



1 March 2013

By email: creditphase2bill@treasury.gov.au

Manager
Disclosure and International Unit
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The Treasury
Langton Crescent
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Dear Sir or Madam

National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the draft National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012.

Briefly, this submission:

- strongly supports the inclusion of a general anti-avoidance provision in the National Consumer Credit Protection Act, and broadly supports the drafting of the proposed section 323A. We have made some recommendations for how to improve s 323A ;
- strongly supports the amendments to section 171 which remove the short term and indefinite lease exemptions currently in s171 of the National Credit Code.
- does not support the current drafting of section 171A(3) which would appear to regulate 'Rent to Own' arrangements as indefinite leases. Rent to Own arrangements are in all substantial terms a credit contract and should be regulated as such;
- supports the extension of the National Credit Code to regulate private lending; and
- provides comments on the provisions regarding small business credit contracts (now removed from the Bill) and investment credit contracts.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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Schedule 2: Extension of responsible lending requirements to some small business credit contracts

We are aware that the schedule regarding small business credit contracts has been removed from the Bill and the Government intends that this issue will be considered at a later date.

We support the extension of responsible lending requirements to small business credit contracts to protect vulnerable borrowers. When these measures are re-considered, we recommend that responsible lending requirements should extend to circumstances where a small business loan is secured by the principal place of residence of a third party guarantor who receives no direct benefit from the loan. These guarantors are often a family member who is providing a guarantee as a favour and has no understanding of the risks of the loan.

Schedule 3: Extension of responsible lending requirements to investment lending

While investment lending is not one of our areas of particular expertise, we welcome the extension of the responsible lending elements of the National Credit Code to investment purpose loans where a loan is secured by the borrower's home.

We have three broad remarks to make about Schedule 3:

- The proposed regime for determining which investment contracts responsible lending requirement apply to (for example, proposed section 133EB) is very complex. Complexity makes it more difficult for consumers to understand their rights and may increase opportunities for avoidance. There may be benefit in applying responsible lending requirements to all investment lending (or a broader range of investment loans) to reduce complexity;
- We support the inclusion of proposed section 133EG, which would prevent licensees from profiting on the reimbursement of fees charged by third parties for providing a service to the consumer. This will enhance the transparency of the fees charged by licensees and limit fee gouging.
- We support the inclusion of proposed sections 133EM and 179 which seek to prevent credit providers from repossessing a borrower's home if the credit provider has knowingly been involved in a breach of the requirement to hold a credit license under the Corporations Act. This provides further protection for consumers whose home is at risk under an unsuitable loan.

Schedule 4: Private lending

We support the extension of the National Credit Code in section 5(1)(d) to cover private lending—where the credit provider is not in the business of providing credit and a person acts as an intermediary between the credit provider and debtor. The following is an example of the type of cases recently seen by our centre.

Vendor terms arrangements

One variety of private lending we have particular concerns with is vendor terms arrangements (or 'terms contracts' in the language used by the *Sale of Land Act 1962* (Vic)). Different vendor terms arrangements take slightly different forms, but the variety we are concerned about involve:

- an individual vendor (that is, the credit provider) who is not in the business of providing credit who wants to sell their home;
- a purchaser (the debtor) who wishes to buy a home for personal or domestic purposes; and

- a third party intermediary who arranges the contract between the credit provider and debtor for profit.

The intermediary (who may be using a system and standard form contracts provided in 'real estate investment' seminars) advertises for potential vendors and purchasers through various channels. Both buyers and seller may be in financial difficulty—the vendor wants to sell their home quickly and may be behind on payments and be very vulnerable. The purchaser typically wants to buy a home but cannot access mainstream credit.

Contract(s) are signed and under the terms of the agreement the vendor moves out and lives elsewhere, but continues to be legally responsible for the mortgage repayments. The purchaser moves in and pays a deposit (which may cover existing mortgage arrears to prevent repossession).

The purchaser then makes regular payments which cover the mortgage repayments and a profit margin for the intermediary and (perhaps) the vendor. How this additional amount is split between the vendor and the intermediary differs between arrangements. In some cases it may be split equally, in others the intermediary takes more than half. We believe it is likely that the seller will receive a lower proportion of the profit the more desperate they are to sell. Over time, the purchaser hopes to build up enough equity to qualify for a loan to purchase the pay out the contract.

There are clear risks for the vendor and the purchaser which vary according to the individual agreement. The vendor would wear responsibility to their credit provider in the event that the buyer defaults on their payments, and if in difficult financial circumstances, may be unable to benefit from the equity in the house for some years. The purchaser does not gain title to the premises, despite having a significant interest in it. The system is complex, and it would be surprising if either the vendor or purchaser (who are both likely to be under some form of financial stress) clearly understand the risks.

Once the contracts are on foot, the purchaser—who has previously been unable to access mainstream credit and is now making repayments well in excess of market rent—may be unable to maintain the high payments. The purchaser may eventually be forced to leave the house, and may forfeit all payments made. There is little or no incentive for the intermediary to ensure that the purchaser is able to afford the payments. If intermediary has received the First Home Owners Grant on entering the contract, the intermediary will generally face no financial risk if payments cannot be maintained.

As some of these vendors are in financial difficulty, other creditors of the vendor could take legal action and sell the home—even if they don't hold a mortgage—to the detriment of the purchaser who will generally be unable to recover payments made under the contract.

Very similar arrangements are also set up as a lease with an option to purchase. A lease option may be paid in a lump sum (as a 'deposit') or may be paid by additional rent payments. We note that the proposed changes would be unlikely to capture this type of arrangement.

Schedule 5: Consumer leases

Removal of short term and indefinite lease exemptions

We strongly support the removal of the short term and indefinite lease exemptions currently in s171 of the National Credit Code. The exemptions serve no discernible purpose and merely created opportunities for avoidance of the National Credit Code.

The following case study was provided by the North Australian Aboriginal Justice Agency (**NAAJA**) and is illustrative of our concerns regarding systemic avoidance of the National Credit Code by consumer lease providers. In the case study the lessor has attempted to avoid provisions of the National Credit Code by drafting the agreement as an indefinite consumer lease.

Case Study

Ms Y is an Aboriginal woman who lives in a town camp on the outskirts of Darwin. She grew up in a remote Aboriginal community in the Northern Territory.

Ms Y has a hearing impairment and her sole source of income is the Disability Support Pension. Ms Y is income managed, which means that she has discretion to spend only 50% of her Centrelink income. She is a Warlpiri speaker and requires the assistance of an interpreter.

In February 2012, a consumer lease provider visited the town camp where Ms Y lives. The consumer lease provider visited Ms Y's niece's house and Ms Y was asked by the consumer lease provider 'if she needed anything'.

Ms Y asked to purchase a mattress and a single bed base. Ms Y instructs that she thought it would cost \$250 for the goods.

Ms Y provided her drivers license as identification and advised the sales person that she received the Disability Support Pension. The sales person completed a form titled "Rental Agreement Schedule" and handed it to Ms Y to sign. Ms Y was not given the opportunity to read the agreement. She was not provided with a copy of the agreement. Ms Y was also directed to complete a form to allow the instalments to be paid via Centrepay from her Disability Support Pension.

The consumer lease provider estimated Ms Y's fortnightly expenses as \$320, which amounts to \$22 per day for food, rent, clothing, transport and other essential items.

Rather than a contract to purchase the single bed and mattress, Mrs Y had entered an agreement to rent the single bed and mattress for a total cost of \$1430 over 12 months. If she wished to keep the goods at the end of the term, Ms Y was required to pay \$1.00 per year payable in advance to enter an indefinite lease.

The Rental Agreement contains a term that 'The Renter agrees that that Owner is the owner of the goods. The Renter only has the right to use them while the Renter meets its obligations...The Renter must keep the Goods insured'.

NAAJA is aware that a single bed and mattress of similar quality can be purchased from a national retailer for \$529.

Ms Y made payments via Centrepay for 8 months which totalled around \$935, before she sought legal advice. Ms Y states 'I just bought it...I thought I would own it. They did not explain about renting. Someone should have told me'.

Ms Y retains the mattress but the base was burned in a fire at the camp.

NAAJA is advocating for Ms Y to be released from the terms of the contract.

Regulation of indefinite leases and Rent to Own arrangements in proposed section 170A(3)

We also support subsections 170A(1), (2) and (4) which further define contracts which will be regulated as 'regulated short term leases' and 'regulated indefinite leases' and seek to address avoidance techniques.

We do not support the current drafting of subsection 170A(3), reproduced below:

If, at the time of entering into a consumer lease, the lessor or a prescribed person has the requisite belief that the lessee wants to use the goods (whether while those goods are hired under the lease or otherwise) for an indefinite period, then:

- a) if the term of the lease is for a fixed period—the lease is a regulated fixed term lease; and
- b) if the term of the lease is for an indefinite period—the lease is a regulated indefinite lease.

It appears that 170A(3) will do two things: address avoidance techniques based on structuring a contract as an indefinite leases (which we support), and define 'Rent to Own' or 'Rent to Buy' arrangements (hereafter simply '**Rent to Own**') as regulated indefinite leases (which we do not support).

We support the regulation of legitimate indefinite consumer leases – that is, where a consumer genuinely intends on leasing an item for an indefinite period, but has no desire or intention to own the goods.

We do not support any amendment that will define Rent to Own contracts as a type of consumer lease because

1. *Rent to Own contracts are in all substantial aspects credit contracts.*

In both cases a consumer takes possession of goods with the intent to own them, pays for those goods through regular repayments over a set term, pays an amount which is higher than the ticket price and in practical terms the financial obligations are very similar.

When the consumer and trader enter this kind of contract, both of them expect that the consumer intends to and will own the goods after completion of the minimum term. Both parties expect that the Rent to Own arrangement allows this, despite the law clearly stating that a consumer lease cannot create a right or obligation to purchase. Rent to Own contracts are technically considered leases by virtue of questionable contract terms to allow a consumer to own the goods without technically providing a right to purchase. For example, some contracts give a right to purchase 'similar' goods rather than the

ones being rented. Other contracts allow the consumer to ask the lessor to give the leased goods as a gift to the lessee's spouse. Others (such as in the case study above) providing a right to enter into a further indefinite lease. Contracts are structured in this way so as to avoid the higher regulatory burden attaching to credit contracts.

2. *regulating Rent to Own arrangements as leases will exacerbate the existing confusing and misleading nature of these arrangements*

Rent to Own contracts create a number of problems for consumers, one of which being that the structure and marketing of these contracts is inherently confusing and often in our view misleading or deceptive. The marketing is confusing because a Rent to Own deal is consciously designed to look like something it is not. The marketing gives the impression that the consumer will have a right to purchase or own the goods at the end of a minimum rental term when this is not the case.

The result is that consumers often (justifiably) misunderstand the nature of the bargain they have entered and think they are paying off a credit contract rather than making rental repayments. Even where consumers understand they have entered a rental contract, they believe they have a right to purchase or own the goods at the end of the minimum term.

In Ms Y's case study above, the consumer was presented with a contract headed 'Rental Agreement' but the nature of the goods and the conduct of the retailer led the consumer into thinking she was purchasing the items. In this agreement (and in others provided by at least one well known national firm), the consumer is led to believe they are effectively purchasing the goods because the contract creates a right to enter an additional indefinite lease for a nominal amount after making a certain number of rental payments.

Despite the consumer's expectation that title to the goods will pass to them, these contracts specifically provide that the retailer retains title to the goods and the consumer merely has a right to use the goods on certain terms. For example, an indefinite consumer lease agreement currently in use contains the following terms:

- The Renter is responsible for loss or damage
- The Renter must not move the goods from the Address...without the prior written consent of the Owner
- The Renter must keep the goods insured

As the retailer retains superior title to the goods, the consumer remains vulnerable to repossession of the goods for the duration of the indefinite lease.

3. *defining Rent to Own arrangements as fitting within a category of consumer leases lends legitimacy to avoidance techniques.*

As we have already argued, Rent to Own arrangements are in substance credit contracts, not leases. By explicitly recognising these contracts as a type of lease, the Government is accepting this avoidance strategy as a tolerable feature of the consumer credit landscape.

Defining Rent to Own contracts as a 'regulated indefinite lease' under 170A(3) will not solve any of the problems we have raised with Rent to Own contracts. Businesses will still structure contracts as Rent to Own in an attempt to avoid the Code requirement that leases cannot provide a right to purchase. Proposed subsection 170A(3) will only make the existing confusion worse by appearing to accommodate Rent to Own deals within the definition of consumer lease when they do not fit that definition because they offer, what is in reality, an effective right to purchase.

Recommendation

We recommend that 170A(3) be redrafted so that it continues to apply to genuine indefinite leases (that is, leases where a consumer genuinely intends to lease an item for an indefinite period, but has no desire or intention to own the goods) but does not apply to Rent to Own arrangements (where the consumer intends to purchase or own the goods or the 'lessor' represents that the consumer may have the right to retain the goods.). The National Credit Code should be amended to explicitly provide that Rent to Buy contracts are credit contracts for the purposes of the National Credit Code.

Consultation question: the need for a definition of cash price

We do not believe there is a need to define 'cash price' or 'cash value'. There is no special or technical definition for these phrases when used in relation to consumer leases. They do not need to be defined by the Code and doing so may only create confusion.

It should be relatively simple to attach a value in good faith to any new goods leased. It should also be quite possible for lessors to value any second hand goods they lease. We would expect that firms who lease second hand goods already have a method of valuing these goods for their own accounting purposes.

Consultation question: the need for an exemption for genuine short term leases

We do not see the need to create an exemption for 'genuine short term leases'. We think that genuine short term leases will already be exempted because the total cost of the contract will not exceed the cash price of the goods. If Government wants to make another exemption for short term leases it needs to be based on a clearly defined problem. There did not seem to be any policy justification for the existing short term lease exemption which created opportunities for evasion. Any new exemption needs to be well targeted and justified by a clear outline of the problem the exemption aims to solve.

Additional issue: failure of lease providers to disclose cost of credit

At present, there is a significant difference between the disclosure obligations of credit providers and consumer lease providers. There is an urgent need to reform the disclosure obligations on consumer leases to bring them up to a similar standard as credit products.

Consumer lease providers are currently required to disclose the total amount of rental payable on a consumer the lease¹. This amount is usually disclosed in the terms of the contract but there is no requirement for it to be mentioned in advertisements or marketing. By comparison, an advertisement for a credit contract must provide an interest rate and a comparison rate if any mention is made of the cost of the contract.²

Most consumer lease providers will advertise a 'per week' or even 'per day' cost but often do not disclose that the quoted price is only available over a minimum term (those that do disclose do so in fine print). None that we know of indicate the total cost of the contract, which is usually around three times more than the cost of buying the goods retail (and can be much more).

This creates significant problems for consumers because the cost of a consumer lease is not easily comparable either with other leases or other ways of procuring the goods (such as purchasing outright or on credit). The lack of disclosure also harms the market more broadly as there it stunts competitive pressure on prices offered by lessors.

¹ National Credit Code s174(1)(f).

² National Credit Code ss 150, 160.

We understand that Government intends to consider reform of disclosure across all consumer credit and consumer lease at a later date. In our view, the poor standard of disclosure by consumer lease providers deserves urgent intervention. This would be consistent with the existing aim of the Government (as evidenced by the consumer lease reforms in the *Consumer Credit Legislation Amendment (Enhancements) Act 2012*) to remove unnecessary differences between the regulation of consumer credit and consumer leases.

Recommendation

All consumer leases should be subject to increased disclosure requirement, including a requirement to disclose the following in advertisements and at point of sale:

- the cash or market price of the goods on offer—or at least a good faith estimate if there are genuine difficulties with calculating the value;
- the cost of credit (that is, the difference between cash price of the goods and the amount the consumer pays for the contract); and
- the total minimum cost of the contract.

Schedule 6: Anti-avoidance measure

We strongly support the inclusion of a general anti-avoidance provision in the *National Consumer Credit Protection Act*, and broadly support the current drafting of the provision at section 323A. The benefit of this approach is that it enables courts and regulators to identify and react to avoidance schemes before consumer detriment occurs. Currently a consumer (and usually a large number of consumers) must suffer detriment before a complaint can reach courts or regulators and it can take a significant period of time before particular business models can be addressed.

In our view the current formulation is well balanced—although subsections 323A(1) and (2) begin with broad definitions (such as the purpose test, the definition of 'scheme' and the 'application' elements, all discussed below), these are balanced against the high threshold that a plaintiff will have to meet in establishing that conduct was for the purpose of avoiding the relevant Acts.

In particular we support:

- **'reversal of onus' provisions at 323A(5) and (7):** We expect that it will be a very difficult evidentiary task to establish that the purpose of a scheme is to avoid the application of a provision of the relevant Acts. Subsections (5) and (7) allow Government or ASIC to respond to known avoidance conduct while still allowing the court flexibility to assess schemes on a case by case basis.
- **'connected person' element** which provides that 323A is breached if the purpose was to avoid the application of the Act to either the defendant or a connected person. Without this element, the s323A would be far too easy to circumvent—previous avoidance techniques commonly use a connected person (such as a sham broker). We note the connected person element is drawn from the *Income Tax Assessment Act* ITAA provisions.
- **breadth of the purpose test**, which allows that a scheme breaches 323A(1) without need to prove that conduct was for a dominant or predominant purpose of avoiding the law. We would oppose restricting the wording of subsection (1) to a 'predominant

purpose' test or something similar— if a scheme is developed to avoid the Act as well as being for other objectives, it remains an avoidance scheme and should be captured.

- **use of an objective test (that 'it would be reasonable to conclude')** rather than using a subjective test where it would be necessary to prove the subjective intentions of a defendant. This would create an insurmountably high evidentiary burden. We note that an objective test is consistent with the anti-avoidance provision in the ITAA (upon which 323A is based) and that objective tests are standard for civil provisions.
- **that 323A(1) is breached if a scheme is for the purpose of any provision of the relevant Acts.** It may be argued that 323A(1) should be limited to avoidance of only certain provisions which are considered more serious or important, or that would generally allow some kind of advantage or benefit. However, we note that 323A(3) already allows the court to consider whether the defendant has or may benefit from the scheme in determining whether it is for the purpose of avoiding the relevant Acts. We also note the inventiveness of businesses in the past in developing schemes to avoid credit regulation. It is important to keep the avoidance provision as broad as possible to capture all avoidance activity.

However we also believe 323A could be strengthened.

Recommendation

We recommend that 323A be strengthened by:

- amending 323(1) to read '*...it would be reasonable to conclude that the purpose, or one of the purposes whether or not it is the dominant purpose*' to ensure that 323A(1) is not limited by a dominant purpose test when interpreted by a court;
- amending 323A(3)(i) to read that the court may have regard to any representation '*whether express or implied*' in considering whether a scheme meets the test at 323A(1). It is often the accumulation of subtle factors which create a misleading impression in a consumer rather than one explicit misrepresentation (for example, a business phone number expressed as 1300 CAR LOAN in context of other factors could give the impression that the product on offer is a loan rather than a lease). It is important to leave the option open for the court to consider implicit misrepresentations.
- Amending 323A(3)(l) to read '*any change in the conduct of a person or a connected person following or in anticipation of amendments*': currently paragraph (3)(l) only applies to conduct following amendments, however it is likely that any business seeking to avoid the Acts would change practice before new amendments were introduced;
- Amend 323A(3)(n) to read '*any other relevant matter whether or not of the same type as those matters listed above*' to be clear that paragraph (n) is not intended to be restricted and to ensure that 323A(3) captures the range of avoidance activity; and

- making amendments necessary to ensure that, if an action under 323A is brought by an aggrieved consumer who only seeks a declaration, the consumer need not prove a loss.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au in the first instance if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE



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