

**THE IMPACT OF THE LAW AND SOCIAL POLICY ON THE
CREDIT CONSUMERS OF VICTORIA:
*A Report on Reckless Lending***

A Joint Discussion Paper of La Trobe Law Students
and the West Heidelberg Community Legal Service

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This Report was written by La Trobe Law Students:

Donna Curnow

Natasha Jankovska

Susanna Kirpichnikov

Elizabeth McGrath

It was written as part of their clinical placement at the West Heidelberg Community Legal Service. It was edited and supervised by Liz Curran, Lecturer in Law and Student Clinical Legal Education Supervising Solicitor. This component of the course was introduced in July 2002 to encourage teamwork and to enhance opportunities for students to engage in the law making process and public policy. Students determine their topics in consultation with the legal service and their lecturer after determining matters of concern arising from their case-work whilst on placement at the legal service or arising from associated problems they identify as relevant to members of the West Heidelberg community and the community more broadly.

EXECUTIVE SUMMARY

Chapter 1 – Susanna Kirpichnikov

Chapter 1 will highlight the issue of over-commitment in the community which stems from the use of credit. It will point out that although there are a number of factors which contribute to the creation of over-commitment, reckless lending on the part of credit providers contributes substantially to its prevalence. The term ‘reckless lending’ as it will be used in this report will be defined and the need for the provision of manageable debt, as opposed to a restriction on the availability of credit, will be highlighted. In addition, this chapter will provide a background to *the Uniform Consumer Credit Code 1994 (UCCC)* and explain why legislative change rather than an educational program is needed to curtail the negative effects of over-commitment.

Chapter 2 – Natasha Jankovska

Chapter 2 consists of an analysis of sections 70-71 of the *UCCC* and clause 25.1 of the *Code of Banking Practice* (2004), by reference to case law and expert commentary. The analysis of these provisions and their application points to the conclusion that the *UCCC* and *Code of Banking Practice*, as they currently stand, provide insufficient protection for consumers against reckless lending. This is predominantly the result of the fact that credit lenders are currently not required to assess the ability of their debtors to repay their debts with reference to their financial position at the time that an increase in credit is provided. The outline of the inadequacies of the *UCCC* and *Code of Banking Practice* in this Chapter also form the foundation upon which the authors of Chapters 3 and 4 will then go on to analyse the practical effects of these inadequacies and alternatives to the reckless lending provisions of the *UCCC*.

Chapter 3 – Donna Curnow

This chapter builds on Chapter Two’s theoretical analysis of the efficiency of the consumer credit system, by exposing the social detriment of the system’s inadequacies. The realities of modern credit policies and products are critiqued and the fuller picture lying behind the statistics revealed. Case studies and interviews with experts are used to expose what is really going on in the field of consumer debt. The evidence presented in this chapter substantiates the assertion by the author in Chapter Two that the community cannot categorically rely on creditor providers to police themselves, despite their adoption of the Code of Banking Practice (CBP). The limitations and competing interests of the relevant key players are critically analysed, as the author reflects on why there is such a prevalence of unrestrained reckless lending within the credit industry. In conclusion, the author makes a number of recommendations as a step towards permanent industry reform.

Chapter 4 – Elizabeth McGrath

Chapter 4 explores the quest to obtain a fair, safe and appropriate loan. Part one examines the context in which unfair loans are offered and recommends greater regulatory control over the services offered by fringe credit providers, like payday lenders. Part 2 explores the efforts that have been made by community organizations, in conjunction with banks, to provide loans that are fair, safe and appropriate. This chapter recommends that these efforts be encouraged by the grant of more public funds and the enactment of legislation to attract mainstream lenders to participate in community development programs. Finally, this chapter will discuss the problem of providing inappropriate, and therefore unsafe, amounts of credit

via credit cards to people who lack capacity to repay. This chapter recommends that Victoria address the situation by enacting legislation similar to the Responsible Credit Bill, now before the NSW parliament.

METHODOLOGY

This Report is the outcome of a review of available literature and relevant legislative provisions of the Uniform Consumer Credit Code. This review has been combined with the information the authors of this report obtained from experts in the field by way of interviews. These acknowledged experts will remain nameless in order to satisfy the conditions of grant of Ethics Approval for this project by the Faculty of Law and Management of La Trobe University. In addition, this report includes case studies that have arisen during the authors' work experience at the West Heidelberg Legal Service and these case studies, too, will remain anonymous to protect clients.

This Report on Reckless Lending has been compiled and written over the period of August to October 2005.

CHAPTER ONE:
By Susann Kirpichnikov

**AN INTRODUCTION TO RECKLESS LENDING AND THE UNIFORM
CONSUMER CREDIT CODE**

INTRODUCTION

Household debt is high and it is rising.¹ While there are many factors contributing to the incidence of household debt in Australia, what is the particular concern of this report is the lending policies and practices of credit providers which have allowed consumers to become overcommitted and which the authors will call ‘reckless lending’. This Chapter will begin by looking at the utilisation of credit in our community, outlining briefly the types of credit available and explaining how over-commitment on the part of consumers can stem from its use. Then, after defining the term ‘reckless lending’, a background to the *Uniform Consumer Credit Code 1994* will be provided to set the scene for an analysis of the relevant provisions of this Code and the need for legislative reform addressed later in this report. Finally, this chapter will consider the reasons why educating consumers about the dangers of credit is not enough to curb its excesses and why the government and the credit industry should instead look at ensuring consumers are given a manageable level of credit in the first place.

THE USE OF CREDIT

In an industrial, market-oriented society where buying is what comes after producing, there is no doubting that credit has become a part of many people’s everyday life.² When we shop we are constantly invited to buy today and pay for the product later. Advertising even sends the message that credit is glamorous, safe – “the norm”, and because credit can not be seen unlike other products, the complexity and risk involved in the utilisation of credit is overshadowed by its alluring convenience.³ With credit you can buy goods and services sooner than if you had to save up plus you can carry less cash on you and pay for things over the internet or telephone. In addition to this, it is also comforting to know that there is a source of short term finance available if an emergency arises. This is all without including the rewards schemes linked to some forms of credit which can be very attractive.⁴ However, it is not the availability of credit options that is worrisome – it is what happens when the level of debt accumulated by an individual or household becomes unmanageable that is of great concern.

¹ Centre for Credit and Consumer Law, Griffith University, *Submission to: Senate Economics Reference Committee – Inquiry into possible links between household debt, demand for imported goods and Australia’s current account deficit* (2005) p 2.

² Australian Securities and Investments Securities, <<http://www.fido.asic.gov.au/fido/fido.nsf/byid/044B0DABE4A650D6CA256C59000A6B4B?opendocument>> at 16.10.05.

³ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, *Consumer Credit Review Issues Paper* (2005) p22.

⁴ Consumer Affairs Victoria, <<http://www.consumer.vic.gov.au/>>, at 16.10.05.

The provision of credit in the community

Before considering the issue of over-commitment by consumers of credit, it is important to realise that there is a large variety of credit facilities and providers in the community. The mainstream credit providers include banks, building societies, credit unions and national finance companies, but they are not the only providers of credit. There has been an emergence of credit providers who are on the “fringe” of the credit industry and these include payday lenders and micro lenders.⁵ Due to the very broad range of credit facilities available to consumers, the authors of this report will pitch their discussion of credit at a general level, but a selection of credit facilities will be briefly outlined now because it is helpful to know the basics of how credit can operate.

One variety of credit is the credit card. Credit cards are one of the most easily obtained types of short-term finance found in the marketplace.⁶ They allow consumers to buy goods and services or take out cash advances up to a limit that has already been predefined and make repayments on the card at a later date with interest. Another variation is the store charge card. This can operate just like a credit card but the interest rates and periods vary from store to store and the cards can only be used to purchase items in that store. An alternative credit option is an interest-free or low-interest period loan. These are actually a very enticing form of credit because you have a period within which you can pay back the loan without incurring any interest at all or only a low interest. However if the entire amount of the loan is not paid back in time, there might be an extremely high amount of interest tacked on to the loan and therefore this is a very expensive choice for consumers who do not think they will be able to pay back the loan within the specified time period.⁷ In addition, a person can obtain a personal loan with interest rates below 10% from banks and credit societies⁸ or a short-term, high cost loan from one of the fringe lenders.

Over-commitment

The range of credit deals available to a consumer reflects not only the increasing competition for the credit dollar,⁹ but also the fact that the consumer credit market is growing. Despite the Reserve Bank of Australia reporting, in its last half-yearly financial stability review, that Australians have been coping well with paying off their debts,¹⁰ on average each household is spending 2.3% more than its household income¹¹ and a conclusion to be drawn from this is that households are relying on credit facilities to make up for the shortfalls in their income. For some people this level of debt is manageable. The unemployment rate is at its lowest since the 1970's and the amount of disposable income in each household has increased by 3.6% in the first half of 2005.¹² For these reasons it is possible to argue that Australians do not have a major problem with repaying credit debts.

⁵ Ibid.

⁶ Consumer Affairs Victoria, above n 5.

⁷ *Credit card deals rise but traps remain*, <<http://www.theage.com.au/news/BUSINESS/Credit-card-deals-rise-but-traps-remain/2005/09/23/1126982208667.html>> at 04.10.05.

⁸ Ibid.

⁹ Ibid.

¹⁰ *Aussies coping with debt levels: RBA*, <<http://www.theage.com.au/news/BUSINESS/Aussies-coping-with-debt-levels-RBA/2005/09/26/1127586779377.html>> at 04.10.05.

¹¹ Centre for Credit and Consumer Law, Griffith University, above n 1, p2.

¹² Jewel Topsfield, 'Debtors coping, bank reports', *The Age* (Melbourne), 27.09.05.

On the other hand, for some people this level of debt is just not sustainable, causing considerable financial hardship. Consumer groups such as the Consumer Credit Legal Centre (NSW) have noted that “over-commitment” has become one of the key issues they have had to deal with since the late 1990’s and they are not alone.¹³ Financial counsellors interviewed for this report also noted the increase in the amount of people coming to them for assistance after becoming over-committed. The Banking and Financial Services Ombudsman (BFSO) has also noted this concern.¹⁴

There are a number of factors that contribute to the creation of high household debt. These include the deregulation of the finance sector and relatively low inflation and interest rates along with the ever increasing value of property.¹⁵ However, as the Governor of the Reserve Bank in 2003 pointed out in his address to the Sydney Institute, there is a real possibility that many households choose a level of debt that makes sense in good times, but does not account for the fact that a decline in economic prosperity or problems in people’s personal lives can take place.¹⁶ Once financial circumstances of a consumer change because of things like unemployment, family breakdowns and ill health, the risk of defaulting on credit repayments or suffering significant financial hardship is increased.¹⁷ However, there is one other factor besides changes in financial circumstances that contributes to a person becoming over-committed and that is the lending policies and practices of credit providers or what this report will call ‘reckless lending’.

RECKLESS LENDING

What is ‘reckless lending’?

Reckless lending is the provision of credit to consumers by credit providers without adequately assessing the consumer’s ability to repay the loan. While some groups may use the words irresponsible or unethical,¹⁸ the authors of this report are using the term reckless to highlight the fact that credit providers are aware of the risks involved in providing credit to consumers that may have difficulty repaying the money they have borrowed and yet still take that risk and continue to carry out the same policies and practices. The risk of a consumer becoming over-committed if they have not been adequately assessed before entering into a credit transaction is real. Financial counsellors and the BFSO often see consumers who have become over-committed for that same reason.¹⁹ Case studies will be provided later in this report to demonstrate how exactly this is happening.

¹³ Consumer Credit Legal Centre (NSW) Inc., *Submission to the Senate Economics Committee in relation to Household Debt* (2005) p4.

¹⁴ Interviews with experts on 11 October 2005 and Banking and Financial Services Ombudsman, *Bulletin 45*, (2005) p2.

¹⁵ Banking and Financial Services Ombudsman, *Bulletin 46* (2005) p2 and Centre for Credit and Consumer Law, Griffith University, above n 1, p4.

¹⁶ I J Macfarlane, *Do Australian Households Borrow Too Much?* (Speech delivered at Sydney Institute, 3 April 2003).

¹⁷ Centre for Credit and Consumer Law, Griffith University, above n 1, p4.

¹⁸ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n, p17.

¹⁹ Banking and Financial Services Ombudsman, above n 13, p7 and Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n, p17.

This is not to say that it is unusual for credit providers to carry out income and expenditure checks when deciding if they will provide credit to a consumer;²⁰ the point is that assessments of a consumer's ability to pay back the amount borrowed is not always sufficient to determine their actual capacity to repay without financial hardship.

There are a number of situations which illustrate the practice of reckless lending. Firstly, the situation where questions asked of consumers about their income and liabilities inquire into how much income an individual is earning and how much they spend in rent, groceries and bills, but the questions as to how much an individual spends on other expenses such as school fees, school books, hair cuts daily costs such as public transport and so on. These all cost money and need to be factored into a household's expenditure even though they are not apparent as part of an average week's expenses. Credit providers might argue that it is up to the consumer to disclose information like this, but it is the experience of consumer groups and financial counsellors that their clients do disclose their financial situation fully and honestly to the extent that they are asked to by the credit provider.²¹ Therefore considering credit providers are the ones carrying out these checks on a daily basis, is it unreasonable to expect them to assist consumers with their disclosure to ensure they have as much information as possible to assess their capacity to pay?

Secondly, nothing exemplifies reckless lending as much as pre-approved offers and unsolicited increases to credit limits.²² These offers are usually made based on behavioural scoring whereby a credit provider looks at a consumer's payment history to decide whether to offer credit. Some credit providers are of the view that your ability to keep up to date with at least your minimum payments shows that you are unlikely to default on payments and hence it is a cost-effective method for determining increases.²³ However, making assumptions about a person's ability to repay based on their payment history is dangerous. There is no way of knowing if their financial situation has changed at all, whether a third party has been helping them to keep on top of the repayments or whether they can afford to make repayments on an increased credit debt.²⁴ Evidence of this is the fact that the BFSO has seen a number of cardholders that have obtained a credit amount that is way over the amount they would have received had the credit provider checked the current financial position of the consumer.²⁵ Once again, financial counsellors and consumer groups have also had a similar experience and evidence of these experiences will be presented later in this report.²⁶

Further to this, something that is even more disturbing than the credit providers who conduct flawed assessments of consumers' abilities to pay or offer unsolicited increases are the credit providers who are explicit about the fact that proof of a capacity to pay is not even required to get credit.²⁷ When the classifieds page of the local newspaper was examined advertising promoting such reckless lending was identified.²⁸

²⁰ Consumer Credit Legal Centre (NSW) Inc., above n 12, p8.

²¹ Consumer Credit Legal Centre (NSW) Inc., above 12, pp 5, 8.

²² Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n, p18.

²³ Banking and Financial Services Ombudsman, above n 13, p7.

²⁴ Banking and Financial Services Ombudsman, above n 13, p8 and Consumer Credit Legal Centre (NSW) Inc., above n 12, p5.

²⁵ Banking and Financial Services Ombudsman, above n 13, p7.

²⁶ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n, p17.

²⁷ Ibid. p25.

²⁸ Consumer Credit Legal Centre (NSW) Inc., above n 12, p7.

The BFSO has noted that there are offers of unsolicited increases which now contain statements asking the consumer to consider whether the offer should be accepted if their financial circumstances have changed. Nonetheless, the BFSO and this author are not satisfied that this additional information is enough to make what would otherwise be reckless lending responsible given the financial pressures on some consumers.²⁹

Manageable Debt

The real issue when it comes to reckless lending is that credit should not be provided if it will be unmanageable. Even if consumers are able to make minimum monthly repayments that does not mean that they have been given a manageable debt.³⁰ For example, if a \$2000 credit card is 'maxed out' it can take up to 7 years to repay.³¹ Therefore, not only should credit providers conduct thorough income and expenditure checks to avoid lending recklessly, they should assess the consumer's ability to repay the entire debt over a reasonable amount of time instead of just assessing the ability to pay minimum monthly repayments.³² The point of countering reckless lending is not to limit the credit options available in the community; rather it is to curtail its excesses.³³

THE UNIFORM CONSUMER CREDIT CODE

Background of the UCCC

The introduction of the *Uniform Consumer Credit Code 1994 (UCCC)*³⁴ was a milestone in the regulation of consumer credit transactions.³⁵ There were calls from businesses and consumers to standardise credit practice in Australia since credit transactions often cross state borders.³⁶ In response to these calls and after a decade of work by all the governments of Australia as well as consumer and industry groups (who knew that it was not enough to rely on market forces to ensure consumers were protected in credit transactions) the *UCCC* was introduced in 1996. Although there had been a previous attempt in the *Credit Act 1984 (Vic)* to control credit procedures in Victoria, this was a largely difficult act to understand.³⁷ In addition, the coverage of the *Credit Act* was limited since it excluded some forms of credit.³⁸ In contrast, the *UCCC* introduced credit information in a clear and easy to understand format³⁹ whilst also covering more credit transactions than ever before.⁴⁰

²⁹ Banking and Financial Services Ombudsman, above n 13, p16.

³⁰ Consumer Credit Legal Centre (NSW) Inc., above n 12, p9.

³¹ Interview with expert 4, October 2005.

³² Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n, p26.

³³ Consumer Credit Legal Centre (NSW) Inc., above n 12, r p15.

³⁴ (1994).

³⁵ Mr Mildenhall, *Second Reading of Consumer Credit* (Speech delivered to the Victoria Legislative Assembly, 24 May 1995).

³⁶ Commonwealth Government, *What is the Consumer Credit Code*,

<http://www.creditcode.gov.au/display.asp?file=/content/what_is_the_credit_code.htm> at 16.10.05.

³⁷ Dr Dean, *Second Reading of Consumer Credit* (Speech delivered to the Victoria Legislative Assembly 24 May 1995).

³⁸ Mrs Wade, *Second Reading of Consumer Credit* (Speech delivered to the Victoria Legislative Assembly 24 May 1995).

³⁹ Commonwealth Government, *Consumer Credit Code*,

<<http://www.creditcode.gov.au/display.asp?file=/content/consumer.htm>> at 16.10.05.

⁴⁰ Above n 33.

The Legislative Structure of the UCCC

The *UCCC* was set up as a template scheme. All Australian states and territories signed the Uniform Consumer Credit Laws Agreement 1993 and then template legislation was passed in Queensland (*Consumer Credit (Qld) Act 1994* and *Consumer Credit Regulation (Qld) 1995*) followed by the remaining states and territories passing enabling legislation.⁴¹ This enabling legislation adopted that template legislation and part 2 of the *Consumer Credit Victoria Code 1996* reflects the agreement between Victoria, the Commonwealth and the other states.⁴² According to this scheme, any amendment to the template legislation applies automatically across all of Australia, but the administration of the *UCCC* is the responsibility of the individual states and territories.⁴³

The Objectives of the UCCC

The objective of the *UCCC* is to provide uniform laws applicable in all Australian jurisdictions.⁴⁴ Like other Codes, the *UCCC* does not try to provide a provision which deals with every possible scenario involving credit transactions and it is not intended to restrict consumer choice or product flexibility.⁴⁵ Nonetheless, it does regulate a credit provider's conduct for the life of the loan. It aims to achieve this by letting market forces restrain the price and availability of credit while also providing mechanisms for redress if credit providers breach the code.⁴⁶

One guiding principle of the *UCCC* is to protect consumers through meaningful disclosure.⁴⁷ It attempts to ensure that consumers have enough information about their credit deal before they enter into the contract so they can make the wisest choice about their credit options. Consequently, although the *UCCC* establishes that while a bargain is just that – a bargain, it recognises that the bargaining powers on each side of a credit agreement are not always balanced.⁴⁸

The Coverage of the UCCC

The *UCCC* applies to any credit providers that offer finance to purchase goods, services, land or lease goods to consumers as long as they charge for it and their customers use it for mostly personal, household and domestic purposes.⁴⁹

One way the *UCCC* aims to achieve its goals is through the creation of positive obligations on credit providers to make sure there is adequate disclosure of the terms of the agreement at the time a consumer is entering into a credit transaction. Further to this, the *UCCC* tries to protect the rights of consumers by letting courts make changes to contracts in certain situations.

⁴¹ Ibid.

⁴² Mr Mildenhall, above n 32.

⁴³ Above n 33.

⁴⁴ Ibid.

⁴⁵ Dr Dean, above n 34.

⁴⁶ Above n 33.

⁴⁷ Mr Mildenhall, above n 32.

⁴⁸ Dr Dean, above n 34.

⁴⁹ Above n 34.

One of the situations in which the court is allowed to make changes to a credit contract is where the consumer is unable to meet the obligations of the contract because of illness, unemployment or other reasonable causes. Under section 68, the court is empowered to make changes to the credit contract that will help the consumer pay back the loan. This is provided that the consumer has already sought the credit provider's agreement to changing the contract under section 66 and the credit provider said no.

Another section of the *UCCC* which provides the court with the power to make changes to a contractual arrangement between a credit provider and a consumer is section 70. This provision allows a court to reopen a transaction and make changes to it if at the time of contracting the circumstances were unjust and goes on to outline a number of matters that the court may take into account when deciding whether a transaction was unjust. This provision will be analysed in the next Chapter of this report, but it is interesting to note that the Credit Code website set up by the Australian Government expressly states that the *UCCC* is meant to ensure credit providers do not make contracts with consumers who would have trouble making repayments.⁵⁰ Therefore, for the purposes of this introduction to the *UCCC* it is important to be aware of the fact that the *UCCC* is meant to cover situations of reckless lending as defined by the authors of this report, but that the authors question whether it really does.

Education

One way to make up for any weaknesses in the *UCCC*'s protection of consumer interests is to educate consumers about the dangers of over-commitment. In particular, one Victorian Member of Parliament suggested in his Second Reading Speech before the adoption of all the Uniform Consumer Credit legislation that a concerted effort on the government's part to inform and disseminate information to consumers could overcome the flaws of the legislation.⁵¹ However, education will not end unmanageable debt because consumers do not usually end up over-committed as a result of ignorance.⁵²

The reality according to the experience of the Consumer Credit Legal Centre (NSW) is that there are two categories of people who become over-committed:

- i. People whose financial situation has suffered as a result of unforeseen circumstances; and
- ii. People whose choices are restricted because of their personal situations.⁵³

In relation to the first group of people, education will not have any sort of impact on reducing the financial hardship they suffer. In the case of the second group of people if they are using credit facilities to pay for necessary living expenses, the decision to pay for this month's electricity bill and work out how to pay for it later is far more rational than the decision not to use credit.⁵⁴ Accordingly, in order to safeguard the interests of consumers the community needs to look at how people end up with the level of debt that they do, ensuring that they

⁵⁰ Above n 6.

⁵¹ Mr Mildenhall, above n 32.

⁵² Consumer Credit Legal Centre (NSW) Inc., above n 12, r p14.

⁵³ Ibid. r p14

⁵⁴ Ibid. r p14

have manageable debts. It is not just about educating them about the choices they have in relation to credit when clearly some consumers do not have that choice in the first place.

CONCLUSION

This Chapter has introduced the problem of over-commitment in the community when it comes to credit debt. It has argued that although there is no single reason for its existence, the lending policies and practices of credit providers play a major part and that the failure of credit providers to adequately assess the capacity of consumers to repay their loan encapsulates a reckless disregard of the serious consequences of providing unmanageable debt. This chapter has defined the term 'reckless lending', given background information about the *Uniform Consumer Credit Code (1996)* and explained why reckless lending needs to be dealt with via legislative change rather than educative measures in order to set the scene for the rest of the report. The following chapters will provide more detailed discussions of the law as it stands now, what is actually happening in the community and how this issue can be handled.

CHAPTER TWO
By Natasha Jankovska

RECKLESS LENDING AND THE LAW

INTRODUCTION

As outlined in Chapter One, the law regulating the provision of credit to natural persons,⁵⁵ wholly or predominantly for personal, domestic or household purposes,⁵⁶ today is found in the *Uniform Consumer Credit Code (UCCC)*.⁵⁷ However, for an Act whose purpose is consumer protection,⁵⁸ it appears that the *UCCC* does very little to protect vulnerable debtors from reckless lenders. Rather than “operate to ensure, as a matter of practice, that the credit provider undertakes a proper assessment of the borrower's capacity to repay before providing finance,”⁵⁹ the *UCCC* operates in an ad hoc manner and provides that the Victorian and Civil Administrative Tribunal (VCAT) ‘may’ access a range of remedies to grant relief to victims of reckless lending⁶⁰ if the transaction leading up to the provision of credit was “unjust.”⁶¹ As encouraging as this may sound, the limited available cases and commentary illustrate that the current legislative scheme is extremely hard to satisfy and that the protection afforded “is at best illusory, and at worst serves to mask unfair and unsafe practices.”⁶² In addition, for people in financial hardship, the prospect of legal costs of the VCAT or a costs order against them may also be a deterrent in taking action. The object of this Chapter is to analyse the reckless lending provisions of the *UCCC* and have a brief look at the relevant provisions of the banking industry’s *Code of Banking Practice* (2004).

THE CONSUMER CREDIT CODE

The Law

Under section 70(1) and 71 of the *UCCC*, the Victorian Civil and Administrative Appeals Tribunal (VCAT)⁶³ may reopen a transaction giving rise to the provision of credit if satisfied that the credit contract, mortgage or guarantee “at the time it was entered into or changed

⁵⁵ *Consumer Credit (Vic) Code 1996 s 6a*.

⁵⁶ *Consumer Credit (Vic) Code 1996 s 6b*.

⁵⁷ In Victoria, the *UCCC* and Regulations have been adopted as the *Consumer Credit (Victoria) Code* and *Consumer Credit (Victoria) Regulations* by virtue of sections 5 and 6 of the *Consumer Credit (Victoria) Act 1995*.

⁵⁸ *Richard David Godfrey v National Australia Bank (2001) NSWSC 977*, Paul Bingham and Rowena Low, ‘Re-opening unjust Contracts’ (1996) 70(6) *Law Institute Journal* 42.

⁵⁹ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria citing Nicola Howell, ‘Consumer Credit Review Issues Paper’ (2005) 24. Expert Interviews: 9 September, 15 October and 29 October 2005.

⁶⁰ *Consumer Credit (Vic) Code 1996 s 71*.

⁶¹ *Consumer Credit (Vic) Code 1996 s 70(1)*.

⁶² David Niven and Tim Gough, ‘The Operation of the Consumer Credit Code’ (2004) *Consumer Credit Legal Service Inc.* 23.

⁶³ “Court” for the purpose of the relevant provisions means Victorian Civil and Administrative Tribunal; *Consumer Credit (Victoria) Act 1995 ss 3(1) and 8(1)a*.

(whether or not by agreement)⁶⁴ was “unjust.”⁶⁵ It may make a variety of orders in respect to the transaction, including the setting aside of the transaction ‘wholly or in part.’⁶⁶ Section 70(7) defines unjust as: “unconscionable, harsh or oppressive,” however, the definition of “unjust” “is not limited to the so called ‘tautological trinity,’”⁶⁷ and “injustice in this context can either encompass injustice in the terms of the document itself or injustice in the party’s conduct at the time the document was entered into.”⁶⁸ In coming to its conclusion, VCAT is to have regard to “the public interest” to ensure that the credit provider has satisfied “community standards of business morality”⁶⁹ and so that the public’s interest in the certainty of contract and the fulfilment of the consumer protection purpose of the Act are protected.⁷⁰ More importantly, the Tribunal is to have regard “to all the circumstances of the case,”⁷¹ and amongst other factors, may have regard to s 70(2)(1);

whether at the time the contract...was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship.

Interpretation and Application of the Law

Although ss 70-71 of the *UCCC* are heavily modelled on the provisions of the *Credit Acts* and the *Contracts Review Act 1980* (NSW), section 70(2)(1) is a novel provision, incorporated into the *UCCC* as a response to the wave of irresponsible lending that occurred throughout the 1980’s.⁷² Given its short period of existence, the “the inability of many consumers to gain access to justice through VCAT”⁷³ and the fact that reckless lending disputes are most often settled through negotiation by financial counsellors, Consumer Affairs Victoria, the [Banking and Financial Services Ombudsman](#) (BFSO) and [Consumer Credit Legal Service](#) (CCLS) solicitors⁷⁴ there is very little case law on the current provisions of the *UCCC*. Often these settlements have to be made in the client’s best interests and the condition of settlement by the creditor is confidentiality. This means that ‘reckless lending’ practices are rarely made public and that the systemic reform that may be needed cannot occur. A good illustration of the interpretation and application of s 70(2)(1) so far can be found in the New South Wales Supreme Court case of *Godfrey v National Australia Bank Ltd.*⁷⁵ The facts of this case are not uncommon and are as follows.

Between 1985 and 1996, Mr Godfrey held a Master Card with the National Australia Bank (NAB) with a credit limit of \$6,000.⁷⁶ However, in 1996 and 1999, Mr Godfrey was offered

⁶⁴ *Consumer Credit (Vic) Code 1996* s 70(1).

⁶⁵ *Consumer Credit (Vic) Code 1996* s.70.

⁶⁶ *Consumer Credit (Vic) Code 1996* s 71c).

⁶⁷ *Consumer Credit (Vic) Code 1996* s 70(7). Robert McDougal QC citing McHugh JA in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 AT 620-1, ‘An Introduction to the Consumer Credit Code’ (1996) 15 *Australian Bar Review* 24.

⁶⁸ *Maisano v Car and Home Finance Pty Ltd (Credit)* [2005] VCAT 1755, [10].

⁶⁹ Paul Bingham and Rowena Low, above n 4, 42.

⁷⁰ *Ibid.*

⁷¹ *Consumer Credit (Vic) Code 1996* s 70(2).

⁷² Paul Bingham and Rowena Low, above n 4, 42, Robert McDougal QC, above n 13, 24.

⁷³ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, above n 5, 19.

⁷⁴ *Ibid* 34, Expert Interviews 15 October and 29 October 2005.

⁷⁵ *Richard David Godfrey v National Australia Bank (2001) NSWSC 977.*

⁷⁶ *Ibid* [32].

and accepted pre-approved increases in his credit limit to \$9,000 and \$12,000 respectively,⁷⁷ based solely on his ability to repay his debts in the past.⁷⁸ Although Mr Godfrey had in the past repaid his debts and at one stage reduced the debt on his card to only one cent,⁷⁹ he was self employed, had a low income and made repayments on the card from money he had borrowed from his mother and had drawn from his superannuation fund.⁸⁰ Mr Godfrey also gave evidence that his “business was showing losses and he was relying on Social Security income at the time the Bank offered him a pre approved increase of credit to \$12,000.”⁸¹ He argued that he should be relieved from his obligation to repay the debt owed on the card on the basis that “the Bank made no inquiry about his financial circumstances when it made the offers of pre approved increases in credit.”⁸² He owed \$12,077.26 plus charges.⁸³

Despite these facts, the Court found in favour of NAB. It did so largely on the basis of section 70(4), which states:

In determining whether a credit contract is unjust the court is not to have regard to any injustice arising from circumstances that were not reasonably foreseeable when the contract was entered into or changed.

That is, although Mr Godfrey had financial problems at the time the credit contract was changed, and there was evidence that the “timing and amounts of the payments were capable of showing the possibility of some difficulty from time to time,”⁸⁴ Mr Godfrey had nevertheless made repayments to the Bank, demonstrating to them that he “was able to pay in accordance with the terms of the contract and without substantial hardship.”⁸⁵

Section 70(2)l) was also considered by the Victorian Administrative and Appeals Tribunal in the case of *Raschilla v General Motors Acceptance Corporation Australia*.⁸⁶ The facts of this case are as follows. In 1998 and 1999, Mr Raschilla and his son entered into two separate car loan contracts with GMAC.⁸⁷ Mr Raschilla’s son became ill and lost his job in 1999. A guarantor under his son’s contract,⁸⁸ Mr Raschilla made repayments on both loans for some time,⁸⁹ until a refinancing contract was entered into in June 2000 to combine the two loans under one contract.⁹⁰ Mr Raschilla continued to make repayments under this contract until he too lost his job.⁹¹ Mr Raschilla allegedly suffered from narcolepsy⁹² and sought to reopen the transaction leading to the refinancing contract on the basis that:

⁷⁷ Ibid.

⁷⁸ Ibid [78].

⁷⁹ Ibid [34].

⁸⁰ Ibid [36].

⁸¹ Ibid [42].

⁸² Ibid.

⁸³ Ibid [3].

⁸⁴ Ibid [83].

⁸⁵ Ibid.

⁸⁶ *Raschilla v General Motors Acceptance Corporation Australia* [2002] VCAT 1653.

⁸⁷ Ibid [6] and [9].

⁸⁸ Ibid [7].

⁸⁹ Ibid [12].

⁹⁰ Ibid [15].

⁹¹ [16].

⁹² [15].

GMAC ought not to have proceeded with the re-financing because it knew, or if it had made reasonable enquiry would have known that Mr Raschilla suffered from narcolepsy, a sleep disorder, that might affect his capacity to work and earn income, and that also because of other debts he would have been unlikely to have been able to meet the commitments under the re-financed loan.⁹³

However, VCAT refused to reopen the transaction because Mr Raschilla had not told GMAC, nor was GMAC put on notice of his condition, at the time of entering into the refinancing contract.⁹⁴ That is, GMAC assessed Mr Raschilla's credit worthiness based on his credit history with them and information provided by him in his credit application.⁹⁵ As far as GMAC was concerned, Mr Raschilla "was an existing client...with a good payment record"⁹⁶ whose "credit application showed sufficient income to be able to meet loan commitment, and did not disclose any debts additional to the ones disclosed in his previous credit application for his previous loan."⁹⁷ Mr Raschilla provided no information to GMAC, at the time of entering into the refinancing contract, "that would reasonably have led it to understand that he was about to be retrenched or that he was ill."⁹⁸ On the contrary, Mr Raschilla had "expressed confidence in being able to meet not only his own obligations, but the obligations under his son's loan"⁹⁹ in a letter to GMAC in February 2000.¹⁰⁰ As a result, s 70(2)l) could not be established.

Although section 70(2)l) did not apply in the case of *Maisano v Car and Home Finance Pty Ltd*,¹⁰¹ it is nevertheless an illustration of the type of circumstances that are required to reopen an 'unjust' transaction. The facts of the case are as follows. Mrs Maisano was a 59 year old Italian pensioner with little knowledge of English.¹⁰² On 17 October 2002, Mrs Maisano's son Dominic applied for a loan with Car and Home Finance Pty Ltd over the phone. As he did not own a car, he listed his mother as co-borrower and offered her car as security for the loan.¹⁰³ The loan was approved later that day¹⁰⁴ and on 18 October 2005, Dominic asked Mrs Maisano to attend Car and Home Finance Pty Ltd's offices to sign the loan contract.¹⁰⁵ Mrs Maisano signed the contract on the basis of her son's assurances that it was his loan and she was only there for "support."¹⁰⁶

VCAT reopened and set aside the contract and mortgage in relation to Mrs Maisano¹⁰⁷ because she "did not understand that she signed as co-borrower or that she mortgaged her car as security for the loan."¹⁰⁸ At the time the

⁹³ Ibid.

⁹⁴ Ibid [47] and [48].

⁹⁵ Ibid [15].

⁹⁶ Ibid.

⁹⁷ Ibid.

⁹⁸ Ibid [48].

⁹⁹ Ibid [47].

¹⁰⁰ Ibid.

¹⁰¹ *Maisano v Car and Home Finance Pty Ltd (Credit)* [2005] VCAT 1755.

¹⁰² Ibid [13] and [14].

¹⁰³ Ibid [15].

¹⁰⁴ Ibid [17].

¹⁰⁵ Ibid [18] and [24].

¹⁰⁶ Ibid [17].

¹⁰⁷ Ibid [1].

¹⁰⁸ Ibid [28].

loan contract was entered into, owing to her lack of English, a result of which she lacked bargaining power, she was incapable of protecting her own interests.¹⁰⁹ In addition, the failure of the credit provider “to take adequate measures to ensure that she understood the nature and implications of the transactions,”¹¹⁰ and the deception on behalf of her son, were all factors considered by the VCAT¹¹¹ Furthermore, the consequences of her non-compliance with the contract would be the repossession and sale of her car; her sole asset.¹¹²

Commentary

Firstly, as the cases of *Godfrey* and *Raschilla* demonstrate, it appears that it is insufficient for the purposes of establishing s 70(1)l), for the debtor to rely on the mere fact that the credit provider relied exclusively upon the debtor’s credit payment history in assessing their ability to repay an increased level of debt.¹¹³ It is also important to understand that “even where this ground is made out in a particular case, the contract will not necessarily be re-opened. The contract will not be re-opened unless there is an overall finding of unjustness.”¹¹⁴ That is, s 70(2)l) is “only one of the criteria to be taken into account by the Court in determining whether the change to the contract was unjust.”¹¹⁵ Thus, in Mr Raschilla’s case, VCAT looked at each of the factors under s 70(2) and held that given that Mr Raschilla’s brother, a GMAC senior manager, helped arrange the loan for considerably lower interest rates on each of the loan contracts, there was an advantage in bargaining power under s 70(2)b), which contradicted any suggestion of unjustness in the circumstances.¹¹⁶

The cases and commentary also suggest that “even where a transaction is impugned on the grounds that it is unjust, the debtor must ‘bring to account the benefit received.’”¹¹⁷ In *Maisano*, Mrs Maisano’s did not benefit from the proceeds of the loan, so there was no reason to refuse to set aside the contract in its entirety.¹¹⁸ In the sphere of reckless lending, taking into account the benefit received makes it “difficult to imagine the circumstances in which the debtor should not be required to repay at least the principal sum... lent.”¹¹⁹ Therefore, in circumstances where the debtor was financially overcommitted, the debtor will not obtain any real or practical relief. What is required in such a case is reduction of or release from liability. Any outcome other than this will merely compound the unfairness to the debtor, and will in turn create a situation in which credit providers have little if any

¹⁰⁹ Ibid [36].

¹¹⁰ Ibid [38].

¹¹¹ [37].

¹¹² Ibid [35].

¹¹³ *Richard David Godfrey v National Australia Bank (2001) NSWSC 977*, *Raschilla v General Motors Acceptance Corporation Australia [2002] VCAT 1653*, Expert Interview: 29 October 2005.

¹¹⁴ Ibid

¹¹⁵ *Richard David Godfrey v National Australia Bank (2001) NSWSC 977 [27]*, Expert Interview: 29 October 2005.

¹¹⁶ *Raschilla v General Motors Acceptance Corporation Australia [2002] VCAT 1653 [36]*.

¹¹⁷ David Niven and Tim Gough citing Hunt J in *Esanda Finance Corporation Ltd v Murphy* (1989), above n 8, 24.

¹¹⁸ *Maisano v Car and Home Finance Pty Ltd (Credit) [2005] VCAT 1755 [30]*.

¹¹⁹ David Niven and Tim Gough, above n 8, 24, Banking and Financial Services Ombudsman (BFSO), ‘*Bulletin 45 Credit card limits and maladministration*,’ (2005) 9, Expert Interview: 29 October 2005.

disincentive to over commitment, on the basis that the only potential detriment will be loss or even merely reduction of profit.¹²⁰

Another barrier to relief, once injustice is found, is that the Court must have regard to section 70(5), which states: ‘In determining whether to grant relief in respect of a credit contract that it finds to be unjust, the court may have regard to the conduct of the parties to the proceedings in relation to the contract since it was entered into or changed.’

So, it can be concluded that s 70(2)l) of the *UCCC* fails to provide effective protection against reckless lending and ultimately operates in the interest of credit lenders. So long as the debtor does not inform or by their conduct make it known to the credit provider that there are changes in their financial position, the credit provider need only look to their credit repayment history to determine the debtors ability to repay an increased level of debt.¹²¹ This is further evidenced in a comment made prior to the introduction of the Credit Code, that:

It is not the purpose of the provision to require credit providers to make inquiries beyond those ordinarily made by prudent lenders. Rather it is intended to deal with those lenders who consciously or recklessly lend without making any, or any reasonable, inquiries into the debtor's ability to pay.¹²²

The most obvious problem with not assessing the current financial position of a debtor to determine whether they are capable of repaying an increased level of debt is that it “may lead to an inappropriate offer of credit,”¹²³ due to changes in the debtor’s employment status, “fixed income such as a disability or age pension or an increase in their financial commitments.”¹²⁴ Furthermore, as *Godfrey’s* case illustrates:

Assumptions about the cardholder’s financial position based on the payment history may be false if the cardholder is obtaining assistance with the debt repayment from a third party or is using other sources of credit to maintain the ability to repay the minimum monthly payment.”¹²⁵

However, not only is it in the best interests of debtors, but it is also in the best interests of credit providers that the *UCCC* be amended to include a positive obligation on credit providers to ensure that the current financial position of the debtor is taken into account before additional credit is provided. That is, it appears that Robert McDougal QC’s 1996 prediction that “s 70 is likely to be used as a defence in enforcement proceedings”¹²⁶ was an accurate one; each of the applicants in the cases discussed above relied on section 70 as a defence to enforcement proceedings initiated by the credit providers to recover debt or repossess vehicles in cases of debtor default. Therefore, obliging creditors to take account of the current financial position of the debtor before providing credit “will ensure that the need to bring enforcement proceedings is limited.”¹²⁷ Namely, more “careful attention to the

¹²⁰ David Niven and Tim Gough, above n 8, 24.

¹²¹ *Richard David Godfrey v National Australia Bank (2001) NSWSC 977, Raschilla v General Motors Acceptance Corporation Australia [2002] VCAT 1653*, Expert Interview: 29 October 2005.

¹²² Victoria, *Parliamentary Debates*, Legislative Assembly, 4 May 1995, 1236 (Attorney-General Wade).

¹²³ Banking and Financial Services Ombudsman (BFSO), above n 65, 8.

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*

¹²⁶ Robert McDougal QC, above n 13, 29.

¹²⁷ *Ibid.*, 28.

granting of credit.”¹²⁸ will not only minimise the prospects of a successful claim (or, in this context, a successful defence to an enforcement action). It should also reduce the need for enforcement actions to be brought at all and, ultimately, bring about a fairer environment for the conduct of credit business.¹²⁹

THE CODE OF BANKING PRACTICE

The *Code of Banking Practice* (2004) is the banking industry’s “voluntary code of conduct”¹³⁰ and is published by the Australian Bankers’ Association.¹³¹ As such, although it “establishes the banking industry’s key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their banking services,”¹³² it will only come into effect when adopted by banking institutions and merely operates as a statement by bankers to their customers that they are “contractually bound by their obligations under the Code.”¹³³ Nevertheless, it is important to talk about the Code because unlike the *UCCC*, clause 25.1 of the *Code of Banking Practice* does impose a positive obligation upon its member banks. It states as follows:

Before we offer you a credit facility (or increase in an existing credit facility), we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay it.

However, as encouraging as it sounds, the nature and scope of this positive obligation is unclear, as the Code provides no definition for ‘credit assessment methods.’ Thus, without further explanation, it is unknown whether this obligation merely replicates the current s 70(2)l, as Richard Viney in his review of the banking code implies,¹³⁴ or whether it seeks to require, like the progressive s 28A of the *Fair Trading Act 1992* (ACT), that a credit provider must undertake a ‘satisfactory assessment process,’¹³⁵ which involves an examination of the financial position of the debtor, prior to the provision of credit to a customer.¹³⁶

Furthermore, even if there is a positive obligation imposed on the credit provider to do so, the lack of an effective enforcement mechanism built into the Code to ensure compliance with the obligation, renders the possible positive obligation meaningless. For example, clause 34 of the Code of Banking Practice provides for the establishment of a Code Compliance Monitoring Committee (CCMC), to monitor the compliance of member banks with the Code¹³⁷ and investigate and make determinations on any alleged breaches under the Code.¹³⁸ Apart from the ability of the CCMC to name in a CCMC report any member bank guilty of

¹²⁸ Ibid.

¹²⁹ Ibid, 29.

¹³⁰ *Code of Banking Practice 2004* cl. 1.1.

¹³¹ Australian Bankers Association Inc. *The main features of the revised Code* (2004)

<<http://www.bankers.asn.au/Default.aspx?ArticleID=450>> at 6 October 2005.

¹³² Australian Bankers Association Inc. *Frequently Asked Questions on the modified Code of Banking Practice 2004* (2004) <<http://www.bankers.asn.au/Default.aspx?ArticleID=448>> at 6 October 2005.

¹³³ Ibid

¹³⁴ Richard Viney, ‘Review of the Code of Banking Practice’ (2001) RTV Consulting Pty Ltd <<http://www.reviewbankcode.com>> at 3 October 2005.

¹³⁵ *Fair Trading Act 1992* (ACT) s 28A.

¹³⁶ *Fair Trading Act 1992* (ACT) s 28A.

¹³⁷ *Code of Banking Practice 2004* cl. 34b)i).

¹³⁸ *Code of Banking Practice 2004* cl. 34b)ii).

“serious or systematic non-compliance,”¹³⁹ failing to comply with a CCMC request to remedy a breach or do so within a reasonable time,¹⁴⁰ breaching an undertaking given to the CCMC¹⁴¹ or not taking any steps to prevent a breach occurring after being warned that they may be named,¹⁴² results in no real sanctions in cases of breach of the Code. As a result, the author agrees with the view that:

If the Code is to achieve credibility as an instrument of self-regulation, there must be demonstrable reasons for having confidence that Code subscribers will comply with the Code and will be subject to appropriate sanctions when they do not.¹⁴³

CONCLUSION

This Chapter’s analysis of the reckless lending provisions of the *UCCC* and the *Code of Banking Practice* demonstrates that the failure of these instruments to impose positive obligations on creditors to assess capacity to repay renders both instruments ineffective in protecting consumers against reckless lending. Given the self-regulatory nature of the *Code of Banking Practice* and its failure to provide for effective enforcement mechanisms for its breach or non-compliance, it is recommended that an amendment to the *UCCC* be made to include a positive obligation on lenders to assess capacity to repay. This recommendation will be further explored in Chapter 4.

¹³⁹ *Code of Banking Practice 2004* cl. 34)i)i).

¹⁴⁰ *Code of Banking Practice 2004* cl. 34)i)ii).

¹⁴¹ *Code of Banking Practice 2004* cl. 34)i)iii).

¹⁴² *Code of Banking Practice 2004* cl. 34)i)iv).

¹⁴³ Richard Viney, above n 80.

CHAPTER THREE

By Donna Curnow

THE INDUSTRY EXPOSED

INTRODUCTION

This chapter focuses on the ‘practical’ aspects of reckless lending by revealing the experiences of those who have encountered it at the ‘coal face’. The author sets the scene by briefly identifying significant changes in the trends of credit card debt. These changes are linked to the controversial but widely implemented ‘behavioural scoring’ system, used by creditors to assess a debtor’s capacity to repay. The chapter analyses opposing perspectives on the current system and uses case studies and interviews with experts conducted for this project to illustrate what is really going on in the field. Structural impediments are identified on a number of different levels including: the credit reporting system; the duty of financial counsellors; current levels of access to the court; and the jurisdiction of the Banking and Financial Services Ombudsman (BFSO).

The author concludes by conceding that no one approach will suffice in eradicating the financial exploitation of vulnerable and unsuspecting members of the community. However, a number of recommendations are put forward to put the credit industry on notice - so that both the government and the community can keep a ‘score’ of *their* behaviour.

THE PLASTIC INVASION

Consumer debt has risen dramatically since the deregulation of the banking sector. Between 1994 and 2001 there was a 46 % increase in Australia of bank issued credit cards,¹⁴⁴ now about 70% of households own at least one.¹⁴⁵ More alarming is the access to seemingly endless amounts of credit, as part of a relentless campaign by most major creditors to offer unsolicited credit limit increases to existing credit card holders. Record amounts are being spent and record amounts of cash withdrawals on credit cards are being made.¹⁴⁶ Incidentally, Australia has rapidly evolved from a low debt-to-income ratio to having one of the highest in the world.¹⁴⁷ Yet ironically, in 2004, the Federal Treasurer congratulated Australian households on the reduction of credit card defaults.¹⁴⁸

¹⁴⁴ Visa International, *Newsroom – Briefing Kit – Facts About Consumer Debt 2* <http://www.visa.com.au/newsroom/briefkit_facts.shtml> at 25th October 2005.

¹⁴⁵ ABC Radio National – Background Briefing, *The Debt Mask* (2005) 14 <<http://www.abc.net.au/rn/talks/bbing/stories/s1413545.htm>> at 25th October 2005.

¹⁴⁶ NSW, *Parliamentary Debates*, Legislative Council, 5 May 2005, 3 (The Hon. Dr Arthur Chesterfield-Evans).

¹⁴⁷ Josh Gordon, ‘Reserve Bank warns on loan defaults’, *The Age* (Melbourne), 26 March 2004, 1.

¹⁴⁸ NSW Legislative Council, above n 3, 1.

THE RECKLESS LENDING MASK

The Reserve Bank of Australia's (RBA) statistics suggest that households are managing their credit card debt because default rates are historically low.¹⁴⁹ According to the RBA only 0.6 percent of credit card holders find themselves in financial trouble.¹⁵⁰ However these statistics can be contradicted as one delves a bit further into actual credit practices. For instance, in local newspapers¹⁵¹ there are advertisements for debt consolidation, refinancing solutions, debt management and the like.¹⁵² The recent emergence of the credit card debt has resulted in a booming debt consolidation industry.¹⁵³ Debt consolidation can be a way of debt masking or trading water,¹⁵⁴ as such those who consolidate do not appear as default statistics.¹⁵⁵

BEHAVIOURAL SCORING

The shift by banks in their approach to lending has played a significant role in the current credit card spending explosion.¹⁵⁶ Most mainstream banks now use an 'automated statistical evaluation process,' as their only means of evaluating an individual's capacity to repay a credit limit increase.¹⁵⁷ Commonly referred to as 'behavioural scoring,' this process automatically deems credit card holders, who maintain minimum repayments, with the capacity to repay substantially larger amounts of debt. Once a customer has 'scored,' automatic unsolicited offers of credit limit increases are triggered without any consideration given to the debtor's:

- Current level of debt;
- Change in personal circumstances, for example – wages, employment status, divorce, capacity to work or age;
- Means of meeting minimum repayments, for example - using one credit card to payoff the other, drawing down on a mortgage, borrowing from others or gambling.¹⁵⁸

CREDITOR'S PERSPECTIVE

A Research Report, commissioned by VISA, directly attributes the reduction of credit card default rates to the bank's commitment to their 'credit scoring' processes¹⁵⁹ ('behavioural scoring'). The creditor states that it is an effective mode of predicting a customer's credit performance as well as removing the subjective nature of the assessments. Interestingly, this is precisely what expert's interviewed for their report, claim is fundamentally wrong with the system.¹⁶⁰

¹⁴⁹ ABC Radio National, above n 2, 8,10; NSW, above n 5; Visa International, above n 1, 2; Nolan Norton Institute, KPMG Consulting and Michael Hartman of the National Australia Bank, *Credit Cards in Australia Summary of a research report, July 2001*, 1 <<http://www.itsa.gov.au> at 16 October 2005>.

¹⁵⁰ NSW Legislative Council, above n 3, 2.

¹⁵¹ Ibid 1.

¹⁵² ABC Radio National, above n 2, 6.

¹⁵³ Ibid.

¹⁵⁴ Ibid 8.

¹⁵⁵ Ibid.

¹⁵⁶ NSW Legislative Council, above n 5, 1; 'Easy Credit puts Australians at risk', *Daily Telegraph*, 06 January 2005.

¹⁵⁷ Visa International, above n 1, 2, 3.

¹⁵⁸ Interview with Financial Counsellor, 11 October 2005.

¹⁵⁹ Visa International, above n 1, 2, 3.

¹⁶⁰ Interview with three different Financial Counsellors on three separate occasions, October 2005.

The VISA Report argues that if credit limits were tightened by 10%, it would disproportionately impact on certain demographic groups who would be denied access to credit.¹⁶¹ However this argument does not address the crux of the reckless lending debate - the inappropriate and unmanageable *amount* of credit, not the initial decision to provide access to it.

Furthermore, the VISA Report claims that if banks were banned from initiating unsolicited credit extensions it would result in an estimated \$30 million national reduction of consumption expenditure per annum.¹⁶² Such an argument is unlikely to hold weight, given that excessive consumer expenditure plays a dominant role in the Reserve Bank of Australia's (RBA) decision to hike up interest rates.

The VISA Report asserts that the selection criteria used in 'scoring' suggests a generally conservative approach.¹⁶³ This view is contested by experts working on a daily basis with those affected by reckless lending. One centre alone reported receiving 6,500 calls in ten months by people not managing their debts.¹⁶⁴

HOW PEOPLE ARE LURED INTO THE DEBT TRAP

The modern approach to lending by mainstream banks is in stark contrast to their previously conservative approach. As one expert in the field reflected, "...it was not that long ago that you'd have to make an appointment to see your bank manager, with your cap in your hand and argue your case for credit. The banks wouldn't lend you money for frivolous things. In 1987 you couldn't use credit to buy groceries...now our economy relies on debt to keep producing output."¹⁶⁵ He used an example of a client who sought financial counselling after obtaining a \$10,000 loan to consolidate his debts, which subsequently blew out to \$30,000 - with nothing to show for it. "Credit providers make most of their money from people who have a credit card debt. Banks buy their money at 5.5 percent and sell it at 18 percent. The minimum repayment has dipped from 5% to 2% - at that rate it takes years to repay, it becomes like another mortgage. \$10,000 at 16.5% interest, making minimum payments, will take 47 years to repay."¹⁶⁶

Similarly if you use the equity in your home to purchase a car, you are paying it off for 25 years. The reduced interest rates are attractive to people but they may fail to realise that a \$25,000 car will end up costing around \$60,000.¹⁶⁷ Similarly, those experiencing hard times are getting caught up in hype of 'debt consolidation,' which is riding on the back of the reckless lending epidemic. However, many don't realise that the better option may be to downsize and escape the 'modern debtor's prison'¹⁶⁸ than to refinance.

¹⁶¹ Visa International, above n 1, 4, 5.

¹⁶² Ibid 4.

¹⁶³ Visa International, above n 1, 3.

¹⁶⁴ ABC Radio National, above n 2, 8.

¹⁶⁵ Interview with Financial Counsellor, 11 October 2005.

¹⁶⁶ Ibid.

¹⁶⁷ ABC Radio National, above n 2, 4.

¹⁶⁸ Ibid 8.

Those lured by marketing campaigns or existing financial stress simply may not realise that the consumer credit system is fundamentally flawed.¹⁶⁹ People unaware of the changes in lending policies are accustomed to the conservative policies of the past and are likely to rely on the bank's 'professional' judgment in assessing their appropriate credit capacity. Others are vulnerable because they are young and inexperienced or simply not in a position to refuse unsolicited offers of credit increases.

During a recent ABC Radio National program titled 'The Debt Mask,' a range of views were sourced from the public about their experiences in access to debt. When asked whether it was too easy to get a credit card, one man replied that he got one as soon as he turned eighteen.¹⁷⁰ He had no money in the bank at the time and had just opened a new bank account (with a bank which had adopted the Code of Banking Practice (CBP)) when he was given a credit card.¹⁷¹

One respondent was a single man on a disability pension, living in a rural area. In order to retain a car, phone and internet service he "...had to accept each one of a steady stream of unsolicited offers of credit increases," on four credit cards. The offers have now stopped but his total credit card debt is \$75,000.¹⁷²

Unfortunately, the above cases are far from isolated incidents according to financial counsellors who assist some of the people in financial trouble as a result of reckless lending.

The following case study reveals how some credit providers are unwilling to grant personal loans for small amounts, but at the same time willing to grant credit cards for larger amounts - extracting higher rates of interest from those who can least afford it.

Case Study

Ms X, on a disability pension unsuccessfully applied to a bank for a \$2,000 loan. She then went to another bank and was also initially unsuccessful. The bank contacted her the following day claiming there had been a mistake. Ms X was then granted a \$5000 credit card, which she 'maxed out' and was subsequently unable to repay.

Ms X sought the assistance of a financial counsellor who negotiated with the bank on her behalf. The banks offer of a personal loan to assist in repayment of the credit card debt was flatly rejected, since Ms X should never even have been granted a \$2,000 personal loan on the basis of her income. Investigations undertaken by an investigator confirmed this position to be true.

As a result of negotiations Ms X was required to repay \$2,000, without interest, by way of minimum monthly instalments.¹⁷³

¹⁶⁹ Interview with a Financial Counsellor, 4 October 2005.

¹⁷⁰ ABC Radio National, above n 2, 2.

¹⁷¹ Ibid 3.

¹⁷² Ibid 6.

¹⁷³ Interview with a Financial Counsellor, 4 October 2005.

Case Study - 'Sexually Transmitted Debt'

Mr. H and Mrs. W had a \$120,000 mortgage which was an 'all in one account' in joint names, though the statements were sent out to Mr. H.

Mr. H, a gambler, would max out the credit card - sometimes blowing up to \$7000 in a week and then would 'vacuum' it up with the mortgage. The creditor neglected to inform Mrs W, the co-owner of the home, when Mr H was drawing on the mortgage.

Mr. H and Mrs. W's mortgage subsequently blew out to \$280,000.¹⁷⁴

Case Study

Ms D requested her mortgage repayments be reduced to 'interest only' payments, due to persistent financial difficulty and pending the sale of her home. There had been significant changes in her personal circumstances, of which she informed the bank. Ms D was left as the sole mortgagor, part time student/employee and single mother. The bank declined her request on the basis that she was over-debited and there was concern that the loan might not be fully repaid within the 22 years remaining on life of the loan. This was despite her house being on the market at a modest price.

A week later, Ms D received an offer by the same bank to extend her credit card from \$6,000 to \$9000. Ms D accepted the offer by signing and returning the form by post.

A short time later, Ms D was closing an inactive account when a staff member of the bank who was accessing her file, noted that she was 'due' to increase her credit card limit from \$9,000 to \$14,500. Ms D asked what procedures were involved to affect the increase. The staff member replied, "...just you saying yes," while she hovered over the 'yes' option with the cursor on the computer screen.¹⁷⁵ This conduct is in breach of section 62(3) of the Uniform Consumer Credit Code (UCCC), which states that a creditor may *only* increase the limit of an existing credit contract at the request of the debtor or with the debtor's written consent.

The bank in question is a mainstream bank and also an adoptee of the CBP.¹⁷⁶ Clause 25.1 of the CBP provides that an adopting creditor will exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in forming an opinion about the customer's ability to repay before an offer of credit increase is made.¹⁷⁷

Although the CBP is not 'law,' per se, adopters are contractually bound by it.¹⁷⁸ However, clause 25.1 is drafted too broadly to encompass each and every mode of operation implemented by creditors, such as 'behavioural scoring.' Therefore, an effective interpretation of the CBP relies heavily on the morality of the lending institutions, where many have a conflict of interest. As such, the author holds the view that reckless lending needs to be tackled from a number of different angles.

¹⁷⁴ Interview with Financial Counsellor, 11 October 2005.

¹⁷⁶ Australian Bankers Association, *Code of Banking Practice*, 2003 1

<<http://www.bankers.asn.au/Default.aspx?ArticleID=460>> at 01 October 2005.

¹⁷⁷ ABA's Code of Banking Practice, Part D: Principles of Conduct, clause 25.1, 2004.

¹⁷⁸ Australian Bankers Association, *Code of Banking Practice*, 1

<<http://www.bankers.asn.au/Default.aspx?ArticleID=448>> at 26 September 2005.

POSITIVE CREDIT REPORTING

To fully endorse a safer, fairer consumer credit market the current credit reporting regime desperately needs to evolve.¹⁷⁹ Australia currently operates under a negative credit reporting regime which provides lenders with limited data about a potential borrower's existing credit obligations.¹⁸⁰ Therefore in some cases, a prudent credit provider who makes the appropriate inquiries may still fail to ascertain a person's real capacity to repay debt - exemplifying the need for a more comprehensive credit reporting system.¹⁸¹

It seems however, that a positive credit reporting system can be a double-edged sword. On the one hand, it enables creditors to make more informed decisions about a person's capacity to repay, but on the other if implemented to the extent it operates in the USA, those who have had problems with credit may be forced to pay higher interest rates to fight their way out of debt.¹⁸² It has been argued that a 'fair' model sits somewhere at the more conservative end of the spectrum. What is certain though, is that maintaining the status quo is neither in the best interests of the Australian consumer nor the credit providers.¹⁸³

RESPONSIBLE CREDIT LENDING – WHOSE RESPONSIBILITY IS IT?

Given that banks are in the business of making money, is it realistic and in the public interest to solely rely on them to act in the interest of the community? Some take the approach that members of the community are responsible for looking after their own interests. However taking such a simplistic approach to a many-faceted problem will not do justice to those who live on the fringes of society. Many people affected by reckless lending are those whose financial choices are limited to paying the bills or feeding their families or deciding which type of medicine to buy and which type to do without in view of the limited income.¹⁸⁴ Reckless lending is a complex issue and to fully understand why it is so prevalent in our society, it is necessary to identify key factors which attract vulnerable groups to credit facilities when they may not be able to service their credit or loan liability.

The provisions of the UCCC provide a *potential relief* mechanism for those affected by reckless lending - but it should be noted that putting a band-aid on a social disease will not prevent it from spreading. The author of Chapter Two outlined the limited case law regarding this specific area of law, which is largely because cases are strategically kept out of court by banks and credit providers. They are instead settled individually through negotiations between creditors and financial counsellors or the Banking and Financial Services Ombudsman's (BFSO). Financial counsellors are 'between a rock and a hard place' - they know that at a community level it is better for cases to go to court so the prevalence of reckless lending may be identified and judicial precedent can be made. However, they are confined in doing what is in the best interest of each particular client so that when a creditor puts something reasonable on the table they are compelled to accept it. AS stated earlier, some settlements include a 'silencing' clause prohibiting counsellor's from discussing

¹⁷⁹ John Harker, *Global players circling over land of opportunity*, 2004, 3

<http://www.experian.co.za/Knowledge_white%20papers.htm> at 15 October 2005.

¹⁸⁰ D&B Australia, 'Consumer Credit Reporting', (Press Release, 22 April 2004) 1.

¹⁸¹ Ibid.

¹⁸² Ruth Williams, 'Bank rate and risk match on the cards', *The Age*, (Melbourne), 27 July 2005.

¹⁸³ D&B Australia, above n 37, 1.

¹⁸⁴ David Tennant, 'Unsolicited credit card offers', (Edited version of a paper presented to the 11th annual Credit Law Conference, Sea World Nara Resort, 22 August 2001) 1.

particular cases.¹⁸⁵ This is insurance for the creditor that really bad conduct is kept in the closet.

THE ROLE OF THE OMBUDSMAN

The BFSO's scheme provides a dispute resolution mechanism, which works on a case-by-case basis as an alternative to court proceedings.¹⁸⁶ Over a four year period complaints to the BFSO related to credit card lending increased by nearly 300%.¹⁸⁷ However, it is important to note that the scheme is not a statutory body. It is funded by the financial institutions whose conduct is being examined.¹⁸⁸ The Ombudsman does not take on a regulatory role and issues regarding the prevalence of credit cards or level of credit card debt are outside the scope of the scheme's jurisdiction.¹⁸⁹

As it is not the Ombudsman's role to change lending policies and the existing legislation and as the uniform industry code does not provide a safe and fair consumer credit market, an alternative approach may be necessary. Reckless lending has been actively lobbied against for years, yet the issue remains manifestly unresolved. The author of this chapter notes that unless credit providers are prepared to abide by the 'spirit' of the law, their policies and practices will invariably seep through the cracks. Changing legislation is time and resource intensive and realistically it may never keep up with the evolving credit industry.

In view of the complexities and inadequacies of the existing system it seems that a more holistic approach is needed, a concerted effort by all players including the government, community members and credit providers.

RECOMMENDATION - 'CREDITOR' BEHAVIOURAL SCORING

The author recommends the establishment of a government endorsed 'Creditor Star Rating System' to be regulated by an impartial statutory body, in the quest to provide a safer and fairer consumer credit industry. Covert investigations and assessments of creditor performance and lending policies by investigators posing as customers would serve to expose what is really going on within the industry.

The more community minded the creditor - the more stars it is awarded.

Credit providers would fund the promotion of the scheme by default because it would be a great selling pitch in their already expansive commercial campaigns. Imagine the hype ... 'Which bank? The safer, fairer bank – the bank with *all* the stars – the bank who genuinely cares about you and your family's financial security – the bank you can really trust – the truly 'Australian' bank – the bank with a conscience.'

¹⁸⁵ Interview with a Financial Counsellor, 4 October 2005.

¹⁸⁶ Banking and Financial Services Ombudsman, *Bulletin 45* (2005) 3; Banking and Financial Services Ombudsman, *Terms of Reference* (2004) 1.1.

¹⁸⁷ John Harker, above n 36, 8.

¹⁸⁸ Banking and Financial Services Ombudsman, *Terms of Reference* (2004) 1.8.

¹⁸⁹ Banking and Financial Services Ombudsman, *Bulletin 45* (2005) 3.

‘Star Rating Conduct’ could include –

- The implementation of a ‘warning system,’ where the creditor makes contact with *all* the associated debtors when a pattern of cash advances on credit has occurred - as often happens in the case of gambling partners.¹⁹⁰
- Creditors who grant small, low interest loans to welfare recipients (known as micro-lending - discussed in detail by the author of Chapter Four).

The possibilities are endless.

The Government could offer modest incentives to first class banks, such as discounts on stamp duty, which can then be used as a way of enticing customers.

LEGISLATIVE CHANGE

While the ‘star rating scheme’ gives creditors the choice of being more community minded, some changes to the current system need to be mandatory.

Things that should be legislatively mandated–

- A positive obligation imposed on all creditors to conduct proper assessments of a person’s capacity to repay (in a similar way to the NSW Fair Trading Amendment (Responsible Credit) Bill.¹⁹¹ – This is discussed in more detail by the author of Chapter Four).
- Positive credit reporting.
- A blanket prohibition on unsolicited credit card increases.
- Implementation of financial education in secondary school.

IN THE MEANTIME...EMPOWER YOURSELF AND YOUR CHILDREN

CPA Australia reports that as a nation we have more than doubled our available credit debt over the last five years and urges credit users to reject automatic credit increases.¹⁹² With the festive season fast approaching, this may well serve as a timely reminder. Banks are known to send out letters offering unsolicited credit increases around Christmas time,¹⁹³ while other creditors are known to approach customers in shopping malls to sign up for store cards.¹⁹⁴

One provider of a consumer credit reporting service highlighted the need for consumers to take better control over their credit, especially during the major holiday periods when people often lose track of what they’ve charged to their card.¹⁹⁵ As one expert pointed out, “Credit management can be a cultural habit if parents have good financial habits often they will pass them on to their kids.”¹⁹⁶

¹⁹⁰ Interview with Financial Counsellor, 11 October 2005.

¹⁹¹ NSW Legislative Council, above n 3.

¹⁹² Daily Telegraph, above n 13.

¹⁹³ Interview with Financial Counsellor, 11 October 2005.

¹⁹⁴ Interview with a Financial Counsellor, 4 October 2005.

¹⁹⁵ D&B Australia, ‘The debt that is getting us into trouble’, (Press Release, 16 March 2005).

¹⁹⁶ Interview with a Financial Counsellor, 11 October 2005.

CHAPTER FOUR
By Elizabeth McGrath

THE QUEST TO OBTAIN A FAIR SAFE APPROPRIATE LOAN

The hardship suffered by debtors often results from the inability of persons on low incomes to obtain a loan that is fair, safe, and appropriate. In this chapter, the context in which unsafe, unfair, and inappropriate loans are offered will be examined. It is recommended that:

- The exploitative practice of charging vulnerable consumers exorbitant fees for finance should be constrained by the enactment of legislation that ensures fringe lenders will not be able to avoid Victoria's interest rate cap of 48%¹⁹⁷ by offering a rate less than 48% and imposing excessive establishment and other fees.
- The efforts made by community organizations, in conjunction with banks, to offer a loan that is fair, safe, and appropriate should be encouraged. This can be achieved by the grant of more public funds, and, the enactment of legislation to give incentive to mainstream lenders to participate in similar community development programs. We recommend that Victoria enact legislation similar to the Responsible Credit Bill¹⁹⁸ that is now before the NSW parliament to deal with the problem of consumer detriment resultant from the inappropriate offer of finance via credit cards.

PART I

UNFAIR LOANS

Mainstream banks seldom offer personal loans below four thousand dollars.¹⁹⁹ Low income consumers are often compelled, therefore, to obtain finance from credit cards or small financial operators, such as payday lenders. These loans may be small, but they are often not fair or appropriate. A credit card gives access to an inappropriately high amount of credit and thus exposes vulnerable consumers to the risk of taking on an unmanageable level of debt. This is especially the case where she/he begins to withdraw funds from one credit card to repay another. The option to borrow from a payday lender has the advantage that the loan is finite, but the process is highly unfair and exploitative. Nicola Howell²⁰⁰ noted that payday lenders were charging from fifty to sixty dollars for a two hundred dollar/fourteen day loan. When this amount is calculated on an annualized percentage basis, it indicates the consumer is paying between 585% and 897% for the loan.²⁰¹ This is in breach of Victoria's requirements to cap interest rates at 48%, but fees and charges are regulated separately from interest rates, therefore a payday lender is able to avoid this constraint. In addition to paying excessive amounts for credit, vulnerable consumers are often exploited when they seek other financial services. One financial counsellor²⁰² claimed that a client of hers was charged fifty dollars to cash a two hundred dollar cheque. The client's urgent need for funds meant that he could not wait for the six days it would take to obtain a bank clearance on the cheque.

¹⁹⁷ Dean Wilson, *Payday Lending in Victoria - Research Report for Consumer Law Centre Victoria* (2002) [83] < <http://www.clcv.net.au/downloads/payday%20Lending.pdf> > at 1 November 2005.

¹⁹⁸ Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Bill 2005.

¹⁹⁹ Wilson, above n 197, 84.

²⁰⁰ Nicola Howell, 'Poverty, Credit and Social Justice: Examining the Links' (Paper presented at the Australian Lawyers and Social Change Conference, Canberra, September 2004) 7.

²⁰¹ Ibid.

²⁰² Interview with Financial Counsellor, 11 October 2005.

Clearly, it is unacceptable that such consumers are exposed to the provision of financial products that are so exploitative because people with no other option may be desperate and as they are unjust.

An attempt to address the situation has been made in NSW by the proposal for a Maximum Annual Rate Percentage Bill.²⁰³ The proposed s 11 (2) provides that the 48% interest rate should be capped and include a calculation of associated fees and charges. Enacting a provision of this kind may force some fringe credit providers out of the market and limit a line of credit that is currently available to low income consumers. But the authors would maintain that providing credit at unjustly exorbitant rates does not serve the interests of the financially vulnerable. Furthermore, the problems associated with accessing finance in this way can be exacerbated when borrowers roll over a loan from one pay period to the next.²⁰⁴

This paper recommends that the Victorian Parliament enact legislation similar to the Maximum Credit Bill (NSW) to ensure that all associated fees and charges are included in the calculation of the 48% interest rate cap.

PART II

PROVIDING SAFE, FAIR AND APPROPRIATE LOANS

The predatory practices of payday lenders show that vulnerable consumers need to access credit from alternative sources. It has been argued, in a developed country access to at least some financial services is ‘essential to participation in social and economic life.’²⁰⁵ This, however, does not mean that access to any type of credit is sufficient; the financial product offered must be “appropriate, fair and safe.”²⁰⁶ To provide the requisite financial product community welfare organizations have joined forces with mainstream banks to organize no-interest and low-interest credit schemes. For example, The Brotherhood of St Lawrence, in partnership with the Bendigo Bank, offers a small value loan of between \$500.00 and \$2,000 with repayments tailored to suit a limited budget.²⁰⁷ The provision of small financial products, often referred to as ‘microfinance’²⁰⁸ has followed the realization that debt cycles are ‘endemically linked’ to the continuation of household poverty.²⁰⁹ Micro-financing has been developed in order to ensure that people on low incomes are protected from events which cause disruption to a household’s financial stability such as illness or unemployment.

²⁰³ Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Bill 2005

²⁰⁴ Wilson, above n 197, 33.

²⁰⁵ Centre for Credit and Consumer Law Griffith University, *Submission to Consumer Affairs Victoria Consumer Credit Review* (2005) [3] <<http://www.griffith.edu.au/centre/cccl/pubs/vccrsub0805.pdf>> at 1 November 2005.

²⁰⁶ Ibid.

²⁰⁷ Brotherhood of St Lawrence and Good Shepherd Youth and Family Service, *Submission to Consumer Affairs Victoria Consumer Credit Review* (2005) [3] <[http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Credit_Review_Submissions2/\\$file/46BrotherhoodStLawrenceGoodShepherd.pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Credit_Review_Submissions2/$file/46BrotherhoodStLawrenceGoodShepherd.pdf)> at 1 November 2005.

²⁰⁸ Ingrid Burkett, *Microfinance in Australia: Current Realities and Future Possibilities*, School of Social Work and Applied Human Sciences University of Queensland (2003) [6]

<<http://www.uq.edu.au/swals/?page=289098&pid=0>> at 1 November 2005.

²⁰⁹ Ibid.

Micro-financing aims to address poverty that sits between market and welfare responses.²¹⁰ As such, it is able to offer the efficiencies and financial resources of the former and the social values of the latter. A benefit of such schemes is that a relationship can be fostered between the lender and the borrower in which the lender can offer additional welfare services like financial counselling.²¹¹ Also, the involvement of the banks means that financial resources are available to buffer risks of debtor default, and, low income consumers are exposed to other mainstream financial products that may be of future benefit to them.²¹² Loans offered in these community welfare programs are always safe, fair and appropriate. If the services can be provided on a profitable basis, either as they stand or by taking into account the potential for banks to increase their client base, there would appear to be no reason why such services could not be provided by more mainstream lenders.²¹³ If these services cannot operate profitably however, the community will be unlikely to see development in this area. It has been observed that banks are motivated to partake in such programs by a desire to improve their standing in the community. But also, that this will motive will be less persuasive than the compulsion to generate profit since a bank's first duty will be to protect the interests of its share holders.²¹⁴

The development of community welfare schemes is not the concern of banks. Therefore, it is unlikely that growth in such projects will occur without encouragement. It is imperative that governments provide incentives. In the United States, banks have been induced to participate in community development schemes by the requirements of the *Community Reinvestment Act 1975 (USA)*.²¹⁵ Under this act, an assessment is made of the extent to which financial institutions respond to the needs of the communities they serve. This includes assessing and responding to the needs of low income consumers. The extent to which financial institutions respond to this obligation is considered in the course of economic regulation, for example, in the case of a bank making an application for a proposed merger.²¹⁶ The obligations imposed by the *CRA* have created benefits for low income consumers. Departments have been created which focus specifically on their needs and this has led to improved expertise in this area.²¹⁷ The *CRA* model may, however, not be transferable to an Australian context. There will be fewer major banking institutions. So, the threat, for example, of disallowing a merger will not provide a great incentive to encourage participation.²¹⁸ Australian institutions are more likely to be motivated by the offer of a benefit, rather than the threat of disallowing certain activities. The offer of taxation relief would be an obvious benefit to motivate Australian financial institutions.

This paper recommends that financial institutions be offered taxation relief to encourage their participation in community welfare programs.

²¹⁰ Ibid.

²¹¹ Centre for Credit and Consumer law, Griffith University, above n 205, 4.

²¹² Brotherhood of St Lawrence and Good Shepherd Youth and Family Service, above n 207, 6.

²¹³ Centre for Credit and Consumer law, Griffith University, above n 205, 5.

²¹⁴ Ibid.

²¹⁵ Therese Wilson, *Submission to the Parliamentary Joint Committee on Corporations and Financial Services - Inquiry into Corporate Responsibility* (2005) [7] <<http://www.uq.edu.au/swals/?page=289098&pid=0>> at 1 November 2005

²¹⁶ Ibid 8.

²¹⁷ Brotherhood of St Lawrence and Good Shepherd Youth and Family Service, n 207, 10.

²¹⁸ Ibid, 11.

PART III

REGULATORY CONTROL OF INAPPROPRIATE LOANS

Many of the problems concerning reckless lending are the result of inadequate regulatory control of credit cards. As stated earlier in this Report, it is of great concern that a line of credit can be both issued and increased without an adequate assessment of the borrower's capacity to repay the debt. It is surely unreasonable that a line of credit should be automatically increased if the borrower succeeds in meeting minimum monthly repayments. As was observed, in chapter one of this report, it can take up to seven years to repay a loan of two thousand dollars if one makes only the minimum repayments indicated on each monthly bill. Where is the humanity in such lending practices? Credit cards make money invisible. Perhaps, this is why people exploited by reckless lending are also invisible.

One of the benefits of community based loans is that a relationship is developed between the loan provider and the borrower. In this context, financial advice is available and the personal circumstances of the borrower are known. The consumer of credit card finance, however, is not recognized as a person, and the relationship that exists between the parties is no more than a few figures at the bottom of an account statement. Under these circumstances, borrowers may be unaware that they could be incurring a debt they can never repay, or it may simply be the case that the pressing needs of today may lead them to take any life-line available regardless of tomorrow's cost.

The Hon. Sylvia Hale MLC has proposed a Bill²¹⁹ in the NSW Parliament to offer protection to consumers. Ms Hale states that the purpose of the Bill is 'to transfer a fair and reasonable level of responsibility and accountability back onto credit providers.'²²⁰ The proposed Responsible Credit Bill contains several amendments which address the difficulties caused by inappropriately high amounts of finance being offered through credit cards. The proposed section s 14A (1) provides:

'A credit provider must not enter into any credit contract or increase the credit limit or amount of credit under any existing contract if the credit provider knows, or ought, after reasonable enquiry, to have known that the debtor does not have the capacity to pay the amounts required under the contract or would incur substantial hardship in paying such amounts.'

This provision is worded along similar lines to s 70 (2) (1) *Uniform Consumer Credit Code*, but there is one significant difference. The constructive knowledge component of ss 70 (2) (1) is qualified under the *UCCC*. The question to be determined under this legislation is: 'whether at the time the contract was made, the credit provider knew, or could have ascertained by reasonable enquiry *of the debtor* at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship.' Thus, the lender could have fulfilled his duties by 'knowing' the borrower could repay minimum amounts, and believing the debtor when s/he says s/he has the capacity to repay. As was pointed out in chapter 2, Mr Raschilla²²¹ was denied a remedy on this basis.

²¹⁹ Fair Trading Amendment (Responsible Credit) Bill 2005 (NSW)

²²⁰ NSW, *Parliamentary Debates*, Legislative Council, 5 May 2005, (Sylvia Hale MLC).

²²¹ *Raschilla v General Motors Acceptance Australia [2002] VCAT 1653*.

The proposed Bill, without this qualification, offers greater protection since it imposes a broader obligation. It is a further improvement that the Bill also offers clearer terms of reference by providing a definition of ‘substantial hardship.’ The proposed s 14A (2) provides that ‘substantial hardship’ ‘includes but is not limited to circumstances where the debtor is unable to repay the whole of the amount of credit within 5 years.’ This definition will help ensure that consumers are not required to make minimum repayments for an indefinite period. It will also discourage attempts by lenders to lessen their obligation to assess a lender’s payment capacity by reducing minimum repayments. For, presumably, anyone has the capacity to repay a dollar a month.

The proposed legislation also offers the benefit of a mechanism to affect an appropriate remedy in cases where credit has been recklessly offered. As was mentioned in chapter 2 of this report, case law is scant on the interpretation of s 70(2)(1) *UCCC*, but the few cases determined suggest it is unlikely a borrower will be relieved of the responsibility to repay a debt where s/he has received the benefit of the loan.

In a recent bulletin²²², the Banking and Financial Services Ombudsman suggests in the case of maladministration resulting from the inappropriate offer of credit that the borrower will be relieved of the obligation to pay interest and associated charges on the amount considered excessive. The borrower, however, will still be required to pay the principal. One financial counsellor²²³ observed, this interpretation acknowledges the guilt of the lender, but leaves the innocent party to carry the remedial burden. Also, such a legal interpretation may result in reduced incentive for lenders to comply with their obligations.

If the penalty is only the loss of profit, lenders may make the prudent commercial decision that non-compliance will better their interests.²²⁴ To address this deficiency of the *UCCC*, s 14A (3) Responsible Credit Bill provides that a credit contract ‘is unenforceable’ to the extent that it imposes a monetary liability on a debtor in contravention of the ‘assessment of ability to pay’ provision. As Ms Hale suggests, this provision ensures that if a customer incurs a debt in a situation where investigation would have revealed there was no capacity to pay, then there will be ‘no obligation on the customer to repay the debt.’²²⁵ We agree with Ms Hale’s observation: if the credit provider has been reckless, then the credit provider should ‘live with the consequences’.²²⁶ The Responsible Credit Bill, therefore, is an encouraging step forward in the quest to protect vulnerable consumers from reckless lending practices. In addition to the protections outlined above, the Bill seeks to ensure that customers will be made aware of all associated fees and charges under s 32B, and, under s 32A, the customer will be advised of the length of time it takes to repay a loan if they do no more than make minimum monthly repayments. While such provisions may not cure all the problems that arise from the misuse of credit cards, they help ensure the customer has stronger armoury to protect herself from abuses that can arise when profit is the chief motive for the provision of credit.

Opposing the Bill, The Hon Melinda Pavey MLC argued that most people pay their credit card bills on time, and that the assessment requirement would generate an ‘administrative nightmare’ for credit providers.²²⁷ Furthermore, the cost of such administration would be passed onto consumers. However, such costs would be a small burden on the community.

²²² Banking and Financial Services Ombudsman, *Bulletin 45* (2005) 9.

²²³ Interview with Financial Counselor, 11 October 2005.

²²⁴ Centre for Credit and Consumer Law Griffith University, n 205, 8.

²²⁵ Sylvia Hale MLC, above n 220, 3.

²²⁶ *Ibid.*

²²⁷ NSW, *Parliamentary Debates*, Legislative Council, 5 May 2005, 3-4 (Melinda Pavey MLC)

They could be disseminated amongst the many millions of consumers who use credit cards. Also, the ‘nightmare’ of administrative requirements is not worse than the ‘nightmare’ consumers live when they incur debts they can never repay. Ms Pavey also argued that the effect of enacting this bill would be to separate NSW credit law from the national uniform regulation under the *UCCC*.²²⁸ But, in a submission to the Consumer Credit Review Issues Paper, the CCLS and CLCV argued that uniformity should not be prioritized at the expense of making reforms required to address serious consumer detriment.²²⁹ The submission noted that the Uniformity Agreement required jurisdictions to make amendments when the need for reform arose. Further, reform processes under the *UCCC* have been historically ‘slow and ineffective.’ This appears inevitable given the broad scope of the Act. The advantage of the NSW Responsible Credit Bill is that it enables reform to be targeted to an area of pressing need. The *UCCC* legislation regulates all kinds of consumer credit, whereas the NSW bill addresses the specific problem of credit card misuse. Victoria could consider provisions similar to the one proposed by the NSW *Responsible Credit Bill*. This is not the only abuse occurring in the consumer credit market, but it is an area where financial counsellors have witnessed a rapid growth in hardship suffered by consumers. The advantage of enacting reforms at the local state level is that the solution will arrive sooner and it can be targeted to particular problem areas.

This paper recommends that the Victorian government enacts legislation similar to that proposed in the NSW Responsible Credit Bill to address the prevalent and expanding detriment to consumers that has arisen from abuses in the provision of finance through credit cards

CONCLUSION

Persons on low incomes are particularly vulnerable when they fail to make ends meet. Finance from payday lenders may help to cover a deficit, but costs are exorbitant and the borrower will encounter more difficulties should a pattern of roll over payments occur. Finance from a credit card provider is prime facie cheaper, but potentially more dangerous. A consumer may seek to cover a deficit of two hundred dollars and be offered two thousand. Community organisations carefully monitor the offer of finance; they consider the welfare of their clients and work with them to find solutions to their financial problems. Since community organisations assist only a few, it is imperative that governments undertake a greater supervisory role. Tighter regulation in Victoria is essential. Vulnerable consumers should not be left to the mercy of those who profit from their inability to make ends meet. Legislation must be enacted to ensure that lending is ‘fair, safe and appropriate.’

²²⁸ Ibid, 4.

²²⁹ Consumer Credit Legal Service (Vic) and Consumer Law Centre Victoria, *Submission to Consumer Affairs Victoria Consumer Credit Review* (2005) [3]