authority with the exception of one in relation to educational software products. It was reported in WA Hansard that in the 12 months to 20 September 2007 the WA

5. **Trust, liking and similarity:** Salespersons can use their presence in the consumer's home to encourage the consumer to develop a sense of trust in their relationship. This trust is initiated by the invitation to the salesperson to enter their home, but can be fostered through techniques such as commencing the interaction with a conversation with the consumer, the disclosure of personal information, or pointing out similarities between themselves and the consumer (using the information visually available in the consumer's home). Studies show that a 'dialogic' conversation as opposed to a monologue can lead to an increased compliance with requests by simulating the type of relationship one might have with a friend.[75]

   For example, one sales scripts for in-home sales requires that, prior to discussing a product, a seller create 'small talk, expand on every question, create a 10 minute conversation...build rapport with the whole family...show empathy in their answers, particularly the older children'.[76] In the words of a salesperson the intimacy and familiarity this interchange 'makes it very difficult for that person to then, sort of – slap you in the face, and say no'.[77]

6. **Authority and expert endorsement:** Studies have demonstrated that deference to perceived authority is a strong social norm, and that the expression of an opinion perceived as expert opinion can therefore be influential in the formation of a person's opinion and behaviour.[78] Products being marketed door-to-door are usually not readily available elsewhere, as otherwise the consumer is less likely to be attracted into making a purchase (because they can easily obtain them from alternative sources). The salesperson is therefore able to present themselves as having a detailed and superior knowledge of the product relative to the consumer, and position themselves as an expert, where either the goods are unique and have no mainstream retail counterpart (as in educational software) or the goods are complex or not readily available (burglar alarm systems).

   It is typical for door-to-door operations to use a range of techniques to bolster their perceived expertise. These techniques include: references by third parties who endorse their products, to generate a higher level of trust in the product (noting that consumers are unlikely to question the legitimacy or independence of the endorsement[79]); the use of brand names to give an impression of expert impartiality or credibility (through, for example, titles such as the 'Australian Institute' to suggest, without being misleading, that the organisation is associated with the government[80]); the use of statistics to provide a heuristic shortcut for the consumer in relation to the product's quality[81]; or, in relation to educational software programs, taking on the role of a teacher by conducting

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Department of Consumer and Employment Protection received 26 complaints about 5 separate maths-tutoring software companies (WA Hansard, Assembly, 20 September 2007, 5492 – 5493).

[75] Dolinski, Nawrat, and Rudak, *Dialogue involvement as a social influence technique*, Personality and Social Psychology Bulletin, 2001, 27 in Consumer Action Legal Centre, 44

[76] Consumer Action Legal Centre, 44 (actual sales script).

[77] Consumer Action Legal Centre, 108 (from interview)

[78] S Chaiken, "*The Heuristic model of persuasion"*, Papers from the 5th Ontario Symposium on Personality and Social Psychology, 1984, 3 – 39 in in Consumer Action Legal Centre, 35 see also S Milgram, '*Obedience to Authority. An experimental view* 1974, 26 in Office of Fair Trading, 9.

[79] Office of Fair Trading,, 27

[80] Consumer Action Legal Centre, 52, note also Consumer Affairs Victoria, Consumer Alert *'Sales tactics to seniors'*, 11/10/2010 "one tactic used to create the impression that the salesperson is associated with a health or welfare organisation is to offer the older consumers free, in-home health appraisals."

[81] Consumer Action Legal Centre, 58

assessment exercises on the children of the consumer.

It is noted that Consumer Affairs Victoria warned consumers in an alert of door-to-door salesmen selling water filter products who were implying an affiliation to government by both using the 'Target 155' water conservation campaign logo, and labelling their flyer as a 'Public Notice' and part of an 'Annual Water Quality Review'. [82]

7. **Intimidation:** The fact that the salesperson is present in the residence of the consumer means they can refuse to leave until the consumer has entered into the contract. The refusal is rarely explicit in nature, with the salesperson rather deflecting the request to leave or continuing the presentation until the consumer is worn down and sees no other option available. Complaints of this type are a regular feature of door-to-door sales; it is believed that the level of complaints underreports the extent of the conduct, given the embarrassment to the consumer in having to admit they were unable to have any control in their relationship with the salesperson.

   It is also necessarily the case that the class of consumers most likely to be affected in this way will be vulnerable and unable to protect their own interests by being assertive enough to have the salesperson respond to requests to leave. They are therefore also unlikely to complain once the retailer has left.

B. Particular Issues in relation to Indigenous communities

In some Indigenous communities, the door-to-door supply of whitegoods and household furniture on finance is relatively common. These contracts are often structured as leases for an indefinite term, and are therefore unregulated by the Credit Act. The particular difficulties associated with the use of this type of contract discussed in detail in the RIS on consumer leases.

There are a number of distinct issues for these communities that make them more susceptible to entering into contracts to purchase goods sold door-to-door, irrespective of the price or quality of the goods, or whether or not they are needed, and to suffering loss or damage as a result.

These issues are:

- There is a documented cultural tendency for 'gratuitous concurrence' – this manifests itself as a propensity to agree with a person to avoid offending them (commonly by saying 'yeh, yeh'), and is not a positive reply that reflects actual concurrence.[83]
- This tendency can be more pronounced for Indigenous women in these communities. The case of *ACCC v Keshow*[84] involved a trader selling educational materials in remote communities with no written contracts and securing payment through direct debits (timed to coincide with Centrelink payment dates) with no end date. [85] The court found that natural 'reticence, diffidence'[86], limited commercial experience, geographic

[82] Consumer Affairs Victoria, Consumer Alert, '*New tactics by water filter salespeople*, 03/08/2010

[83] Indigenous Consumer Assistance Network, '*Unconscionable Conduct and Aboriginal and Torres Strait Islander Consumers*', 2010, 19

[84] *ACCC v Keshow* [2005] FCA 558 at 85

[85] The lack of documentation meant that these contracts, while functionally similar to credit contracts, were not regulated as credit under the UCCC.

[86] *ACCC v Keshow* [2005] FCA 558 at 108

isolation, lack of education and low income all were factors that demonstrated the dealings to be unconscionable.

- Many of the people in these communities will experience language difficulties, as English may be only their second or third language.
- For communities in Far North Queensland or the Northern Territory there may be no means of reasonably accessible advice, severely limiting the capacity of borrowers to seek assistance or remedies.
- As discussed in more detail in the RIS on leases, consumers may be provided with goods by operators who have no other markets or infrastructure, and who operate, in effect, as distributors of the goods only, so that consumers cannot obtain repairs for defective goods or have complaints addressed.
- Low levels of financial literacy, language barriers and limited economic experience mean that for Indigenous consumers in regional and remote areas of Australia the contracts and documentation associated with the purchase of goods and services sold door-to-door on finance are complex and difficult to comprehend.[87]

C. The role of finance in door-to-door selling

Businesses selling goods or services door-to-door usually have an existing arrangement with a financier who will provide finance to consumers. These arrangements are essential as they enable the salesperson to increases the class of consumers to whom the products can be sold. Otherwise, irrespective of whether the outcome of the sales presentation was agreement by the consumer to purchase the item, there would still be some consumers who could not afford to pay for it, or would use this as an easy method of refusing to buy it.

Door-to-door selling through these types of linked finance arrangements creates additional risks to consumers, because they are entering into two transactions with two different parties, and taking on a greater liability through the finance contract than if they were paying cash.

This creates the following problems for consumers, where they use the finance arranged by the salesperson.

1. **Flexible pricing.** Regulators and consumer advocates consistently report that there is a significant degree of flexibility in the cost of products sold door-to-door, and that the salesperson can increase the cost of the product according to the circumstances of the person they are dealing with. For example, the price of largely similar educational software can vary from between less than $500 to more than $6000, with credit charges then also payable.[88] Similarly, water filters (that have only a nominal value) have been sold for $3000 with the price increased through the addition of maintenance services.[89] This results from the dynamics of the relationship in the door-to-door context, where the decision to purchase is not primarily based on the cost or quality of the goods, and where therefore the price does not need to be competitive.

   The availability of linked finance arrangements can result in consumers paying more in

[87] Indigenous Consumer Assistance Network, 7 -8
[88] Consumer Action Legal Centre, 93
[89] Consumer Affairs Victoria, Consumer Alert, '*New tactics by water filter salespeople*, 03/08/2010

two ways. First, the cost of the product can be increased and matched to the amount of credit the consumer can afford. The CALC Report found that people who used finance provided by the sales representative were significantly more likely to be charged a higher amount for the educational software programs.[90] This suggests that the availability of 'on the spot' finance is an integral part of these transactions and that it can increase the cost of the goods to the consumer.

Secondly, the presence of two separate transactions allows for costs to be moved between the finance contract and the sale contract, to suggest the consumer is obtaining a benefit when this is not the case. For example, in the door-to-door context, significant use has been made of 'interest free' finance deals where the supplier paid an amount equivalent to interest to the financier and included this cost in the amount charged to the consumer (necessarily increasing the cost of the product significantly above its retail price).[91]

2. **Lack of remedies against financier for conduct of retailer**. While the consumer enters into a contract with a financier they usually do not have any direct contact with this entity. Accordingly, the consumer will not necessarily find it easy to obtain a remedy against the financier because of the conduct of the salesperson. This problem was discussed in detail by National Legal Aid in its submission to the Green Paper. It commented that: 'by the time the consumer feels confident enough to complain about the quality of the goods purchased the company selling the products is usually un-contactable or no longer financially viable. As a consequence, vulnerable consumers, who in many instances suffer from poor English and financial literacy, are often left with a product that has little value and a finance contract paying for the goods that has 2-5 years still to run on the product.' [92]

   It is noted that the Credit Act does make the financier liable to the consumer for the conduct of the supplier in some situations. However, the way in which these remedies are currently structured means that consumers cannot easily use EDR schemes to provide them with compensation. In practice the consumer's only avenue for obtaining redress may be court action, which is often not a viable option.

3. **High cost of credit and lack of competition.** The cost of credit charged by financiers in door to door transactions is typically high relative to other forms of credit (and, in particular personal loans or credit cards which are the alternative products available to finance these purchases):

- Educational software programs were often financed through credit contracts with interest rates at 24 per cent.[93]
- The 'interest free' finance arrangements discussed above had underlying exchanges of money between the supplier and the financier that resulted in the consumer paying effective interest rates up to 24 per cent.

[90] Consumer Action Legal Centre, 93
[91] *Australian Finance Direct Limited v Director of Consumer Affairs Victoria* [2007] HCA 57
[92] National Legal Aid, Response to Green Paper on National Credit Reform, 44 - 45
[93] Consumer Affairs Victoria, Consumer Alert, *'Parents warned about aggressive sales techniques'* , 03/02/2008

- As discussed in more detail in the Chapter on leases, consumers were charged a cost of finance equivalent to interest rates of 109 per cent.

These costs are the result of the context of the decision-making process in the door-to-door environment. The analysis of the psychological factors set out above indicates that the decision to purchase goods or services will be made separately from and prior to the decision in relation to the finance arrangements to pay for the purchase. The consumer will give little separate consideration to the finance decision as they are already committed to the purchase. There is therefore an absence of competitive pressures, in the sense that the cost of credit will not affect whether or not the consumer enters into the contract.

Objective of Government Action

The objective of government action is to promote the operation of fair and efficient markets by providing appropriate consumer protection in situations where the consumer is subject to an added vulnerability or disadvantage due to the nature of the sales process.

Options

Option 6.1 Maintain the status quo

Under this option, there would be no change to the current regulatory arrangements. Niche businesses would continue to sell goods or services door-to-door via linked credit and these practices would continue to be associated with the same problems.

Impact Analysis

Under this option, there would be no new impacts on consumers and business. The detriment caused by these types of sales is likely to continue to fall disproportionately on low-income consumers, and to therefore have a greater impact on them relative to someone who has a greater disposable income.

Option 6.2 Prohibit the unsolicited financing of goods door-to-door, through credit contracts or leases

Under this option:

- The unsolicited selling of credit and leases door-to-door would be prohibited, even where it was provided incidentally to the sale of goods and services.
- The prohibition would only apply where the salesperson acts as an agent for the financier or has arrangements with a financier (for example, a consumer could still make a purchase using their current credit card).
- The prohibition would apply where the salesperson contacts the consumer without prior arrangement, and 'prior arrangement' would be defined so that it does not include situations such as a consumer giving their contact details for another purpose (such as a competition) or when returning a missed call.

Impact Analysis

Consumers

As noted above, there is a significant correlation between whether or not a consumer enters into a credit contract or lease as a result of unsolicited selling and their income, with door-to-door selling more likely to be effective to low-income consumer. The benefits of a prohibition will therefore have a significant impact on this class of persons, and enable them to make more effective purchasing decisions with relatively limited income.

Consumers who wish to purchase items currently being sold door-to-door via linked credit would have the alternative option of purchasing the goods through cash, using their own credit card, or arranging their own finance. This would enable them to make separate decisions in respect of the goods or services, and the means of finance, and this should result in:

- consumers not being pressured into more expensive finance options through unsolicited selling; and
- being able to refuse to purchase or acquire the goods because they cannot afford them, with the salesperson having to accept this as a legitimate reason, without then being able to offer their own finance arrangements.

They could also choose to actively seek out these goods or services and purchase them directly from retailers. The proportion of the population that lives in very remote communities, with limited access to retail outlets will need to make other arrangements, consistent with the current practices of those persons who obtain goods and services other than through unsolicited selling.

Credit providers, lessors and credit service providers and door-to-door retailers

67 of the 6,836 persons who had applied for an ACL with ASIC by 31 December 2010 nominated their function as 'Door-to-Door or Phone Sales'. This figure provides a reasonable estimate of the maximum number of businesses that may be affected, noting that these persons would self-identify their functions when applying to ASIC. It is possible that not all of the 67 persons use a business model that would constitute unsolicited selling.

It is considered that the majority of these persons will be providers of credit services rather than credit providers or lessors, as there are only a small number of financiers operating in the unsolicited selling sector.

Door-to-door selling of goods and services can continue to happen, but goods and services will not be able be purchased (on the spot) with linked finance. Purchases will continue to be possible via cash, direct debit, or a person's own (pre-existing) credit card. A person will also be able to choose to seek finance themselves to fund the transaction. For a door-to-door salesperson this means that there may be a reduction in 'immediate' sales where a person could not otherwise afford the product but for the credit. This may require some businesses to adopt different business models, where they are required to offer goods or services that are of a quality or nature that will attract custom in themselves, rather than the salesperson being able to rely on the psychological advantages available when operating in the home environment.

The impact on credit providers, lessors and credit service providers will therefore be proportionate to the extent their practices rely on psychological manipulation; those who are most dependent on it to achieve sales will have to make greater adjustments to their business, while those already offering goods or services that are attractive will have to make minor adjustments. This would be an intended consequence of any regulation.

In summary this option would result in the following costs and benefits:

- A relatively small number of businesses who engage in unsolicited selling practices may need to change their business practices, in particular by changing the nature of the goods or services they are retailing.

- Consumers, disproportionately those on low income, would be able to make better purchasing decisions in respect of both goods and services being offered door to door, and the type of finance used to acquire those goods. This could be expected to save consumers thousands of dollars, either because they do not enter into contracts in the first place, or because they use cheaper options to finance the purchase.

Option 6.3 Educate consumers about the risks associated with door-to-door selling

This option would see the use of education or information campaigns to encourage consumers to be more assertive in their dealings with door-to-door retailers, and more selective in their choice of goods and services.

It would operate by:

- utilising education campaigns to provide short messages to consumers, for example informing them of their rights in relation to unsolicited selling, and advising them to shop around for better deals (with these campaigns potentially targeted at 'high risk' categories of consumers); and

- allowing credit providers, lessors and providers of credit services to continue offering products as a result of unsolicited selling practices.

Impact analysis

This approach would have the following impact:

- It would only have an impact on those consumers who receive and absorb the message.

- It would require these consumers to be able to use the information in a way that overcomes the psychological factors associated with selling in the home.

- Credit providers, lessors and providers of credit services would only change their business models if the results of the education campaign were effective in changing consumer behaviour.

This option would result in limited benefits to consumers relative to the other options, in that the factors above suggest only a relatively small class of consumers can be expected to respond to the education campaign. Credit providers and lessors, and retailers, would not be required to incur any upfront costs. They would only need to make changes, particularly in relation to the types of goods and services they market, where there is a significant change in consumer behaviour resulting from the education campaign.

In summary this option would result in the following costs and benefits:

- There would be no immediate impact on those businesses who engage in unsolicited selling practices. Some may need to change their models over time, where consumer education is particularly effective.

- Consumers who absorb the education messages would be better able to refuse to enter into contracts as a result of unsolicited selling practices. However, this is still likely to result in continuing levels of sales to some consumers (and by definition to a more vulnerable class, who do not understand or appreciate these messages).

Stakeholder views

Of the 56 formal submissions to the Green Paper, nine provided comments on this issue. Five were supportive or not opposed to further regulation. One was neutral on the proviso that it did not impact on legislation regulating the privacy of individuals in relation to credit matters. One was directly opposed to further regulation, and two believed that there was insufficient evidence to support further regulation.

Supportive of further regulation

The Brotherhood of St Laurence, supported expanding the anti-hawking provisions to credit, including credit offered incidentally for the financing of goods and services in a persons' home, noting that 'the decision to enter into a consumer credit contract is a significant one—and one that could result in financial hardship—there is no reason to see why consumer credit products should be treated any differently from other financial products and services'.

Good Shepherd Youth and Family Service was of the view that there is need to consider further regulation of credit sold door to door to finance the sale of goods and services.

Similarly, the National Financial Services Federation view was that that hawking provisions in the Code should reflect that hawking provisions elsewhere.

National Legal Aid agreed with the concern that the provision do not adequately cover telemarketing and forms of unsolicited contact such as 'invited' home visits or the sale of linked credit, and argued that all should be further regulated.

Door-to-door selling is not generally a distribution channel used by mainstream credit providers. However, the ABA noted it would be comfortable with the government considering reform if market failures warranting regulatory intervention have been identified.

Both CALC and CCLC supported the extending the current prohibition on doorstep canvassing of credit to credit that is incidental to the unsolicited sale of goods or services. CALC notes that the availability of credit is often a powerful tool in a range of high pressure selling situations, and such availability can enable expensive sales to proceed where they may otherwise have not. CCLC suggests that section 156 should be widened to there should be a prohibition on consumers entering into credit contracts by signing them in their home when a sales person, broker or credit provider is present, on the basis that the consumer is always vulnerable to hard selling in their home.

Not supportive of further regulation

Both GE Finance and the AFC stated that they were not aware of evidence that would justify additional regulation.

Qualified support

The Office of the Privacy Commissioner noted that 'any changes to the regulation of unsolicited sales of credit that are inconsistent with the privacy protections in the *Privacy Act 1988* would be a departure from current policy. The Office believes that any such departure would need to demonstrate significant community benefit and be accompanied by strong privacy protections'. It is not envisaged that the Options would be inconsistent with the *Privacy Act 1988*.

Recommended option

Option 6.2, prohibiting the unsolicited selling of credit and leases door-to-door, is the recommended option.

Attachment A – Members of consultation groups

Members of the Industry and Consumer Representatives Consultation Group	
Industry representatives	**Consumer group and legal representatives**
Australian Finance Conference	CHOICE
Australian Bankers' Association	Consumer Credit Legal Centre (NSW)
ABACUS Australian Mutuals	Consumer Action Law Centre
National Financial Services Federation	Law Council of Australia
Mortgage and Finance Association of Australia	**Dispute resolution providers**
Finance Brokers Association of Australia	Credit Ombudsman Service Ltd
Financial Services Council (formerly Investment and Financial Services Association)	Financial Ombudsman Service
Financial Planning Association	**Government**
GE	Commonwealth Treasury
Australasian Retail Credit Association	Australian Securities and Investments Commission
	New South Wales Office of Fair Trading (as observer for the States and Territories)

<table>
<tr><th colspan="2">Members of the Financial Services and Credit Implementation Taskforce</th></tr>
<tr><td>Commonwealth
Treasury
ASIC</td><td>Western Australia
Department Of Commerce</td></tr>
<tr><td>New South Wales
Office Of Fair Trading
Department Of Premier And Cabinet</td><td>South Australia
Attorney-General's Department</td></tr>
<tr><td rowspan="2">Victoria
Consumer Affairs Victoria
Department Of Treasury & Finance</td><td>Tasmania
Office Of Consumer Affairs And Fair Trading</td></tr>
<tr><td>Northern Territory
Department Of Justice</td></tr>
<tr><td>Queensland
Department Of Justice And Attorney-General
Department Of Employment, Economic Development And Innovation</td><td>Australian Capital Territory
Office Of Regulatory Services
Department Of Justice And Community Safety</td></tr>
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