

Regulation Impact Statement –
licensing debt management firms

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Background

Debt management firms typically offer consumers four types of services relating to consumer credit:¹

- developing and managing budgets;²
- advising and arranging formal debt agreements under Part IX of the *Bankruptcy Act 1966*;
- debt negotiations with credit providers on behalf of consumers; and
- ‘credit repair’ through challenging default listings and representing consumers in disputes with financial services firms.

Debt management firms are unregulated with the exception of debt agreement activities, which are regulated under the oversight of the Australian Financial Security Authority (AFSA). Debt agreement administrators assist debtors to prepare debt agreement proposals and administer debt agreements. A debt agreement, also known as a Part IX, is a legally binding agreement between a debtor and a creditor.³ Debt agreement administrators are required to be licensed by AFSA.⁴

Debt management firms, particularly debt negotiators, operate in a space where consumers are at their most vulnerable (i.e. during significant financial hardship). Based on evidence that debt management firms propagate harmful practices a range of industry stakeholders, including consumer advocates, industry ombudsman, credit providers, and industry associations, have independently taken steps to mitigate the detriment caused by debt management companies.

The Australian Financial Complaints Authority (AFCA) recently excluded a debt management firm, MCR Partners, from submitting complaints on behalf of consumers.⁵ The firm was found not to be acting in the best interests of its customers, including by submitting unmeritorious complaints. The

¹ Report 465: Paying to get out of debt or clear your record: the promise of debt management firms, available at: <https://download.asic.gov.au/media/3515432/rep465-published-21-january-2016.pdf> (accessed 3 March 2021).

² Personal budgeting services provide assistance to individuals that are struggling to manage their debts and typically offer assistance to set up a customised budget plan, a customised payment of bills and other debts on your behalf, and will provide an allowance for expenses in accordance with the individual’s savings plan. These services are generally provided for an up-front ‘establishment’ fee, as well as ongoing management fees.

³ Debt agreements are regarded as a flexible way to come to an arrangement to settle debts without incurring bankruptcy. Debtors typically negotiate to pay a percentage of their combined debt so that it is affordable over a period of time, and make repayments to their debt agreement administrator, rather than individual payments to their creditors. After the payments are completed and the agreement ends, creditors cannot recover the rest of the money owed.

⁴ AFSA licence eligibility involves completing the mandatory qualifications in the *Bankruptcy Regulations 1996* (certain tertiary education certificates, diplomas or degrees, or certified accounting qualifications), a criminal database check, demonstrated ability to perform the duties of a debt agreement administrator, and compliance with the obligations as set out in the legislation. A recent determination issued by the Attorney-General’s Department prescribes that, from 1 January 2021, debt agreement administrators will be required to become members of the AFCA in order to meet their conditions of registration.

⁵ Media release: AFCA bans paid representative from lodging complaints, available at: <https://www.afca.org.au/news/media-releases/afca-bans-paid-representative-from-lodging-complaints> (accessed at 12 March 2021).

exclusion represents the first invocation of Rule 2.2, where AFCA may exclude a paid representative from submitting complaints with AFCA if they are engaging in inappropriate conduct which is not in the best interests of their client.

Additionally, there has been some movement from other parts of industry, including the banks, to signal that their customers' welfare is important.

NAB recently announced that it will not engage with any unlicensed debt management firms to protect their customers from being placed in a worse financial position amidst the COVID-19 pandemic. The bank stated that in 2019, almost 20,000 customers sought financial hardship assistance, with 9 per cent of these customers engaging debt management firms. In 2020, the number of customers seeking assistance has exceeded 150,000 as a consequence of the pandemic.⁶ Other banks, such as CBA are reviewing their relationship with credit repair and debt management firms, announcing they were taking steps to terminate arrangements with firms they believe do not act in the best interests of their customers.⁷

The Australian Banking Association has published the Banking Industry Guiding Principles on Debt Management Firms.⁸ The principles are a common approach to communicating with customers who are engaged with debt management firms who may not be acting in the customer's best interests. Banks have indicated that they will refuse to communicate with these entities and instead will deal directly with customers to ensure that only accurate information is being provided.

Stakeholders continue to raise concerns about debt management firms. ASIC have noted that "AFCA and consumer groups continue to raise concerns with ASIC about the conduct of debt-management firms and the potential harms these entities may cause consumers, including that they may provide unsuitable services and engage in predatory conduct".⁹

Treasury estimates that there are approximately 100 debt management firms currently providing debt negotiation and credit repair services across Australia. This estimate is not definitive, given the lack of data gathering available on an unregulated population, but it has been informed by consultation with regulators.

1. What is the problem?

Consumers often seek the support of debt management firms to represent their interests as they

⁶ Media release: NAB cracks down on unlicensed debt management companies, available at: https://news.nab.com.au/news_room_posts/nab-cracks-down-on-unlicensed-debt-management-companies/ (accessed 5 March 2021).

⁷ Banks line up to revoke 'debt vultures' amid rising pandemic debt, available at: <https://thenewdaily.com.au/finance/finance-news/banking/2020/08/07/debt-vultures-nab-banks/> (accessed 1 March 2021).

⁸ Debt management firms, available at <https://www.ausbanking.org.au/for-customers/debt-management-firms/> (accessed at 19 March 2021).

⁹ ASIC - Handling complaints and paid representatives: ASIC provides financial firms with guidance, available at: <https://asic.gov.au/about-asic/news-centre/articles/handling-complaints-and-paid-representatives-asic-provides-financial-firms-with-guidance/> (accessed at 18 March 2021).

experience financial hardship, when they are highly vulnerable. Solutions presented by debt management firms can include directly negotiating with creditors, engaging in dispute resolution schemes, or lobbying credit reporting bodies to have credit reports altered on behalf of the consumer. However, the unregulated nature of the sector has resulted in high-cost and low-value services. For example, consumer advocate groups such as the Consumer Action Law Centre (CALC) have reported instances of consumers being charged fees for no service and receiving conflicting or misleading advice regarding the services being offered. The conduct of these firms and the negative consumer outcomes which arise have been widely reported.¹⁰

The problem is exacerbated by the economic disruptions caused by the COVID-19 pandemic. Based on the current estimates from the banking industry, approximately 10 per cent of consumers who enter hardship have sought assistance from a debt management firm to support debt negotiations. The pandemic has increased the number of individuals experiencing stress, as demonstrated by number of consumers that have sought loan deferrals.¹¹

Research released by CALC in December 2020 found that debt management usage and exposure amongst the community is high. Over the previous 12 months, approximately 1.4 to 1.9 million Australians paid for debt management or credit repair services, and 55 per cent of survey respondents reported that they had seen or heard advertising from debt management firms. CALC's report also found that financial pressures are impacting many Australians, where two in five respondents flagged that they are struggling to pay everyday bills.

Moreover, the outlook for widespread economic recovery remains uncertain. Following the end of bank loan repayment deferrals and the tapering off of Government support payments such as Jobkeeper, there may be an increase in consumers experiencing financial hardship and therefore potentially seeking assistance from debt management firms.

There is strong industry support for reform to debt management firms, reflected in a widely signed industry communique in 2016.¹² This stance remains consistent with the views expressed to Treasury by many of the same stakeholders. Around forty representatives from consumer advocacy groups, industry associations, ombudsman schemes and government regulators called for regulatory reform, asserting that misleading and predatory behaviour can leave consumers worse off. Consumer advocacy groups have consistently argued that engaging a debt management firm can further disadvantage customers already experiencing financial difficulty, as services often offer little value at a high cost.

The problems associated with debt management firms has been explored over the last few years including in a previous 2016 ASIC report, where issues were confirmed by a 2019 Senate Inquiry

¹⁰ Up to 1.9 million Australians paid debt vultures in the last 12 months, available at: <https://consumeraction.org.au/up-to-1-9-million-australians-paid-debt-vultures-in-the-last-12-months-report/> (accessed 29 March 2021).

¹¹ Media release: Temporary loan repayment deferrals due to COVID-19, September 2020, available at: <https://www.apra.gov.au/temporary-loan-repayment-deferrals-due-to-covid-19-september-2020> (accessed 30 March 2021).

¹² Debt management firms, available at: <http://consumeraction.org.au/wp-content/uploads/2016/03/Debt-Management-Firms-Communique-.pdf> (accessed at 30 March 2021).

report. These reports set out a number of case studies which illustrate the problems being faced by consumers in these highly vulnerable situations. Treasury continues to hear these concerns from stakeholders, and receive similar case studies, while the issues raised continue to be reported in the media.

ASIC's report highlighted a tendency for debt management firms to obtain court records about debtors, and use this information to market directly to vulnerable debtors in financial strife.¹³ In doing so, debt management firms may provide assurance to consumers that they can prevent lenders from foreclosing. However, this assertion can be misleading and overly optimistic, as the consumer often has no practicable options to retain their property and it would be in their best interests to proactively sell the property. Engaging a high-fee service, which still results in the sale of the home, generally further exacerbates financial hardship.

More recently, the 2019 Senate Economics References Committee inquiry and report into credit and financial services targeted at Australians at risk of financial hardship (the Senate Inquiry) found that debt management firms operate in an inappropriate manner that does not consider the best interests of customers.¹⁴ In an appearance before the Committee, AFCA testified that debt management firms are prone to overpromising and under-delivering, where the end result is that consumers are often left worse-off. The Financial Rights Legal Centre (FRLC) noted that debt negotiation services have often charged high fees for results which do not solve the consumer's problems. The consumer group testified that they have seen cases where the consumer had "\$150,000 in credit cards and they (the debt management firm) reduces it to \$70,000, they'll take 50 per cent, 40 per cent or 80 per cent of the saving". The high fee therefore means that the consumer has not saved a substantial sum, particularly when free alternatives are available.¹⁵

Case study provided by the Australian Banking Association

Australian banks have limited visibility over the fee structures charged by debt management firms. However, we offer the following observations based on interactions with our bank customers that have engaged such firms.

Fee structures appear to be charged based on the complexity of the overall hardship situation of the customer. At times, ongoing fees can be between \$300 to \$700 per month. These fees can make up roughly half of the total repayments that a customer is obligated to pay each month to their various creditors, placing them into further financial hardship

Case study provided by WEstjustice

Chan arrived in Australia in her adulthood as a refugee, and has limited financial and legal literacy. She fell into severe mortgage hardship after being out of work following an injury, and built up about

¹³ This practice is still ongoing, as evidenced by the *Wade v J Daniels and Associates* case in November 2020.

¹⁴ Australian Parliament House: Chapter 4 – Debt Management, available at: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Creditfinancialservices/Report/c04 (accessed at 18 March 2021).

¹⁵ This was consistent with the findings of ASIC's 2016 Report 465: *Paying to get out of debt or clear your record: The promise of debt management firms*. The report showed that in debt negotiation cases where the firm takes the difference between the balance owed and the amount negotiated with creditors, there may be no net financial benefit to the consumer from the service, after the payment of fees.

\$5,000 in mortgage arrears. She first found out that the situation had escalated when she received a letter from a debt management firm telling her lender was taking her to court, before she had even been physically served with any documents. This was followed up by an unsolicited knock at the door by one of the firm's salespeople.

Chan rang the firm's number and, believing they could help stop the bank from moving on her home, completed online documents signing her up for its services. She did not fully understand everything in the contract, which was densely worded, and later discovered that the fees in the contract were higher than what she had been led to expect on the phone.

When she stopped receiving updates from the firm, she approached WEStjustice for assistance with her mortgage matter. We immediately contacted the firm and demanded they cease performing work for Chan and deal directly with us. Instead, they tried to ring her directly a number of times to pressure her to keep using their service. Chan was never provided with an explanation of exactly what work, if any, they had performed for her.

Chan eventually had to sell her house to avoid repossession. However, days before settlement it was discovered that the debt management firm had placed a caveat over her property, and they refused to remove this until the amount they had invoiced was paid in full. Although it is likely that Chan had strong arguments under the ACL about the firm's conduct and the performance of its services, she did not have time for her financial situation to deteriorate and paid what the firm was asking.

Chan described a feeling of being held 'hostage' by the firm's conduct. She says if she had realised the DMF would be given the ability to place a caveat over her home like it did she would have never made an agreement with it. Our concern is that even if these firms are required to be licensed, opportunistic tactics such as allowing for a charge over property in contracts will continue unless expressly outlawed.

Furthermore, services may be poorly aligned to the customer's financial situation and amplify hardship through a lack of disclosure about important considerations. For instance, firms engaging in credit repair services have been found to make false or misleading representations about the prospects of removing defaults from a credit report¹⁶, and withhold the fact that credit reporting agencies are within their rights to ignore unmeritorious complaints.

Case study provided by WEStjustice

Georgia was attempting to clear her credit record after escaping from a violent relationship. She had a range of utility debts (energy, water, and telecommunications) which had defaulted and been listed. She responded to an ad on social media from a firm which promised to clear her credit record. After an initial call she paid a total of \$1,100 (all of her savings at the time) to the firm.

When Georgia came to WEStjustice two years later, none of the debts had been removed and it was not clear what, if anything, the credit repair firm had done. Ultimately, we were able to get the debts waived promptly on the basis of the family violence circumstances by advocating for Georgia through the respective companies' policies.

¹⁶ Debt vultures prey on vulnerable as pandemic woes rise, available at: <https://www.theage.com.au/national/victoria/debt-vultures-prey-on-vulnerable-as-pandemic-woes-rise-20201106-p56c2h.html> (accessed at 2 March 2021).

When we wrote to the firm demanding a refund for the money Georgia had paid, they offered only a partial refund as settlement. With ongoing family law proceedings occurring, Georgia felt she did not feel able to deal with another legal matter and reluctantly agreed to the partial refund.

Financial firms noted through consultation that there were instances of debt management firms failing to advise consumers of offers from the lender to resolve the debt or advising the consumer against taking offers from their lender – contrary to the best interests of the consumer. A consequence of such practices is that the dispute can be unnecessarily prolonged; this increases the fees payable to the debt management firm while causing the consumer to accrue further interest on their outstanding debt. ASIC and the Senate Inquiry report that debt management firms capitalise on consumers often being unaware that they can access free legal counselling services or freely submit complaints to AFCA (for issues with their financial firm that are obliged to hold AFCA membership) without the services of paid representatives.

The 2016 ASIC Report also highlighted the current issues with credit repair services. Credit repair services promote their ability to clear ‘negative’ information¹⁷ from a consumer’s credit report by challenging a credit listing held by a credit reporting body, and correcting errors on the client’s credit report to allow access to better loans. Many consumers who seek the services of credit repair firms are more likely to be in financial hardship, which places them at greater risk of vulnerability, both from facing unaffordable, avoidable costs, as well as potentially accessing unsuitable credit (see below case studies).

ASIC Report 465 – Case study 4: Credit repair

Mr W was out of work for a period and accrued a credit card debt of approximately \$7,000. Mr W took out a personal loan to pay the bill but struggled to make repayments and defaulted. The personal loan debt was assigned to a debt collector who commenced proceedings and obtained default judgment against Mr W in the local court. Mr W managed to enter into an arrangement with the debt collector under which he would pay off his debt at \$100 per week and paid off the entire debt 18 months earlier than the originally agreed timeframe.

When Mr W later tried to finance a boat purchase, he was told the default judgment with the debt collector was listed on his credit report. Mr W wanted to have the listing removed, so he could now borrow.

Mr W paid a total of \$1,995 in fees, comprising \$900 to Firm A and \$1,095 to Firm B, in an attempt to have the default listing with the debt collector removed from his credit report.

ASIC Report 465 – Case study 5: Credit repair

Ms X had moved house and advised her telco of her change in address, yet her phone bill was sent to her previous address. The telco had listed a default for \$120. Ms X engaged Firm D to remove the listing. Ms X paid Firm D \$1,100 to remove the listing.

Firm D refused to refund the \$1,100 to Ms X as they insisted she had entered a contract with them.

¹⁷ “Negative’ information covers late or missed payments and defaults.

Equifax analysis – consumers accessing credit repair

One in four correction requests have been lodged by a credit repairer. Recent demographic data analysis on credit repair consumer indicates that:

- 14 per cent of people lodging a dispute via a credit repair service likely earn less than \$650 a week and in total 42 per cent less than \$1,250 a week;
- 12 per cent are aged 25 or younger and 26 per cent are aged between 26-35.

While these firms may be successful in removing the credit information, there was concern from industry and regulators that this may not always be due to the information being incorrect but could instead be due to the time and cost associated with financial firms advocating the accuracy of the specific information. While financial firms can reject the challenge and retain the data, debt management firms can threaten taking action against the firm via external dispute resolution which will come at a cost even when the ruling is in favour of the financial firm.¹⁸ It is for this reason that industry noted an increasing practice of credit information being removed off consumers' files in response to challenges from debt management firms, to avoid the time and cost for financial firms to argue its accuracy.

This practice has negative impacts on both lenders and consumers. For lenders, it reduces the value of credit information in the system. Lenders utilise credit information when undertaking credit assessments of consumers seeking additional credit. With incomplete information in the system, there is a risk that a lender will make an assessment that they would not otherwise have made if complete information was available about the consumer. For consumers, the driver for challenging their 'negative' credit reporting information is the inability to access further credit. However, depending on their financial situation, there is a risk that taking on additional credit could place them into financial hardship, particularly where the lender no longer has access to a complete picture of the borrower.¹⁹

Currently, there are no uniform standards or obligations imposed on debt management firms. The lack of a comprehensive regulatory framework has enabled these firms to operate largely without supervision or oversight, and this has contributed to the widely reported instances of poor consumer outcomes associated with the industry. This problem is exacerbated by the limited avenues for redress, as industry participants are not required to be members of AFCA. Consumers who have suffered from misconduct can only seek redress via the courts, a costly option unlikely to be available to the majority of consumers experiencing financial difficulties.

The various issues identified across reports and various case studies, demonstrate the problem of debt management firms taking advantage of consumers who are at their most vulnerable and further exacerbating the financial hardship they find themselves in. There is no one cohort of consumers engaging with debt management firms that are deemed more vulnerable, but rather,

¹⁸ Illion Submission to public consultation

¹⁹ The recently passed *National Consumer Credit Protection Amendment (Mandating Comprehensive Credit Reporting) Act 2019* will encourage greater sharing of 'positive' credit information in the credit reporting system. This will allow consumers with 'negative' credit information on their credit file to demonstrate to lenders that they are of good credit quality through meeting their current financial obligations.

consumers in these situations are vulnerable due to the very nature of their circumstances – those experiencing significant financial hardship.

Relative to the wider suite of debt service offerings, there is limited evidence that firms engaging in budgeting activities cause significant detriment to consumer welfare. The risk of significant financial hardship from high fees or misrepresentations is substantially lower, and the service may be potentially helpful for consumers who require the expertise, control, and time-savings on offer.

2. Case for government action/objective of reform

The Government has sole responsibility for regulating credit activities and for addressing any perceived regulatory gaps within the industry. Implementing a clear and comprehensive framework will supersede the piecemeal regulatory settings that have allowed misconduct to persist and ensure that debt management firms can no longer take advantage of consumers that are either in financial hardship or are not aware of free services available to them.²⁰

There is consensus amongst all stakeholders who made submissions during public consultation that an industry-led approach to reform is insufficient.²¹ The lack of binding obligations and low risk of enforcement renders measures such as codes to be less effective, particularly when they are the sole regulatory mechanism. This issue is especially pronounced in the debt management industry, where there is no peak body or association that represents industry participants.

Educating consumers can empower them to understand their rights in these situations and what avenues are available for resolving their situation. The ASIC MoneySmart website provides important freely available information to consumers on how to get on top of their debt, including a warning to avoid credit and debt repair companies who may charge consumers high fees for things that can be done for free.²² However, this can only go so far.

Financial firms and consumer groups have stressed that an education campaign on the risks of engaging debt management firms, and on the availability of free community alternatives, would have little effect. They note that many vulnerable consumers do utilise free financial counselling in the first instance, but may be dissatisfied with realistic advice, such as selling a property to retain equity. Therefore, consumers may be desperate and induced by a debt management firm's false promise that other solutions are available and that a property, or savings, may be retained.

Instead, Government action appears to be the best way of protecting consumers in these circumstances. Consumer advocacy groups such as CALC and FRLC have consistently argued that there is significant consumer harm associated with the sector, and that a regulatory framework is

²⁰ Banks want debt management firms licensed, available at: <https://7news.com.au/politics/banks-want-debt-management-firms-licensed-c-2173605> (accessed 25 March 2021)

²¹ The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry found that, taken generally, financial industry self-regulation is typically inadequate - <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>

²² ASIC MoneySmart – Managing Debt, available at: <https://moneysmart.gov.au/managing-debt> (accessed 1 April 2021).

required.²³ These groups assert that debt management firms peddle conflicted advice and inappropriate solutions, and have reported numerous case studies exhibiting poor consumer outcomes. CALC has previously stated that the “community expects the Government to introduce strong protections—that’s why 92% of Australians want the same protections against debt vultures as in the UK”.²⁴

Importantly, while self-regulation and further consumer education can help, these two interventions still do not solve the problem of what consumers are willing to risk in order to resolve their situations. When in significant financial hardship, and despite being informed of their rights, some consumers will still feel desperate enough to consider every last available option open to them, including debt management services. This only perpetuates the hardship cycle as these firms take advantage of consumers in extremely vulnerable situations. Therefore, Government action is required.

3. Policy options

Option 1: Status quo

Retain the current framework where firms engaging in credit repair and debt negotiation services are not regulated. Rather, interventions in this area would need to be industry-led, with AFCA and credit providers banning or refusing business with debt management firms that they deem to be not acting in the best interests of the consumer.

Option 2: Australian Credit Licence regime

Require debt management firms that are paid to represent consumers on matter related to credit activities to hold an Australian Credit Licence (ACL), where the licensing regime administered by ASIC imposes an obligation to be a member of an external dispute resolution regime and other conduct obligations.

Obligations imposed on ACL holders include obligations to:²⁵

- act efficiently, honestly, and fairly;
- engage in credit activities competently;
- ensure that clients are not disadvantaged by conflicts of interest;
- comply with credit legislation;

²³ Stop Debt Vultures, available at: <https://consumeraction.org.au/stopdebtvultures/> (accessed 31 March 2021).

²⁴ Up to 1.9 million Australians paid debt vultures in the last 12 months, available at: <https://consumeraction.org.au/up-to-1-9-million-australians-paid-debt-vultures-in-the-last-12-months-report/> (accessed 29 March 2021).

²⁵ ASIC sets out these obligations for credit licensees at <https://asic.gov.au/for-finance-professionals/credit-licensees/your-ongoing-credit-licence-obligations/>. The obligations are found in section 47 of the *National Credit Consumer Credit Protection Act 2009* (Cth).

- have appropriate internal and external dispute resolution facilities (being a member of AFCA);
- have appropriate compensation arrangements.
- have adequate resources (including financial, technological and human resources) and risk management systems; and
- have appropriate arrangements and systems to ensure compliance.

In order to obtain a credit licence, applicants must demonstrate that they are fit and proper persons, which is assessed by the following criteria:²⁶

- is competent to operate a credit business (demonstrated by knowledge and skills);
- has the attributes of good character, diligence and integrity;
- is not disqualified by law from performing their role in the credit business; and
- has no conflict of interest in performing their role in the credit business.

Under this option a debt management firm will be required to adhere to the fit and proper requirement when first obtaining a credit licence, followed by the ongoing obligations outlined above for when conducting business as an Australian Credit Licensee.

Licensees are also subject to ASIC's compulsory information-gathering powers. ASIC can use these powers for surveillance and enforcement purposes, enabling ASIC to monitor and enforce compliance with the law. Information gathered as part of the licensing process will also provide a greater understanding of debt management sector, including the number of operators and the scope of services provided.

Option 3: Broad-based reform

Require debt management firms that are paid to represent consumers on matters related to credit activities to hold an Australian Credit Licence (ACL), as described in Option 2, complemented by additional specific obligations to prescribe the type of services that can be offered and how.

Additional obligations would include the following measures:²⁷

- a prohibition of upfront fees for service;
- a prescribed scale of costs, ultimately capping the total amount of fees that can be charged for services;
- increased disclosure obligations through requiring firms to provide credit guides about the services being offered prior to entering into a contract;

²⁶ For further information on what ASIC will consider in determining whether a potential licensee is a fit and proper person, see 'Credit licence applications: Providing information for fit and proper people' at <https://asic.gov.au/for-finance-professionals/credit-licensees/applying-for-and-managing-your-credit-licence/credit-licence-applications-providing-information-for-fit-and-proper-people/>.

²⁷ Measures include those recommended by the 2019 Senate Inquiry into Credit and financial services targeted at Australians at risk of financial hardship (Recommendation 8).

- requiring firms to clearly signpost to consumers that there are free alternatives available, in particular access the AFCA;
- an obligation to act in the best interests of their clients, similar to obligations that apply to mortgage brokers and are proposed to be extended to other credit assistance providers; and
- banning unsolicited sales.²⁸

4. Cost benefit analysis of each option/Impact analysis

Option 1: Status quo

Retains piecemeal regulatory framework where debt management firms, providing credit repair or debt negotiation services are not required to be licensed.

The status quo will leave consumers in the same position, where unlicensed debt management firms will continue to provide services that do not meet the consumer's needs. This problem will be exacerbated in the current environment with more borrowers expected to fall into financial hardship. AFCA and industry may continue to undertake targeted interventions, however they are likely to be insufficient to address the industry-wide problem of poor value-for-money services and inadequate redress.

Advantages

- Government action and resources are not required – avoids increasing regulatory burden, where there may be a perception that the industry can address concerns themselves.

Disadvantages

- The majority of debt management firms will remain unregulated – poor and inappropriate services are therefore likely to persist. There will continue to be limited information, outside of what is provided by stakeholders, about the number of operators as well as the scope of services provided to consumers.
- Consumers continue to receive services that will often be seen as high-cost, low-value – it is unlikely there will be sufficient motivation for the industry to self-regulate, especially in absence of a peak body to coordinate efforts.
 - There is likely to be a greater uptake in these services following the COVID-19 pandemic, when a higher numbers of consumers is expected to experience financial hardship.
- Does not provide easily accessible avenues for redress when inappropriate services have caused financial hardship for consumers – as the majority of debt management firms are not required – and are not – members of AFCA, redress to consumers is only available through the courts which can be timely and costly.

²⁸ This would be similar to other instances in the *National Consumer Credit Protection Act 2009* (Cth) where unsolicited communications are banned. This includes the banning of unsolicited credit card limit increase invitations and prohibiting unsolicited communications by SACC providers.

- Additionally, without any specific obligations on debt management firms, the availability of court action is significantly limited.

Regulatory costs

As this option would maintain the status quo, and therefore require no regulatory or legislative changes, there are no new regulatory costs associated with this option.

Option 2: Australian Credit Licence regime

This option requires debt management firms that are paid to represent consumers on matters related to credit activities to hold an ACL.

Bringing debt management firms into the ACL licensing regime will deliver a net benefit for consumers. This will be achieved by compelling debt management firms to meet the general licensing obligations, including that the licensee and their representatives are fit and proper persons, and operate their business 'efficiently, honestly and fairly'. ACL holders are required to be members of AFCA.

Mandating that licensed debt management firms acquire AFCA memberships will enable consumers to seek redress where they have disputes with their debt management firms over the services provided – this redress is free for consumers.²⁹

Advantages

- Licensing will increase the quality of firms engaging in services – debt management firms will need to satisfy the fit and proper person test in order to be licensed, as well as meet ongoing licensing obligations, such as the requirement to operate efficiently, honestly and fairly.
- Consumers will have access to redress – a condition of holding an ACL is the requirement to be a member of AFCA.³⁰ This will enable consumers to lodge a complaint with AFCA and seek redress if they have a complaint about the services provided to them by the debt management firm.
- Regime is targeted and easy to implement – the ACL regime can be efficiently implemented through Regulations with relative speed and clarity, which is important in the context of a

²⁹ When considering cases, AFCA will rule based on legal principles, applicable industry codes of practice, good industry practice, and previous relevant determinations of AFCA or predecessor schemes. If AFCA finds that the firm breached its obligations, it may decide that the financial firm undertake a course of action to resolve the complaint such as a payment of money, forgiving or varying a debt or releasing the security for a debt. The remedy will seek to place the consumer in the position they would have been if the conduct of the financial firm had not caused the loss, or compensate the consumer for their loss to the extent AFCA holds the financial firm responsible for the loss. The time taken to resolve a complaint depends on its complexity and whether it can be resolved at registration, case management, preliminary assessment or adjudication by an ombudsman or panel. In 2019-20, the average time to resolve a complaint was 73 days.

³⁰ An indication of the benefits of access to AFCA can be seen in the following. In the 2019-20 financial year, AFCA had received 80,546 complaints and resolved 77,057 complaints. It had also resolved 71 per cent of complaints by agreement or in favour of the consumer, while also having resolved 60 per cent of complaints within 60 days.

heightened risk of financially distressed consumers caused by the COVID-19 pandemic. The regime is less onerous relative to other options, which could only be achieved through changes to primary legislation and therefore timing of implementation is subject to the Parliamentary agenda. Firms will be required to pay an initial, one-off licensing fee, and their annual supervisory cost recovery levies, which are largely dependent on their activities.

Disadvantages

- Increase in regulatory burden – The proposal will increase the number of firms that are required to be licenced.
- Does not enable specific activities to be banned or regulated – the proposal would not allow for regulations to limit or ban certain activities that particularly cause consumer detriment. For example; the introduction of a cap on fees or a ban on unsolicited communications in line with the Senate Inquiry recommendations and suggestions conveyed in consultation.

Regulatory costs

Each debt management firm that engages in debt negotiation and credit repair services would be subject to approximately \$510,000 in regulatory costs, per year.³¹ Treasury expects around 85 firms to be captured by this proposal,³² meaning that the total regulatory burden would amount to \$43.4 million per year.

It is not possible to provide a meaningful estimate of the monetary loss caused by debt management firms, or the monetary loss avoided that is expected from licensing debt management firms. Debt management firms provide a broad range of activities and there is a lack of comprehensive data that details the average or typical financial losses caused by each debt management interaction.

However, based on the case studies provided through consultation it is evident that an improvement in the quality of debt management services will provide a material reduction in consumer harm. Therefore, the benefits of a licensing regime will be certain to outweigh the regulatory costs.

Option 3: Broad-based reform

This option requires debt management firms that are paid to represent consumers on matters related to credit activities to hold an ACL, as well as imposing a number of other specific obligations.

The implementation of broad-based reform is likely to deliver a net benefit to consumers. A comprehensive regulatory regime that involves holding an ACL, as well as imposing a range of obligations and prohibitions, can effectively compel debt management firms to adjust their practices

³¹ Entities will be required to pay an initial, one-off credit license application fee. An annual supervisory cost recovery levy is also payable. Each credit intermediary pays a minimum annual levy of \$1,000. A variable amount is then added which is calculated based on the number of credit representatives the entity has. The structure of the levy represents the intensity of ASIC's regulation. For example, large credit intermediary businesses with significant customer bases may require more regulatory attention by ASIC. Licensees must lodge an annual compliance certificate with ASIC, in which they certify whether they have complied with their obligations as a licensee.

³² The requirement to be licenced is expected to result in some firms exiting the market or amending the business model so as to provide services outside of those covered by the new regime.

and mitigate the potential for further consumer harm. Consumers will have access to AFCA for when they have disputes against the debt management firm for services provided, and redress is likely to be more readily available given the specific additional obligations.

However, implementation would be more complex than Option 2, and delayed reforms may be especially problematic as pandemic-related financial difficulty develops.

Advantages

- Address the high-cost and potentially predatory nature of the service – the reforms would introduce cost caps on services provided by debt management firms as well as bans on unsolicited communications.
- Consumer access to redress – a condition of holding an ACL is the requirement to be a member of AFCA.³³ This will enable consumers to seek redress if the debt management services they have paid for are inappropriate, or puts them in a worse financial position.

Disadvantages

- Higher regulatory burden – the proposal will increase the number of firms that are required to be licenced and there will be more prescriptive obligations compared to Option 2.
- Delayed commencement – the framework would be more legislatively complex to implement, requiring legislation enacted by Parliament. Delaying commencement would be particularly detrimental as the delayed implementation would not address the acute financial difficulty caused by the COVID-19 pandemic.

Regulatory costs

Debt management firms that engage in debt negotiation and credit repair services will be subject to approximately \$936,000 in regulatory costs, per year. Treasury expects around 50 firms to be captured by this proposal,³⁴ meaning that the total regulatory burden would amount to \$46.8 million per year.

It is not possible to provide a meaningful estimate of the monetary loss caused by debt management firms, or the monetary loss avoided that is expected from subjecting debt management firms to broad-based reforms. Debt management firms provide a broad range of activities and there is a lack of comprehensive data that details the average or typical financial losses caused by each debt management interaction.

However, based on the case studies provided through consultation it is evident that an improvement in the quality of debt management services will provide a material reduction in consumer harm,

³³ An indication of the benefits of access to AFCA can be seen in the following. In the 2019-20 financial year, AFCA had received 80,546 complaints and resolved 77,057 complaints. It had also resolved 71 per cent of complaints by agreement or in favour of the consumer, while also having resolved 60 per cent of complaints within 60 days.

³⁴ The requirement to be licenced, as well as the extent of the additional obligations, is expected to result in a larger consolidation in the market compared to Option 2.

greater than that of Option 2. Therefore, the benefits of a licensing regime will be certain to outweigh the regulatory costs.

5. Consultation

Treasury had ongoing consultation with relevant stakeholders, including consumer groups, industry, credit reporting bureaux and regulators, over the last year on their concerns regarding services provided by debt management firms. In the lead up to the Government's announcement on 25 September 2020, an interim RIS was developed which informed a decision to include the measure in the 2020-21 Budget.

Treasury then undertook four week public consultation on draft Regulations from 15 January 2021 to 12 February 2021. The draft Regulations proposed a licensing regime akin to Option 2. Treasury received around 20 submissions covering over 25 stakeholders from consumer groups, industry ombudsman and peak bodies, legal bodies and credit reporting bureaux. Broadly, there was consensus support from submissions that, at minimum, a licensing regime for debt management firms was required, with most supporting additional regulation of the industry, albeit with differing views on the content of additional regulation.

These calls for the imposition of further measures, similar to those that were considered under Option 3, largely mirrored the feedback that Treasury heard from a number of stakeholders through consultation prior to the Government's announcement.

Debt management firms did not engage with Treasury prior to, during, or after consultation. No submissions were lodged, and the absence of a single industry association has limited Treasury's ability to proactively consult with these firms.

Regulators

ASIC has stressed the importance of appropriately licensing the debt management industry. Their 2016 report, *REP 465 Paying to get out of debt or clear your record: The promise of debt management firms* outlined the activities, purported value add, and areas of concern within the industry. Foremost of these concerns is that debt management firms charge high fees for services of little value, provide inappropriate services that can leave consumers worse off, and make misleading and predatory representations about the effectiveness of their services. In addition to the activities referred to elsewhere in this Statement, the ASIC report summarises three relevant case studies provided by the FRLC.

Case study 3 describes the detriment cause by a debt negotiation service provider such as not getting credible advice as to how to handle creditors, but also made offers to creditors that individuals were never in a position to fulfil. Case studies 4 and 5 espouse the harms associated with credit repair service providers, such as charging high fees for services they could never deliver on or would refuse to fulfil their obligations on.

As the responsible regulator, ASIC has proactively contacted a number of debt management firms to generate awareness about the new licensing regime, provide clarity on the expected obligations of licensees, and address queries from prospective licensees on the process. In its contact with likely

affected stakeholders, ASIC has amongst other things, referred stakeholders to the Treasurer's consumer credit reforms factsheet, and the draft Regulations that were released for consultation by the Treasury. ASIC has also published a webpage on its website that provides information and resources about the reform and is encouraging direct engagement via a designated mailbox.

Industry ombudsman

AFCA noted that it recently excluded a debt management firm from representing consumers at external dispute resolution (EDR), in the first evocation of Rule 2.2, which allows exclusion where the representative is engaging in inappropriate conduct which is not in the best interest of the complainant.

AFCA advised that the most common alleged breaches of misconduct with respect to debt management firms relate to misleading and deceptive conduct, including high fees for inappropriate services, false representations as to the firm's ability to remove defaults, and refusal to refund fees despite services not being rendered. The Australian Small Business and Family Enterprise Ombudsman supported the bill, but recommended that further reforms could be taken to support small businesses. This includes having costs paid by debt management services for AFCA complaints, where debt management firms have initiated unmerited claims. Currently, small businesses will bear the 'user charges' invoiced by AFCA regardless of which party is at fault.

Consumer groups

Consumer advocate groups, such as the Consumer Action Law Centre, Financial Counselling Australia and Financial Rights Legal Centre, provided insights into the harms perpetuated by debt management firms, including case studies and direct marketing material that exhibits the predatory tactics employed by debt management firms.

The case studies show the severity of financial harm and distress caused by the high-pressure sales techniques and unrealistic promises prevalent throughout the industry. CALC provided an egregious example, where an unlicensed debt management provider scoured through court records to find individuals who had had repossession proceedings filed against them, and then contacted these individuals to offer unsolicited services. The customer engaged the debt management firm and was charged fees far higher than what was verbally agreed. Moreover, after selling the property with the aid of community lawyers, the customer discovered that there was a significant caveat on the property sale from the debt management firm. The firm refused to remove the caveat and forced the payment in order for the sale to proceed. For this reason, consumer groups were more supportive of Option 3, which provides for a robust regulatory framework to ensure that all debt management firms were appropriately licensed, whether it is implemented through a staged approach.

Consumer groups strongly advocate for a Government regulatory response, noting that an industry-led response is unlikely to yield an appropriate outcome.

Peak bodies

The Australian Banking Association (ABA) supported Government reform in this area, specifically the introduction of a licensing regime, and noted that further regulation could be imposed on the debt management industry. The ABA noted that it has been closely monitoring the debt management industry and believes that a licensing regime is imperative for reining in widespread misconduct. The

ABA advised Treasury of instances where exploitative conduct was evident, including searching court records for potential customers, high pressure sales methods, complex contracts, charging high fees and no suggestions that free community legal advice is available. Moreover, debt management firms often intentionally extend the resolution process and the duration in which consumers are obliged to continue paying them exorbitant fees.

Regarding the profile of consumers typically using debt management services, the ABA advised that any consumer, even those considered more financially literate, can be enticed to engage the services of a debt management firm if they are desperate and are concerned they will lose their house. Vulnerable consumers in financial hardship may have already received realistic advice – such as selling their home to retain equity – from free financial counselling services, but may be dissuaded by debt management firms promising unrealistic outcomes in an exploitative manner. The ABA noted that it continually engages with its members and consumer advocacy groups to consider an industry-led solution, however acknowledges that there may be limitations to such an approach as bank customers have been placed in financial difficulty as a result of dealing with debt management and credit repair firms for non-credit related debts.

Other peak bodies, such as Australian Finance Industry Association, Australian Institute of Credit Management (AICM), the Australian Restructuring Insolvency and Turnaround Association and Australian Collectors and Debt Buyers Association were all supportive of introducing a licensing regime. However, there were suggestions of further reforms as the lack of regulation meant there was no accountability or recourse to help consumers if something goes wrong. One proposal from the AICM is to ensure that commercial credit providers can lodge complaints with AFCA, as there is currently no clear avenue for credit members to report the belligerent activities of credit repair firms and debt negotiators. With the licensing of debt management firms, this would give consumer recourse to use AFCA if a complaint arises.

Credit reporting bureaux

Credit reporting bureaux, such as Illion and Equifax, supported the introduction of a licensing regime and provided insights into the predatory methods employed by debt management firms to remove correct credit information, which has led to detriment from industry lenders. These actions have also been targeted at vulnerable individuals, perpetuating the existing harms on consumers.

Illion stated that AFCA's current services are being abused at the expense of banks and small lenders. A large number of complaints filed by credit repair firms do not serve the interests of the consumer they are representing, but lenders may decide to remove a correct entry as the costs involved with external dispute resolution entities, such as AFCA, outweigh the administrative costs in removal. This is problematic as the credit information being reported is not accurate, hence has resulted in the diminishing integrity of the credit reporting system. Nevertheless, the new obligations to become members of AFCA can ensure that credit repair firms are held accountable and consumers and lenders can raise concerns about the costs they pay where they may have been misrepresented by a credit repair firm.

Equifax advocated for stronger consumer protections, such as prohibitions on consumers paying upfront fees to a credit repairer where there is no incentive to collect money where there can be no

change to the consumer's credit report. Additionally, Equifax sought for the changes to extend beyond consumer credit to other information such as those relating to utilities.

6. Option selection/Conclusion

Based on the regulatory costs of implementation, the information available on the sector, and the speed at which a solution is required in the current environment, Treasury's preferred option is Option 2 – Requiring debt management firms, specifically those providing debt negotiation and credit repair services, that are paid to represent consumers on matters related to credit activities to hold an ACL. This options balances the impact on the industry with the benefits to consumers.

Extending the Australian Credit Licence regime to debt management firms satisfies the most important considerations; namely to be of fit and proper standing to operate in the industry; the ongoing requirement to act efficiently, fairly, and honestly; and to become members of AFCA. The introduction of a licensing regime will provide the regulator and policy makers with a better understanding of the industry and greater ability to monitor the behaviour of debt management firms.

As there is not currently comprehensive data of the industry or the services provided to consumers, Treasury has not been able to properly assess whether any consumers are receiving valuable services from industry. As such, in absence of such an assessment, there is insufficient justification to proceed with Option 3 given the expected resulting consolidation in the industry.

Table 1: Cost-Benefit summary of options

<i>Option</i>	<i>Benefit</i>	<i>Cost</i>
1. Status quo	<p>Government action and resources are not required.</p> <p>Avoids increasing regulatory burden where there may be a perception that the industry can address concerns themselves.</p>	<p>The majority of debt management firms will continue to operate without the obligations imposed by licensing and propagate consumer harms.</p> <p>Does not address the problem of limited redress for consumers who have been disadvantaged by dishonest practices, as firms have no compulsion to be AFCA members.</p> <p>Inaction will attract criticism from consumer groups and industry bodies who have called for greater regulation.</p>
2. ACL regime	<p>Licensing will increase the quality of firms engaging in services as they will need to meet ongoing obligations to operate efficiently, fairly and honestly.</p> <p>Holding an ACL compels firms to be members of AFCA, which is a key avenue for redress when consumers have disputes regarding services provided by debt management firms.</p> <p>An ACL regime is targeted and can be quickly implemented, particularly in the context of addressing increased financial distress arising from the COVID-19 pandemic.</p>	<p>The proposal will increase regulatory burden, as it will increase the number of firms that are required to be licensed.</p> <p>Does not enable the regulation of specific operational models – for instance introduction a cap on fees or banning unsolicited sales in line with recommendations that have been made in the area.</p> <p>Debt management firms are estimated to incur \$510,000 in regulatory burden in a given year.</p>
3. Broad-based reform	<p>Comprehensive suite of reforms would mirror Senate Inquiry recommendations and address the broadest possible range of harms caused by debt management firms.</p> <p>Prohibitions and operational mandates would ensure that firms refrain from exploitative behaviour to avoid enforcement action.</p> <p>Consumer groups and industry would strongly support a comprehensive regime.</p>	<p>An extensive regime involves greater optionality and complexity. Adequate analysis and policy development may be unsuitable, given the COVID-19 pandemic time pressures.</p> <p>Impositions involved may be considered overly onerous, where firms may be forced to adjust their practices to comply with regulations.</p> <p>Limited evidence base on industry participation and prevalence of harm means that it may be difficult to justify a more onerous regulatory regime.</p> <p>Debt management firms are estimated to incur \$936,000 in regulatory burden in a given year.</p>

7. Implementation and evaluation

The proposal would make use of the regulation-making power contained in s 6 of the *National Consumer Credit Protection Act 2009* to expand the definition of credit activity to include debt management firms engaging in the representation of consumers in disputes with financial services firms.

The measure will be evaluated by assessing the prevalence of harm and complaints associated with the debt management industry in the post-implementation period. It is expected that a higher number of firms will become licensed in order to continue operating, and will therefore become members of AFCA. The imposed obligations are expected to improve behaviour in the industry and reduce the incidence of misconduct, and AFCA membership may result in an increase in complaints processed by the body. Such an outcome would be considered an improvement from the status-quo, where most aggrieved customers would be unable to seek redress through EDR.