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Predatory Lending: Time to Regulate?

This Research Brief seeks to discuss the changes in home lending practices that have emerged in recent decades. Consumers now have a choice of lenders – bank and non-bank – and an array of loan products to select from. The entry of non-bank lenders into the finance market has been accompanied by the emergence of mortgage brokers who act as intermediaries assisting consumers to arrange a home loan best suited to their circumstances. However, these developments in the industry have also led to a range of consumer issues such as unscrupulous mortgage brokers and lenders trapping unwary and unsophisticated borrowers into home loan products that they cannot service, leading to considerable financial stress.

Recent events, particularly some examples of predatory conduct highlighted in the media and a recent inquiry by a House of Representatives Standing Committee, have led to calls for better legislative oversight of mortgage brokers. In Queensland (as in Tasmania, South Australia and the Northern Territory) there is no broker specific regulation and, as discussed in this Brief, of all the Australian states and territories, only Western Australia requires mortgage brokers to hold a licence. However, in November 2007, the Ministerial Council on Consumer Affairs released an exposure draft model national Bill seeking to regulate finance brokers.

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EXECUTIVE SUMMARY

This Research Brief seeks to discuss the changes in home lending practices that have emerged in recent decades. Consumers now have a choice of lenders – bank and non-bank – and an array of loan products from which to select. Many people whose unstable or insufficient income would once have prevented them accessing a home loan are now able to secure finance to buy their own home. The entry of non-bank lenders into the finance market has been accompanied by the emergence of mortgage brokers who act as intermediaries assisting consumers to arrange a home loan best suited to their circumstances. However, these developments in the industry have also led to a range of consumer issues such as unscrupulous mortgage brokers and lenders trapping unwary and unsophisticated borrowers into home loan products that they cannot service, leading to considerable financial stress.

This Research Brief firstly considers the rapid changes in the finance market, the entry of non-bank lenders and the new types of loan products now available: **section 2**.

A discussion of ‘low-documentation’ loans and ‘non-conforming’ loans attempts to explain the differences between these products and the dangers associated with the latter type due to the greater risks involved: **section 3**.

The Brief goes on, in **section 4**, to discuss the benefits and risks of using a mortgage broker to negotiate a loan and the industry self-regulation provided by the Mortgage and Finance Association of Australia.

The concept of ‘predatory lending’ is then considered, in the context of the various reasons why people get into financial difficulty: **sections 5 and 6**. Various examples of predatory lending and case studies are provided in **section 6.1**.

A brief overview of current legislative oversight of mortgage brokers is provided as it currently exists at the Commonwealth, state and territory levels. There is very little specific statutory regulation of the mortgage broking industry in Australia, with Western Australia being the only state to require brokers to have a licence. The Australian Capital Territory, New South Wales and Victoria have broker specific legislation and, in the case of the NSW Act, a number of measures regulating broker behaviour. Queensland, like Tasmania, South Australia and the Northern Territory, does not have broker specific legislation: **section 7**.

The Ministerial Council on Consumer Affairs has released a consultation draft Bill that will provide a framework for nationally consistent legislation to regulate mortgage brokers and impose a requirement for licensing of brokers in every jurisdiction: **section 7.8**.

In September 2007, the Commonwealth Parliament’s House of Representatives Standing Committee on Economics, Finance and Public Administration (the Committee), tabled its *Home Loan Lending Report* on the Inquiry into Home Loan Lending Practices and the Processes Used to Deal with People in Financial Difficulty. The key recommendation by the Committee was that the

Commonwealth Government should assume control of the credit industry, including the regulation of mortgage brokers and non-bank lenders: **section 8**.

In the meantime, the Queensland Government is proposing that Queensland mortgage brokers should be subject to interim regulation to ensure that Queensland consumers are not targeted by 'rogue' brokers before the national uniform laws take effect. In April 2007 the Queensland Office of Fair Trading released the *Regulation of Finance Brokers in Queensland – Regulatory Impact Statement* for public comment. The *Regulatory Impact Statement* assessed the proposal to regulate Queensland brokers through a Code of Conduct. The Code would be mandatory, having effect as a Regulation under the *Fair Trading Act 1989* (Qld). The proposed measures in the Code include disclosure provisions regarding commissions, behavioural provisions, and the requirement to provide a statement of reasons about aspects of the loan product chosen by the broker: **section 9**.

The information in this Research Brief is current as at 11 February 2008.

1 INTRODUCTION

This Research Brief seeks to discuss the changes in home lending practices that have emerged in recent decades. Consumers now have a choice of lenders – bank and non-bank – and an array of loan products from which to select. Many people whose unstable or insufficient income would once have prevented them accessing a home loan are now able to secure finance to buy their own home. The entry of non-bank lenders into the finance market has been accompanied by the emergence of mortgage brokers who act as intermediaries assisting consumers to arrange a home loan best suited to their circumstances. However, these developments in the industry have also led to a range of consumer issues such as unscrupulous mortgage brokers and lenders trapping unwary and unsophisticated borrowers into home loan products that they cannot service, leading to considerable financial stress.

Recent events, particularly some examples of predatory conduct highlighted in the media and a recent inquiry by a House of Representatives Standing Committee, have led to calls for better legislative oversight of mortgage brokers. In Queensland (as in Tasmania, South Australia and the Northern Territory) there is no broker specific regulation and, as discussed in this Brief, of all the Australian states and territories, only Western Australia requires mortgage brokers to hold a licence. However, in November 2007, the Ministerial Council on Consumer Affairs released an exposure draft model national Bill seeking to regulate finance brokers.

2 RECENT CHANGES IN HOUSE LENDING PRACTICES IN AUSTRALIA

Over the past decade or so, there has been a change in Australia's home lending environment, prompted by the deregulation of the financial market in the late 1980s. This is characterised by a transformation of lending standards and practices; the introduction of new loan products; and the entry of 'non-bank' lenders and intermediaries, such as mortgage brokers, into the home lending market. Non-bank lenders appear to be gaining a bigger slice of the market, traditionally the preserve of banks, building societies, and credit unions, leading to greater competition.¹

¹ Parliament of Australia, House of Representatives Standing Committee on Economics, Finance and Public Administration, Inquiry into Home Loan Lending Practices and the Processes Used to Deal with People in Financial Difficulty, *Home Loan Lending*, Report to the 41st Parliament, September 2007 (*Home Loan Lending Report*), p 3, <http://www.aph.gov.au/house/committee/efpa/banklending/report/fullreport.pdf>.

At the same time, the demand for housing credit has climbed, fuelled by the increasing availability and flexibility of home loans and the benefits flowing from a strong economy. It has been suggested that Australians have become wealthier, with private sector wealth per person being around \$350,000 in 2006 – about double the average wealth in 1998.² Inflation has remained relatively low and, since late 2001, unemployment has continued to fall and was around 4.3% in December 2007 (Queensland's unemployment rate standing at 3.7%). The trend estimate of employment is now over 10.5 million with the job participation rate very high.³ Average earnings in August 2007 stood at over \$875 per week, a rise of 1.4% from the previous quarter.⁴ Some commentators and reports have suggested that the relatively low interest rates over much of the decade have increased the size of a loan which an average household can service.⁵

In Queensland, the average size home loan commitment for owner occupied dwellings has more than doubled since July 1997 from \$102,300 to \$242,200 in July 2007.⁶ Private dwelling investment in Queensland is forecast to rise by 4.1% over the 2007-08 financial year, higher than the forecasted 0.2% national increase over the same period.⁷ A consequence of the rising demand for houses has been an escalation in housing prices. It has been reported that there were around 49 lenders in Australia offering borrowers large loans of \$1 million or more – aimed at the 'prestige' end of the market.⁸

² *Home Loan Lending Report*, p 3, citing estimates from the Australian Government Treasury, 'Australian net private sector wealth', *Economic Roundup*, Summer 2007. The nominal figures for wealth have been divided by a 'household consumption deflator' which means that wealth is expressed in terms of the amount of consumer goods and services (but not including assets such as houses) that could be bought with it.

³ Australian Bureau of Statistics (ABS), *Australian Economic Indicators – February 2008*, Cat 1350.0, pp 86,118; Stephen Long, 'Economy competes with jobs growth, credit market crisis', *ABCNewsOnline*, 7 September 2007.

⁴ ABS, *Australian Economic Indicators – February 2008*, Cat 1350.0, p 118.

⁵ *Home Loan Lending Report*, p 4. See also R Gastaldon, *Housing Affordability*, RBR 2007/27, Queensland Parliamentary Library, October 2007, pp 36-37 quoting Ross Gittins, 'Housing crisis: we did it ourselves', *Sydney Morning Herald Online*, 25 July 2007.

⁶ ABS, *Qld Stats, September 2007 – Housing Finance Summary*, Cat 1318.3.

⁷ Econtech, *Australian National, State & Industry Outlook – Queensland Economic Forecasts*, Australian Economic Forecasts. Forecasts made May 2007.

⁸ Kate Patterson, 'Rush for mega loans - \$1 million is no sweat for lenders and borrowers', *Sunday Mail*, 3 June 2007, p 40. This article preceded the August/September significant rise in the global cost of credit (to be discussed later) so it is unclear what, if any, impact this has had on the 'prestige' end of the market.

Despite the data indicating that most Australian households are in a good financial position, fostered by a growth in disposable incomes over recent years,⁹ there are disturbing media reports of people struggling to service their mortgages and opting for dubious refinancing packages that lead to more hardship. Home loan defaults and housing repossessions, particularly in New South Wales, are frequently in the news.¹⁰ Although the Reserve Bank of Australia (RBA) and the Australian Prudential Regulation Authority (APRA) refer to data showing that loan arrears, while increasing in recent years, have remained low by historical and international standards, it has been recognised that there are some borrowers who are suffering financial strain.¹¹ There is some consensus that the availability of home loans to a wider range of people, including ‘non-conforming’ loans (discussed later) offered to borrowers who do not meet the standard criteria of traditional lenders, has posed concern. While occupying a small fraction of all home loans (around 1%), it appears that non-conforming loans tend to have the greatest rate of repayment arrears. These loans generally carry higher interest rates, the larger cost of the loan commensurate with the riskier profile of the borrower. Non-conforming loans appear to be an area of lending in which so-called ‘predatory lenders’ tend to operate.¹²

In reaction to growing concerns, especially in the light of the current global cash shortage and consequent pressure on the cost of credit (meaning higher interest rates), governments at the state and federal level are planning legislative initiatives to protect vulnerable borrowers against predatory lending and to regulate mortgage brokers. Only Western Australia has legislation requiring mortgage brokers to hold a licence; elsewhere they are subject to a disparate range of legislation meaning that broker operations are largely unregulated. The current issue is whether state and territory governments should finalise legislation to implement a nationally consistent licensing regime containing strict controls on mortgage brokers, or whether the Commonwealth Government should step in to regulate the area itself.

⁹ See the Joint Reserve Bank of Australia (RBA) & Australian Prudential Regulation Authority (APRA), Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry, *Submission No 7*, July 2007, p 1, (Joint RBA & APRA Submission), <http://www.aph.gov.au/house/committee/efpa/banklending/subs/sub007.pdf>.

¹⁰ See, for example, Stephen Long, ‘Home repossessions rising in Sydney, Melbourne, and the Australian Capital Territory’, *Lateline, ABCOnline*, 13 September 2006.

¹¹ Joint RBA & APRA Submission, pp 1, 6-7; *Home Loan Lending Report*, pp 21-22.

¹² See *Home Loan Lending Report*, pp 21-22, Joint RBA & APRA Submission, pp 4-5.

2.1 THE RISE OF ‘NON-BANK’ LENDERS

The home lending industry was traditionally occupied only by banks, building societies, and credit unions. These bodies are called ‘authorised deposit-taking institutions’ (ADIs) as they raise funds from retail deposits, and are subject to prudential oversight by APRA. The past decade or two has witnessed the entry of new players into the industry – the ‘non-bank’ lenders which do not raise funds from retail deposits and are not subject to regulation by APRA. Some of the more high profile non-bank lenders include RAMS, Aussie and Wizard. The new non-bank lenders’ foothold in the house lending market has been fostered by the spread of Internet usage, enabling potential customers to compare loans and lenders online. A recent survey has found that the Internet is the top source of information about loans, with 63% of respondents using it to access material about new loans.¹³

In addition, markets for securitised loans have become more liquid.¹⁴ ‘Securitisation’ is a process where lenders raise money for new home lending by ‘bundling up’ existing housing loans into big pools of assets and selling them into global financial markets as bonds. Traditional bank lenders – the ADIs – generally raise funds for new loans from deposits. In recent months, however, the US has experienced a mortgage crisis with consequent rises in the cost of credit, i.e. interest rates. Investors in the securitisation market are demanding bigger returns on their investments.¹⁵

Borrowers are attracted to non-bank lenders by the convenience, flexibility and diversity of products provided. Non-bank lenders were the first to offer innovations that are now available from many mainstream ADIs, such as home-equity and interest-only loans. These lenders appeared in the market offering not just traditional home loans but a whole range of products aimed at a wide diversity of borrowers, including those who could not qualify for a loan from a bank because they did not meet its more stringent lending criteria. The advent of non-bank lenders gave rise to the ‘non-conforming’ loan for borrowers with riskier profiles and poor credit histories.¹⁶ It was not merely the range of products and relaxed standards that intrigued consumers but also other conveniences such as the lender coming to their homes at suitable times rather than the consumer needing to arrange an interview at the lender’s premises. These newer lenders, particularly

¹³ BrandManagement, MFAA/BankWest Home Finance Index, Winter 2007, p 18, http://www.mfaa.com.au/uploads/MFAA_BWest_July07_HFI_WEB.pdf.

¹⁴ *Home Loan Lending Report*, Chapter 2, pp 4ff.

¹⁵ Stephen Long, ‘Credit crunch likely to hit Australian investors, borrowers’, *ABCNewsOnline*, 15 August 2007.

¹⁶ *Home Loan Lending Report*, pp 9-10; Joint RBA & APRA Submission, pp 4-5.

those with smaller branch networks, relied on intermediaries like mortgage brokers to originate loans.

Despite the growing popularity of non-bank lenders, it is reported that ADIs still account for over 80% of all mortgage commitments in Australia.¹⁷ Nevertheless, ADIs have had to find ways to compete. Measures to attract borrowers have included –¹⁸

- shaving interest margins on housing loans and waiving/absorbing establishment fees;
- easing the debt-servicing ratio ‘rule of thumb’. APRA recently said that while ADIs used to have a ‘rule of thumb’ that mortgage repayments should not exceed 30% of gross income (the debt-servicing ratio), they now work on an assessment of the amount households have left over after paying tax, repaying other debts and spending on basic living items. In any event, APRA survey data shows that, in September 2006, the most common debt-servicing ratio for new borrowers was 21-25% of income, with only 9% having ratios greater than 40%. Thus, most borrowers continue to have debt-servicing ratios below the allowable limit. It seems that higher income households would now be more willing to take on debt-servicing ratios of up to around 50%.¹⁹ On the flipside, a recent industry survey of 384 people with outstanding debt on their home found that respondents on lower incomes are using up more of their income on repayments (46% of respondents claiming to use 55% or over of their income to do so earn less than \$75,000 per annum);²⁰
- making a diverse range of home loan products available, such as ‘low-documentation’ loans that appeal to the self-employed and a reduction in the interest rates charged on them, and ‘interest-only’ loans for a certain period of the loan;
- allowing higher loan-to-valuation loans so that low – including zero – deposit home loans can be offered to borrowers with little or no equity. These loans are regularly mortgage insured which may add to the cost of the loan;
- easing the rigour of property valuation methods (e.g. basing valuations on information from a contract of sale or using desktop electronic methods); and
- relying on third parties such as mortgage brokers to initiate loans.

¹⁷ Liberty Financial, Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry, *Submission No 24*, August 2007, p 3.

¹⁸ Joint RBA & APRA Submission, pp 2ff.

¹⁹ Joint RBA & APRA Submission, p 3, Graph 2.

²⁰ BrandManagement, MFAA/BankWest Home Finance Index, p 22.

While the number of changes over recent years, particularly new products and different ways of assessing consumers' ability to repay loans, could be seen by some as representing a reduction in lending standards, the counter-argument is that it has also allowed some people access to finance who may otherwise never have had a chance to gain a foothold into the home ownership market.²¹ For example, product innovations such as shared-equity loans and interest-only loans have made it easier for first home buyers to purchase a house, and low-documentation loans have helped many self-employed people to obtain a loan which would not have previously been possible because of their inability to prove a steady income stream.

3 'LOW-DOCUMENTATION' AND 'NON-CONFORMING' HOME LOANS

As mentioned, non-bank lenders have, for some time, been providing alternative types of home loans for people who may have had difficulty qualifying for a conventional home loan from traditional lenders. People with a variable income (e.g. casual workers, welfare recipients) and the self-employed fall into this category and have welcomed the availability of 'low-documentation' or 'low-doc' loans. Such loans have now become more mainstream, offered by ADIs as part of their product range. Low-doc loans should not be confused with 'non-conforming' loans which have caused some concern in the community – being aimed at consumers who are often the most unsuited to servicing a mortgage. Low-doc and non-conforming loans are now discussed.

3.1 'LOW-DOCUMENTATION' HOME LOANS

'Low-documentation' or 'low-doc' home loans have grown in popularity and now account for 10% of new approved home loans compared with less than 0.05% in 2000.²² While, in the past, low-doc loans were offered at a higher rate of interest than the standard variable rate on traditional mortgage loans, there now tends to be little difference in the interest rates.²³ Low-doc loans are designed mainly for

²¹ Joint RBA & APRA Submission, p 1.

²² Joint RBA & APRA Submission, p 4.

²³ InfoChoice website, 'Low Doc Loans', <http://www.infochoice.com.au/banking/lowdochomeloans/default.asp>. The InfoChoice websites are run by InfoChoice Limited (formerly Market faxes), an Australian independent 'infomediary' in the market place for financial and investment services. It seeks to provide unbiased information on a wide range goods and services to consumers, companies and to farmers in rural and regional Australia.

people who may have difficulty in providing sufficient documentation needed for a traditional home loan, such as tax returns or company financial statements.²⁴ They attract the self-employed or people who are full-time investors who have trouble proving a high level of, or regular, income because they write off various expenses (to minimise taxable income), or reinvest profits into their business.²⁵ Thus, the potential borrower may well have the ability to repay the loan but have insufficient proof in their paperwork to secure a more ‘traditional’ loan.

3.1.1 What is Required To Obtain a Low-Doc Loan?

Low-doc loan applicants –

- must have a clean credit history and a good repayment record for past loans;
- will be usually asked to complete a declaration that they can afford the loan (i.e. self-certification);
- need to show that they retain at least 20% equity in the security (although some lenders might require more);
- may be required to prove they have had a registered Australian Business Number (ABN) for a certain time.²⁶

Low-doc borrowers who are later able to provide financial statements, tax returns etc. may be able to ask that the loan be re-assessed as a standard loan at a lower interest rate.²⁷

Low-doc loans are usually mortgage insured. The lender’s main interest will tend to be the value of the asset used as security, meaning that loans may not be given in relation to high risk areas such as large rural allotments.²⁸

An indication that low-doc loans are becoming more mainstream is the recent announcement by the Commonwealth Bank that it was easing lending restrictions for such loans. For instance, applicants need only prove one year’s self-employment rather than two, as previously required. In response to concerns by

²⁴ InfoChoice website, ‘Low Doc Loans’.

²⁵ InfoChoice website, ‘Low Doc Loans’.

²⁶ InfoChoice website, ‘The low-down on low-doc loans’.

²⁷ InfoChoice website, ‘The low-down on low-doc loans’.

²⁸ InfoChoice website, ‘What is a non-conforming loan?’

consumer bodies, a Commonwealth Bank executive has said that the bank would ensure that additional checks would be placed on low-doc applicants.²⁹

3.2 'NON-CONFORMING' HOME LOANS

Low-doc loans are sometimes confused with another new type of loan – a 'non-conforming' home loan – although a low-doc loan is sometimes considered a type of non-conforming loan in some of the literature. Non-conforming loans do not conform to a 'traditional' lender's typical underwriting criteria and are designed for people who have a poor credit history (e.g. a past inability to meet credit card repayments), have been bankrupted, have unstable incomes (e.g. some pensioners, casual workers), or are unemployed. Traditional lenders are more likely to reject the loan application completely. Lenders will typically charge a higher interest rate on non-conforming loans due to the borrower having a greater chance of defaulting.³⁰ This type of lending is sometimes called 'sub-prime lending', after a similar form of lending in the United States. Providers of such loans are usually non-bank lenders who are not subject to prudential regulation.

Some features of non-conforming loans are –³¹

- they may be for applicants who want to borrow more than 80% of the security's value (which is not typical among low-doc loan applicants);
- the rate of interest charged is based on the credit history of the applicant and may be quite high if the risk is significant. The rate on these loans tends to be around 2% to 2.5% above the official interest rate to reflect the higher risk involved.³² The interest payable might be thousands of dollars over the lifespan of the loan; and
- there may be more stringent repayment conditions imposed on the loan and some lenders may require borrowers with a poor credit history to undertake financial counselling (but some lenders offer rewards after one or two years of solid repayments on the loan). Thus, these loans may be a way of gaining or restoring a good credit rating.

²⁹ Jacob Saulwick & Jessica Irvine, 'Big bank moves to lure low-doc borrowers', *Sydney Morning Herald Online*, 1 September 2007.

³⁰ Mortgage & Finance Association of Australia (MFAA) website, 'The Essentials of Borrowing #18', <http://www.essentialsofborrowing.com.au/~am/484/Mortgage-Basics/Home-Loans-Australia/who-can-help-with-mortgages/MFAA>.

³¹ InfoChoice website, 'What is a non-conforming loan?'; 'What you should know about 'non-conforming' finance'.

³² InfoChoice Website, 'Non-Conforming Loans – Tips and Tricks'.

It has been reported that the non-conforming loan market is growing by up to 40% per annum and is dominated by lenders such as Liberty Financial, Bluestone, GE and Pepper Homeloans.³³

Non-conforming loans have been causing concern among consumer bodies and others as they seem to serve a self-fulfilling prophecy. They are aimed at the very consumers most at risk of defaulting – and they often do so. Although non-conforming loans represent only around 2% of new loan approvals, RBA and APRA data shows that, in April 2007, 6.5% of non-conforming loans were in arrears as compared with 0.40% of standard loans and 1.07% of low-doc prime loans.³⁴

Some lenders are focused on the value of the asset offered as security – usually the home. This, it would seem, makes the borrower's ability to repay of lesser importance.³⁵

While such loans are commonly for those who have a poor credit history, they can attract non-resident borrowers who wish to purchase property in Australia but do not meet the residency requirements of traditional lenders; those who cannot raise a deposit and wish to borrow more than 90% of the total price of the property; or those borrowers wanting to secure a loan against properties that tend not to be seen as appropriate security (e.g. serviced apartments).³⁶

4 WHAT ARE 'MORTGAGE BROKERS'?

The fact that there are now many housing lenders in the market has created the opportunity for intermediaries such as mortgage brokers to enter the scene. Prior to deregulation of the industry, lenders used the 'old-fashioned' way of providing housing loans only to established customers with a good savings record. Now it is common for all lenders, particularly smaller lenders lacking the capacity to engage in wide marketing, to use brokers to originate loans. Mortgage brokers assist consumers to compare the proliferation of home loan products on the market and to choose the one with best value and features.³⁷ Mortgage brokers can be quite

³³ InfoChoice website, 'What is a non-conforming loan?', citing industry sources.

³⁴ Joint RBA & APRA Submission, pp 6-7, Graph 6.

³⁵ Amy Kilpatrick (principal solicitor of the ACT Consumer Law Centre), 'Easy money home loans: a race to the bottom', *Opinion – ABCNewsOnline*, 21 August 2007.

³⁶ InfoChoice website, 'Who are non-conforming loans for?'

³⁷ *Home Loan Lending Report*, p 5.

helpful for consumers as they do most of the time-consuming activity of looking around to find a suitable loan at a competitive interest rate.

All mortgage brokers have to become accredited with a lender to offer the lender's product and many brokers have a panel of lenders from which they recommend a loan product.³⁸ As most brokers receive a commission from lenders for the loans that they write, the broker does not generally charge the consumer a fee. However, as will be discussed later, it is wise not to assume this is the case. The consumer should ask the broker if the broker is on commission and whether there are fees payable by the consumer. Most lenders offer the same rate via a mortgage broker as they would to the consumer directly, so if the broker does not charge a fee, he or she can really assist in providing consumers with experienced advice, thus saving a lot of time and money. In terms of monetary savings, the broker should know if a particular lender's product has penalties attached, hidden fees, or future pitfalls and be able to help the consumer avoid taking out a loan that may become a huge burden in the future.³⁹

However, consumers should tread carefully before committing to a particular broker. A problem that can arise is uncertainty about who is the lender and who is the broker – a consumer may think he or she is dealing with the lender when it is actually the broker. Adding to the confusion further, some lenders are becoming brokers as well. The implications are that it may be unclear whether a consumer is dealing with an independent broker offering a range of products from various lenders; an agent for one lender only; or a person who is both broker and lender. The consumer should ask questions to clarify the role of the person he or she is dealing with and this will help determine just how 'independent' the advice being given is.⁴⁰

4.1 MORTGAGE & FINANCE ASSOCIATION OF AUSTRALIA

In most jurisdictions, there are currently no legal requirements imposed on mortgage brokers to hold a licence or to possess any particular skills, qualifications or training. Thus, anyone can become a mortgage broker.⁴¹ Financial advisers, on

³⁸ MFAA website, 'The Essentials of Borrowing #06'.

³⁹ MFAA website, 'The Essentials of Borrowing #06'.

⁴⁰ Queensland Department of Justice and Attorney-General, Office of Fair Trading (Queensland OFT website), www.fairtrading.qld.gov.au/, 'Using finance/mortgage brokers', *Fair Trading Facts*; InfoChoice website, 'Beware when using a mortgage broker'.

⁴¹ Queensland OFT website, 'Using finance/mortgage brokers'; InfoChoice website, 'Beware when using a mortgage broker'.

the other hand, operate under a Commonwealth licensing regime overseen by the Australian Securities and Investment Commission (ASIC). In Western Australia, brokers are required to be licensed and in the Australian Capital Territory, they must be registered. Although lacking comprehensive legislative oversight, most mortgage brokers are members of the Mortgage & Finance Association of Australia (MFAA), an industry association formed to raise standards among mortgage brokers, finance brokers and the like. The MFAA is now the peak industry body representing over 12,500 mortgage, home, land and finance professionals.⁴²

To become a member of, and accredited by, the MFAA mortgage brokers must meet education and experience (of at least two years) criteria. Ongoing education and professional development are necessary to maintain membership.⁴³

Members must adhere to the industry Code of Practice.⁴⁴ While it is not a legislative document, it is nevertheless binding on MFAA members and a breach may be sanctioned under the MFAA's disciplinary rules. The MFAA website indicates that six members were expelled during 2007.⁴⁵ The Code of Practice is intended to complement legislation such as the Commonwealth *Trade Practices Act 1974*, the *Corporations Act 2001*, the *Australian Securities and Investments Commission Act 2001*, state Fair Trading Acts, and the Uniform Consumer Credit Code (UCCC). The aim of the Code of Practice is to set a standard of good industry practice and fair dealing in the finance marketplace for MFAA members so that public confidence in those members will be enhanced.⁴⁶ It sets out minimum standards and other requirements applying to members. Those include (but consult the complete Code of Practice document for more detail) –

- a requirement to have relevant education, qualifications and experience, and to undertake ongoing education and development;
- a need to maintain professional indemnity insurance of at least \$1 million;
- compliance with all the abovementioned legislation and other relevant laws and regulations;
- a requirement to recommend only those loan arrangements that are genuinely and reasonably believed to be appropriate to the consumer's needs;

⁴² MFAA website, 'The Essentials of Borrowing #1', <http://www.mfaa.com.au/default.asp?menuid=22>.

⁴³ MFAA website, 'The Essentials of Borrowing #1'.

⁴⁴ MFAA *Code of Practice*, <http://www.mfaa.com.au/uploads/Code%20of%20Practice.pdf>.

⁴⁵ MFAA website, <http://www.mfaa.com.au/default.asp?menuid=512>.

⁴⁶ MFAA *Code of Practice*, p 4.

- a prohibition on ‘churning’ – that is, receiving a commission etc. for negotiating a refinanced loan for a consumer with a different lender from that which originally financed the loan if the consumer is not better off as a result;
- a requirement that, if the broker is acting as agent for a lender, the broker must recommend to the consumer that the consumer should rely on his or her own inquiries about the suitability of the loan;
- a disclosure requirement regarding loan details and about any fees or commissions;
- a need for full disclosure about any relevant conflict of interest;
- a need to make necessary inquiries to determine the consumer’s capacity to repay;
- a requirement to provide the consumer with advice about the outcome of the application;
- a skill, care and diligence obligation and a requirement to have honest and honourable relationships in professional and commercial dealings (which includes not engaging in misleading, dishonest, deceptive or fraudulent conduct or advertising);
- an obligation to advise a consumer who makes a complaint about the way in which complaints are handled (discussed further below); and
- obligations regarding the handling of trust moneys.

The MFAA states that whenever a consumer chooses to borrow through a mortgage broker (or through a range of other financial specialists), the consumer should ask if the broker is a MFAA member because, in doing so, the consumer can be sure that he or she is dealing with someone who has demonstrated knowledge, experience and integrity.⁴⁷ MFAA members are bound by the Code of Practice and can be subject to expulsion from the association. The MFAA website enables consumers to be able to check whether a broker has been expelled. It would seem that possible expulsion and the trend for lenders to deal with MFAA members may encourage mortgage brokers to join, thereby lifting broking standards.⁴⁸

⁴⁷ MFAA website, ‘The Essentials of Borrowing #01’.

⁴⁸ Queensland Office of Fair Trading, ‘Regulation of Finance Brokers in Queensland’, *Regulatory Impact Statement*, April 2007, p 7, (*Regulatory Impact Statement*), [http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/88C107897D31C5EC4A2572B30081C11C/\\$File/Regulatory%20Impact%20Statement%20-%20Finance%20Brokers.pdf](http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/88C107897D31C5EC4A2572B30081C11C/$File/Regulatory%20Impact%20Statement%20-%20Finance%20Brokers.pdf).

4.2 BENEFITS OF USING A BROKER

In a recent industry online survey, the 697 respondents who had heard of mortgage brokers perceived the following benefits of using one (in order of rank) –⁴⁹

- brokers do the ‘leg work’ for you, saving you time (around 89%);
- brokers are experts in a range of mortgages from many lenders (around 83%) and have a wider loan range (around 83%);
- brokers enable you to obtain a loan suited to your circumstances (around 79%); and
- brokers are more flexible (around 61%).

4.3 SOME CAUTIONS FOR CONSUMERS

It is estimated that mortgage brokers are now involved in around 30% of new loan transactions.⁵⁰ The Queensland Office of Fair Trading (Queensland OFT) estimates that there are around 648 mortgage brokers in Queensland.⁵¹ Given the burgeoning growth in their share of the market, it is inevitable that bad customer experiences with mortgage brokers can occur. Using a broker makes the connection between a lender and borrower weaker and it is possible that some brokers’ incentives may be aligned more with the volume of loans than the quality of them.⁵² If the broker receives a higher commission from some lenders, this can create a situation where some brokers’ impartiality is compromised when choosing the best loan for the consumer.

The Queensland OFT has received complaints regarding brokers’ conduct relating to fees. Such behaviour includes where a fee is paid and no loan is provided or it is not refunded if a loan cannot be arranged, or the consumer is overcharged. There are cases where there is misleading, or no, information about fees associated with the loan product. Another source of complaint is that the broker does not take the consumer’s personal circumstances into account when arranging a loan. This may

⁴⁹ BrandManagement, MFAA/BankWest Home Finance Index, Winter 2007, p 16, http://www.mfaa.com.au/uploads/MFAA_BWest_July07_HFI_WEB.pdf. There were 814 people from a mid to mass affluent respondent base taking part in the May/June 2007 survey. Compared with the November 2006 Survey, the sample is younger (almost a quarter being under 29), with around 22% earning less than \$50,000 in household income.

⁵⁰ *Home Loan Lending Report*, p 5, referring to Mr J Broadbent of the Reserve Bank of Australia, *Transcript of Evidence*, p 28.

⁵¹ Queensland OFT, *Regulatory Impact Statement*, p 4 (observations from Yellow Pages).

⁵² *Home Loan Lending Report*, p 26, citing Joint RBA & APRA Submission.

be because the broker is incompetent or has made a misrepresentation about the loan product.⁵³

Consumers should be mindful of the following matters when dealing with a mortgage broker –⁵⁴

- it might be useful to shop around for a mortgage broker and speak to family and friends who have used a broker to check whether they had a good experience;
- check the qualifications and experience of the broker that you wish to engage and ensure that the broker belongs to the MFAA and, thus, is bound by its Code of Practice. If the broker is not a MFAA member, the consumer should beware;
- consider checking the MFAA website which provides a publicly available list of members that have been expelled;
- because a broker may act for a number of lenders or just one lender, the broker you choose may not necessarily find the loan best suited to you. The broker might recommend a loan because it makes them the best commission. At the outset of your meeting with the broker, ask if he or she charges a fee. As explained earlier, most will not do so as they receive a commission from the lender. Do not pay an up-front fee or any fee until you receive the loan;
- ask the broker if they are an agent for just one lender or are, in fact, a lender so you know exactly who you are dealing with;
- a broker should have a wide range of loan products from various types of lenders (banks and non-banks) because this allows the broker to find a suitable loan for the borrower's individual circumstances. A good broker should examine your circumstances and future plans to ascertain the loan that is right for you. Ask how the broker researches the range of products that are available and the rates of interest on them. Request that the broker provides you with a formal comparison of any loans recommended, including fees and average annual percentage rates;
- although having a broker to arrange the loan does save a lot of leg work, you should double-check to ensure that you have been given correct and objective recommendations. All lenders are required by law to publish a 'comparison rate'. A 'comparison rate' is a single percentage figure, including some fees

⁵³ Queensland OFT, *Regulatory Impact Statement*, p 4, reviewing complaints received since 2000.

⁵⁴ Queensland OFT website, 'Using finance/mortgage brokers'; InfoChoice website, 'Beware when using a mortgage broker'; and MFAA website, 'The Essentials of Borrowing #06'.

and charges etc., which is the ‘true cost’ of the loan.⁵⁵ This makes it easier for consumers to more readily compare loans between various lenders;⁵⁶

- ascertain whether the broker will still be available to you for any enquiries you might have after you have secured the loan and whether the broker can assist if there is a dispute between you and the lender. If there is no ongoing relationship, there may be less incentive for the broker to ensure that a good product is secured;⁵⁷
- ensure that you have a written agreement with the broker covering matters such as what fees you must pay (which should only be paid once you have a suitable loan, not just any loan); the type, length and amount of the loan being arranged; whether the interest rate is fixed or variable and for how long; and any special features you want as part of the loan product;
- seek independent legal advice on any agreement before you sign it so, if the broker comes to your home, ask the broker to leave the contract with you so you can obtain that advice. Do not allow the broker to pressure you into signing then and there (such tactics should set ‘alarm bells’ ringing regarding the type of broker you are dealing with). Some consumers have signed what they thought was a loan application only to find – too late – that they have signed a contract with the broker and that a large fee is payable to the broker, even if the loan does not proceed.

If there is a problem with the broker that cannot be sorted out directly, a borrower can avail himself or herself of the MFAA’s internal dispute resolution procedures. If there is no satisfactory outcome, an external dispute resolution (EDR) scheme such as the Credit Ombudsman Service Limited (COSL) may be able to assist. The MFAA’s Code of Practice requires members to belong to an ASIC-approved EDR scheme but there is no actual legislative mandate. The COSL is such a scheme,

⁵⁵ Part 9A of the Consumer Credit Code (appendix to the *Consumer Credit (Queensland) Act 1994* (Qld)).

⁵⁶ The InfoChoice website has a page containing a table which enables potential borrowers to compare rates, fees and conditions across a number of lenders in the relevant state. For Queensland see <http://www.infochoice.com.au/banking/homeloans/compare/tables/summary/oo/QLD.asp>. See also, Queensland OFT, ‘Comparing Loans’, *Fact Sheet* for further information about comparison rates and what is and is not included; and the Cannex website at <http://www.cannex.com.au/>. Cannex researches, analyses and rates more than 20,000 consumer finance products to help consumers compare products’ rates and features.

⁵⁷ Queensland OFT, *Regulatory Impact Statement*, p 6.

with over 8,000 members (mainly mortgage brokers but also others, such as non-bank lenders) who write around 36% of all home loans.⁵⁸

A problem that has been identified in relation to dealings with mortgage brokers is the difficulty in seeking timely redress.⁵⁹ The COSL considers that the importance of EDR schemes lies in the role they play in allowing consumers a quick and inexpensive means of resolving complaints, often avoiding court proceedings. Such schemes can make a binding decision if a resolution is not achieved.⁶⁰

In cases of a borrower in financial hardship who is in dispute with a lender, the COSL can intervene and try to negotiate with the lender first – hopefully resulting in the lender agreeing (although there is no legislative obligation to do so) on a payment plan that the borrower can manage, such as postponement of payments or a freezing of the interest rate.

4.3.1 The MFAA/BankWest Home Finance Index, Winter 2007

The MFAA/BankWest Home Finance Index reports on quantitative research using an online survey. The Winter survey was carried out during May/June 2007 with 814 respondents from a mid to mass affluent respondent base.⁶¹

Some key findings of the survey specifically regarding mortgage brokers were –

- awareness of mortgage brokers is around 86% and is the highest in Queensland, at over 88%;
- mortgage broker preference for choice of loan is highest in WA (40.8%) and lowest in Victoria (28.1%). Mortgage broker satisfaction is 7.8 out of 10, second only to credit unions at 7.9.
- of the 384 respondents with a home loan, around 50% used banks. While banks are the most widely used loan source, banks' share of the market is dropping. Mortgage brokers were used by around 25% of borrowers, a figure virtually unchanged since June 2006; and
- around 17% of those respondents using banks and almost 19% of those using brokers had experienced problems (but these figures were lower than for building societies and non-bank specialist lenders). Similarly to past surveys,

⁵⁸ Credit Ombudsman Service Limited (COSL), *Submission No 18* to the House of Representatives Standing Committee's Home Loan Lending Inquiry, July 2007.

⁵⁹ Queensland OFT, *Regulatory Impact Statement*, p 6.

⁶⁰ COSL, *Submission No 18*.

⁶¹ BrandManagement, MFAA/BankWest Home Finance Index, pp 12ff.

the most common difficulty was a communication problem or administrative mistakes (around 56% experiencing these or misquoted repayment amounts). Many, over 40%, found that the lending process took too long or the lender was too slow. Around 28% reported not being told about all or some of the fees or costs involved.

5 BORROWERS IN FINANCIAL DIFFICULTY

Despite data showing that the household sector is generally in good financial shape with growing incomes, there are indeed some households that are struggling with their debts and mortgage repayments, particularly in some parts of NSW. While RBA and APRA data indicates that only 0.38% of the value of housing loans made by banks are in arrears of more than 90 days and this figure is lower than was typical in the past, it is still the case that roughly 12,000 borrowers are in arrears by at least 90 days.⁶²

Applications for property repossessions appear to be higher than in the 1990s but, overall, it is difficult to obtain firm data from the courts and to interpret it to show whether home repossessions – as distinct from other property repossessions – have increased.⁶³ There are, however, media reports that, as at September 2007, the number of Queensland homes being repossessed was 756 so far in the current year. The number has increased over the past three years and is significantly more than the 484 repossessions during the whole of 2004.⁶⁴ The rapid upward trend in house repossessions has been particularly apparent in NSW, with reports that these have more than doubled since four years ago.⁶⁵

Those people whose payments are in arrears or whose homes are threatened by foreclosure are very likely to be facing considerable financial hardship, despite the fact that the economy is performing well. A possibly telling piece of information from RBA and APRA data is that arrears rates are higher for non-conforming loans, with 6.5% of these loans in arrears by more than 90 days. This also reflects

⁶² Joint RBA & APRA Submission, pp 6-7.

⁶³ Joint RBA & APRA Submission, p 8. *Home Loan Lending Report*, pp 20-21, citing submissions from the Australian Bankers Association, the Finance Sector Union and Virgin Money.

⁶⁴ 'Qld home repossession rate skyrockets', *CCH News Headlines*, 24 September 2007.

⁶⁵ Stephen Long, 'Home repossessions rising in Sydney, Melbourne, and the Australian Capital Territory', *Lateline, ABCOnline*, 13 September 2006.

the greater risk involved.⁶⁶ It might also be indicative of the very fact that non-conforming loans – usually characterised by high rates of interest – are taken out by borrowers least likely, through poor financial management or other personal circumstances, to be able to service the repayments. There are borrowers desperate to buy their own home, despite not having the necessary credit history or proof of ability to service the loan to satisfy traditional lenders' requirements. It is often these people who fall into difficulty.

There have been claims that some borrowers who are facing ongoing default on their repayments are drawing on their superannuation⁶⁷ and that APRA figures indicate that the number of applications for release has grown. In 2006, APRA approved almost 14,000 applications for release (equal to around 0.05% of the number of accounts) compared with around 10,500 in 2005 and around 31,000 in 2001.⁶⁸ Some consumer groups say that they have seen evidence of lenders assisting borrowers to access their superannuation in cases where the borrower is likely to lose the home in any event. The superannuation is only used by the lender to limit its losses (especially if there is negative equity in the home).⁶⁹

Maybe the recent events are not entirely unexpected. A study by an international banking organisation in 2006 pointed out that Australia has gone from having one of the lowest housing debt to income ratios in the world during the 1980s to one of the highest now, accompanied by a doubling of house prices. This is despite Australia having comparatively high mortgage interest rates.⁷⁰

5.1 POSSIBLE REASONS FOR REPAYMENT DIFFICULTY

A timeworn but accurate warning given by the financial experts is that if the loan on offer seems too good to be true – it probably is. The lender or mortgage broker might suggest a loan product that is open to borrowers with a poor credit history or who have even been bankrupted or to borrowers with a small or non-existent

⁶⁶ Joint RBA & APRA Submission, pp 6-7.

⁶⁷ APRA is required to release a person's superannuation if the person can demonstrate that they are faced with mortgage foreclosure: *Home Loan Lending Report*, p 25.

⁶⁸ Joint RBA & APRA Submission, p 9, Graph 9.

⁶⁹ Consumer Action Law Centre, Submission to the House of Representatives Standing Committee's Home Loan Lending Inquiry, *Submission No 18*, July 2007.

⁷⁰ *Home Loan Lending Report*, p 11, citing Bank for International Settlements Committee on the Global Financing System, 'Housing finance in the global financial market', *CGFS Papers*, no 26, January 2006.

deposit. The fine print is something that should always, without fail, be carefully scrutinised as it is rare that the path to owning the home will be as smooth as it appears on the face of the loan.⁷¹

The MFAA website lists some traps to avoid when seeking a mortgage from any lender –⁷²

- avoid accepting the loan at face value – check the fine print;
- do not become too focussed on the interest rate as this can detract from paying attention to all the fees and charges and the loan’s flexibility – the *entire* cost of the loan is important, not just the interest rate. For some borrowers, features such as the ability to use Internet banking or to off-set savings against the mortgage (although these loans often have higher interest rates) are essential;
- do not forget to ask about penalties and charges linked to a home loan – for example, are there charges that apply if one wishes to pay extra at certain times? Is there a charge if one wants to move or refinance the loan?
- do not overlook extra fees that arise when buying a home. The common fees are: stamp duty, legal costs and search fees etc., mortgage insurance, loan application fee, valuation fee, and a registration fee. The InfoChoice site warns that on a loan of \$300,000, one should expect to pay at least \$15,000 in fees and taking out mortgage insurance brings the amount of fees up to around \$17,470;⁷³
- do not get ‘sucked in’ by the offer of a ‘deferred establishment fee’ without further investigation of the implications of the fee. An establishment fee covers the costs of setting up the loan but it might be deferred and repaid at a later date at a higher rate. Consumers should check to ascertain the consequences of repaying a loan early because some lenders apply it if the loan is repaid within five years;⁷⁴
- do not forget to check the ‘comparison rate’ of the lender, which, as noted earlier, shows the total repayments once fees and charges are added to the interest cost (although some costs are not included); and

⁷¹ MFAA website, ‘The Essentials of Borrowing #19’.

⁷² MFAA website, ‘The Essentials of Borrowing #19’.

⁷³ InfoChoice Website, ‘Non-Conforming Loans – Tips and Tricks’,
<http://www.infochoice.com.au/banking/learn/tips/nonconforming/default.asp#8684>.

⁷⁴ John Collett, ‘Still going for brokers’, interviewing Denis Orrock, general manager of InfoChoice.

- if using a mortgage broker, do not allow the broker to ‘churn’⁷⁵ you from one loan to another as this will often disadvantage a borrower who is left with large fees that accompany the new loan. It has been reported that bad cases of churning have recently come to light.⁷⁶

Poor or deficient financial literacy can be a cause of many borrowers taking on too much personal debt on top of their home loan or overstating their income to obtain a loan. Also, many products are quite complicated and the average consumer may not realise the huge difference to loan repayments that a slightly higher interest rate can make.⁷⁷ However, help is at hand with the introduction in 2005 by the Commonwealth Government of the Financial Literacy Foundation. The Foundation has a website and resources directed at educating consumers about financial matters, including budgeting, saving, investing, as well as much other information.⁷⁸

There are, however, other reasons personal to the borrower himself or herself for falling into financial difficulty. Unforeseen accidents, ill-health or unemployment are among the causes of mortgage stress. Borrowers should always take such eventualities into account when determining the amount that they can actually afford to repay.

Sometimes borrowers can facilitate their own misfortune by assuming further debt on top of their home loan to buy consumer items, such as expensive entertainment systems.⁷⁹ It has been observed that two decades ago, the primary concern of borrowers was to repay their home loan as quickly as possible. These days, people are less willing to forgo luxuries such as televisions and stereos until they can afford them and will seek out a loan or use their credit cards to buy these items. This practice can set borrowers up for a large amount of debt.⁸⁰

Once substantial personal debt builds up, some borrowers may default on their mortgage repayments or they might consolidate their debts by refinancing their

⁷⁵ See explanation of this term in section 4.1 of this Research Brief.

⁷⁶ Michelle Innis, ‘Mortgage brokers face tougher rules’, *brisbanetimes.com.au*, 13 December 2006, citing a comment by a solicitor from the NSW Consumer Credit Legal Centre.

⁷⁷ *Home Loan Lending Report*, p 29.

⁷⁸ *Home Loan Lending Report*, pp 29-30. See the Foundation’s website at <http://www.understandingmoney.gov.au/>.

⁷⁹ *Home Loan Lending Report*, p 27.

⁸⁰ *Home Loan Lending Report*, p 27, citing Halifax Bank of Scotland (Australia), *Submission No 3*.

mortgage. There may be huge charges involved, creating an even larger debt and significantly eroding the equity in the borrower's home. The Consumer Action Law Centre⁸¹ comments that many borrowers who fall into trouble see refinancing as the best and only option. Unfortunately, they may still lose their home.⁸² If the borrower ends up having to sell, which may happen very quickly, they have nothing left. When borrowers are encouraged to refinance in such circumstances, it may amount to predatory lending (discussed below). It has been noted that refinanced home loans seem more likely to be defaulted upon.⁸³

Conversely, when looking at the position from a lender's point of view, it can be difficult for a lender to tell exactly what a potential borrower's debts are at the time of granting a mortgage. Some people overstate their income to obtain a low-doc loan and some do not disclose the full level of the debts.⁸⁴

6 'PREDATORY LENDING'

Predatory lenders prey on the vulnerable and the desperate would-be home owners by lending them amounts which the lenders know the borrowers cannot possibly service and quickly move in to repossess the property when the borrower defaults. The value of the asset is the important thing to the lender. The predatory lenders may sometimes use low-doc loans but do so in an improper manner. Another source of consumer detriment arises from refinancing. The consumer may be told that the refinanced loan will be cheaper but it actually ends up costing more over time.⁸⁵

The MFAA lists the following as characterising predatory lending –⁸⁶

- very high set-up costs financed by the loan;

⁸¹ A Victorian organisation and the largest specialist consumer legal practice in Australia. It provides legal advice and help to vulnerable consumers and engages in policy and law reform work at various levels.

⁸² Consumer Action Law Centre Submission to the House of Representatives Standing Committee's Home Loan Lending Inquiry.

⁸³ *Home Loan Lending Report*, pp 27-28, citing Halifax Bank of Scotland (Australia) Submission.

⁸⁴ *Home Loan Lending Report*, p 28, citing Halifax Bank of Scotland (Australia) Submission and evidence from Mr D Grafton, Commonwealth Bank, *Transcript of Evidence*, 10 August 2007.

⁸⁵ Queensland OFT, *Regulatory Impact Statement*, p 6.

⁸⁶ MFAA website, 'MFAA Acts on Predatory Lending', *Media Release*, 18 September 2007.

- one or more intermediaries involved in arranging the loan (e.g. mortgage brokers, accountants, solicitors);
- inflexible provisions for hardship;⁸⁷
- high ongoing interest rates, high default interest rates and swift enforcement action;
- no access to alternative dispute resolution;
- indifference to poor credit history or to past defaults; and
- reliance on asset rather than income to service the loan.

The Consumer Credit Legal Centre in Sydney has indicated that predatory loans tend to be provided ‘*via a chain of intermediaries including at least one broker, a solicitor, sometimes an accountant, and one or more lenders.*’⁸⁸ The Centre has identified concerns such as commission-based remuneration encouraging brokers to engage in pressure selling; and brokers ‘cold calling’ or visiting the consumer’s home where the consumer cannot walk away from the high pressure sales pitch.⁸⁹

The Consumer Action Law Centre in Victoria notes that in almost all of the cases the Centre takes on regarding mortgages, a mortgage broker was involved in setting up the loan and the broker has often been implicated in some unscrupulous conduct. Practices range from getting a consumer to sign a ‘business purpose’ statement (to avoid the application of the UCCC consumer protection provisions, discussed later) to producing fraudulent payslips to lenders to secure the loan. In some cases clients are from non-English speaking backgrounds.⁹⁰

Deregulation of the financial market in the late 1980s prompted a rapid growth in non-bank lenders, such lenders being free of prudential supervision by APRA.⁹¹ It has been reported that, in the ACT, for example, non-bank lenders were responsible for 73% of the recent actions for repossession of ACT homes.⁹² It

⁸⁷ Stuart Washington, ‘Warning of predatory lenders who target poor’, *brisbanetimes.com.au*, 5 July 2007, citing the Consumer Credit Legal Centre.

⁸⁸ Stuart Washington, quoting the Consumer Credit Legal Centre’s submission to the Productivity Commission’s review of consumer protection laws.

⁸⁹ Consumer Credit Legal Centre NSW (Inc), ‘A report to ASIC on the finance and mortgage broker industry’, March 2003.

⁹⁰ Consumer Action Law Centre, Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry.

⁹¹ Michelle Innis, citing David Tennant, Chair of the Australian Financial Counselling and Credit Reform Association.

⁹² Michelle Innis, citing a comment made by David Tennant.

should be said, of course, that not all mortgage defaults and housing repossessions are a result of the dishonest practices of unscrupulous lenders. Most non-bank lenders do behave appropriately in their lending practices.⁹³ Mr Phil Naylor, the chief executive officer of MFAA, recently commented that ‘predatory lenders’ (some of whom are, or, use mortgage brokers) are estimated to make up just 0.5% of the mortgage market but they do considerable damage to the reputation of the mortgage industry in general as well as harm to vulnerable consumers.⁹⁴

MFAA’s submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry noted that brokers do not have much effect on lending practices as they just sell products that lenders make available, including any changes to the lending criteria.⁹⁵ Nevertheless, even the MFAA has acknowledged that self-regulation provided by the MFAA’s Code of Practice is not enough as there will always be some propensity for improper practices to occur.⁹⁶ There is also the issue that not all brokers become MFAA members and some brokers have been expelled from the MFAA – these being the very operators posing the most risk of engaging in unscrupulous practices.

The submission by the lender, Liberty Financial, to the House of Representatives Standing Committee’s Home Loan Lending Inquiry indicates that its potential borrowers have to satisfy a test which assesses their ability to repay a loan. Liberty says that it will not lend to customers who can ill afford it, and it responds quickly when a borrower falls into difficulty by offering more repayment options (e.g. interest rate reductions, lower fixed payments) or other solutions.⁹⁷ James Boyle, Liberty Financial’s general manager of mortgages, also said that Liberty ‘has stringent accreditation criteria for our mortgage brokers. We are completely reliant on mortgage brokers so we take their conduct very, very seriously.’⁹⁸ It appears that the

⁹³ *Home Loan Lending Report*, pp 23-34.

⁹⁴ Letter to the Office of the Treasurer from Mr Phil Naylor, chief executive officer of the MFAA of 20 August 2007.

⁹⁵ MFAA, Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry, *Submission No 2*, July 2007, p 1, <http://www.aph.gov.au/house/committee/efpa/banklending/subs/sub002.pdf>.

⁹⁶ Queensland OFT, *Regulatory Impact Statement*, p 11, citing Phil Naylor, ‘Bridle the Brokers’, *Business Review Weekly*, 28 November 2002, pp 63-64.

⁹⁷ Liberty Financial, Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry, pp 6, 13.

⁹⁸ Stuart Washington, citing James Boyle of Liberty Financial.

Consumer Credit Legal Centre recently wrote to Liberty requesting that it no longer deal with a broker that had recently been expelled from the MFAA.⁹⁹

There is some comfort to be taken from evidence provided to the recent Home Loan Lending Inquiry that traditional lenders (ADIs) tend not to be involved in inappropriate lending practices and most non-bank lenders operate responsibly.¹⁰⁰ The MFAA submits that lending standards are actually very high due to various legislative and self-regulatory measures, and strong dispute resolution schemes. At the end of the day, as the MFAA points out, most lenders do want to satisfy themselves that the loan can be repaid without too much difficulty.¹⁰¹

6.1 EXAMPLES OF RECENT PREDATORY LENDING PRACTICES

The Cooks

Michael and Karen Cook, a New South Wales couple with two children, borrowed money from St George to build a home. They had a reasonable deposit and borrowed the \$110,000 remainder. However, sometime later, Mr Cook developed non-Hodgkins lymphoma, which became malignant, and he lost his job soon after. The Cooks resorted to a series of loans to refinance the mortgage so as not to lose the home. After defaulting on some loans they sought to refinance. The broker organised two loans, the largest being from Permanent Mortgagees for \$195,000. At some stage, the Cooks signed a declaration that the loan was for 'business purposes'¹⁰² although it was actually a refinancing of their existing home loan (i.e. personal purposes).¹⁰³ The repayments increased, along with the associated fees, to the point that loss of the family home seemed inevitable.

The Cooks sought assistance from Legal Aid NSW which brought court proceedings against Permanent Mortgages on the basis that the mortgage and credit

⁹⁹ Stuart Washington.

¹⁰⁰ *Home Loan Lending Report*, pp 23-24, citing Ms H Richards, APRA, *Transcript of Evidence*, 10 August 2007 and Mr P Naylor, MFAA, *Transcript of Evidence*, 10 August 2007.

¹⁰¹ MFAA Submission to the House of Representatives Standing Committee's Home Loan Lending Inquiry, July 2007, p 2.

¹⁰² As noted in this Brief, sometimes 'business purpose' loans fall outside consumer protection provisions of the UCCC.

¹⁰³ Michelle Innis; Michael Carey, 'American mortgage shock waves hit Australia', *7.30 Report*, *ABCOnline*, 15 August 2007.

contracts were unjust.¹⁰⁴ The court said that when the ‘business purposes’ declaration was made, the lender was aware, or would have had reason to believe, that the credit was to be applied for personal purposes. Patten AJ found, on balance, that the mortgage and credit contracts were unjust. It said that the Cooks were foolish but there were other factors involved. The Consumer Credit Code (UCCC) is designed to protect the unsophisticated borrower from his or her own foolishness. Given the low income of the Cooks and their credit history, the lender was aware, or would have been aware had it made the most perfunctory of inquiries, that the Cooks were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgaged property.¹⁰⁵ While the court did not set aside the loan, the fees were reduced by over \$13,000 and it was ordered that the Cooks not be charged a higher default rate or the lender’s default costs. A solicitor with Legal Aid NSW said that the case should make it more difficult for lenders to escape the UCCC consumer protection provisions by having the borrower sign a ‘business purpose’ declaration and to ‘lend without regard for the borrower and their circumstances’.¹⁰⁶

Sample and Partners

In May 2007, the finance broking company, Sample and Partners, with offices in NSW, Victoria and Queensland, was found guilty of misleading and deceptive conduct. Representatives of the company would ‘cold call’ consumers and organise to come to the consumers’ homes. Agents would falsely represent fake case studies to the consumers and tell them that switching to Sample and Partners would take years off their mortgage. Agents also falsely represented that they had researched the market for the appropriate loan for the consumer when, in fact, there were only a small number of lenders on their panel.¹⁰⁷

ASIC v Tonadale Pty Ltd and Skeers

In October 2006, ASIC and the Australian Federal Police raided the offices of a Canberra mortgage broker, Tonadale Pty Ltd (trading as ACT Mortgages). Tonadale, through an employee, Skeers, provided an unemployed 19 year old with a \$365,000 low-doc loan. It appeared Tonadale did not actually know what Skeers

¹⁰⁴ *Permanent Mortgages Pty Ltd v Cook* [2006] NSWSC 1104, [http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/nsw/supreme_ct/2006/1104.html?query=title\(permanent%20mortgages\)](http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/nsw/supreme_ct/2006/1104.html?query=title(permanent%20mortgages)).

¹⁰⁵ *Permanent Mortgages Pty Ltd v Cook* [2006] NSWSC 1104, paras 88, 92.

¹⁰⁶ Michelle Innis, quoting John Moratelli of Legal Aid NSW.

¹⁰⁷ Kelsey Munro, ‘Brokers need fixing’, *brisbanetimes.com.au*, 29 August 2007.

was doing. The teenager had inherited \$180,000 but had no job. The teen said that he had never been asked to prove his income and that he was only asked basic questions. Skeers knew that the information contained in the loan application was not correct (it said that the borrower had a \$75,000 annual income and had considerable assets) and that it was possible that the borrower had insufficient income to meet all the repayments. The borrower eventually defaulted on the loan.¹⁰⁸ ASIC took legal proceedings against Tonadale and Skeers alleging unconscionable and misleading conduct. On 3 October 2007, the Federal Court made orders by consent that Tonadale pay \$31,831 in compensation to the borrower and noted Tonadale's undertaking to establish an education and training program for employees regarding employees' responsibilities and obligations in arranging loans.¹⁰⁹ On 9 October 2007, the Federal Court declared that Skeers had engaged in misleading and deceptive conduct and unconscionable conduct and ordered him to pay ASIC's costs.¹¹⁰

Accounts in the Media

- It is reported in a news article that the Consumer Credit Legal Centre in Sydney found a case where an unemployed couple with four children were provided with a loan of \$182,250 at an interest rate of 8.95% on \$110,000 of the total and 23.6% on the remaining \$72,250.¹¹¹
- A case under investigation by the Credit Ombudsman Service (COSL) in Victoria is that of a lady who apparently signed for a home loan without realising what was on the application form – which said she was an Australian citizen with a full time job and had over \$15,000 in the bank. In reality, the woman was an unemployed asylum seeker who could not speak English. It is believed that the incident arose when the woman's then husband – who had since left her – initially dealt with the mortgage brokers and she was later asked to sign some documents, apparently coerced by her now ex-husband. The woman is said to have paid a deposit of around \$10,000 and around \$7,000 in loan repayments. However, she also paid about \$14,000 in fees and charges.

¹⁰⁸ 'Mortgage broker raided over loan to jobless teen', *ABCNewsOnline*, 27 October 2006.

¹⁰⁹ See Federal Court of Australia's website at <http://esearch.fedcourt.gov.au/Esearch?showDoc=25303125>. Downloaded 12 October 2007.

¹¹⁰ See Federal Court of Australia's website at <http://esearch.fedcourt.gov.au/Esearch?showDoc=25306840>. Downloaded 12 October 2007.

¹¹¹ Stuart Washington.

Some time later, after experiencing financial difficulty, the woman and her two children were evicted.¹¹²

CHOICE Case Study

As part of an investigation into mortgage brokers in 2004, the consumer body, CHOICE, put forward some case studies. One of these involved a Victorian couple, P and J, who were visited by a broking company representative after a cold call about how a certain loan refinancing product could cut interest and years off their mortgage.¹¹³ After the representative had been at the couple's home for around three hours, J needed to collect her child at school and she said that she felt rushed into signing an agreement and paying a \$195 fee. A second meeting with the couple took several hours and resulted in a 'Plan' that suggested budgeting and refinancing would save the couple almost \$100,000 in interest and lower their mortgage term from 22 to nine years. P and J said they felt pressured into signing. J said that there was no list of comparable lenders, just one lender, and P felt that the plan under-budgeted for living expenses. After hearing nothing from the brokers for around six weeks, they contacted the lender who apparently thought that the broker's fee (almost \$6,000 when the loan settled) was too high and advised P and J against going through with the refinancing. The problem was that the broker's cancellation fee was \$2,000. After CHOICE contacted the broker, the parties reached a settlement.¹¹⁴

'Ponzi' Loans

The COSL is noticing a growth in 'Ponzi' loans – loans that can only be repaid by acquiring a bigger loan or selling the home. This occurs when lenders – usually 'fringe' lenders who are not members of the MFAA – refinance home loans in situations where the borrower has no ability to repay the loan. The lender is relying solely on the value of the security (the home), not the borrower's capacity to meet the repayments. Invariably, the borrower quickly finds himself or herself in default of their loan and risks losing the home. The loans have generally been taken out of the reach of the protections given to consumers under the UCCC by the desperate borrower being prepared to sign a declaration that the loan is for

¹¹² Kirsten Veness, 'Mortgage broker accused of predatory lending', *ABCNewsOnline*, 19 September 2007.

¹¹³ It should be noted that only the consumer's version is reported in the CHOICE study as the broker was "unable to comment".

¹¹⁴ CHOICE, 'Mortgage brokers investigated', March 2004, <http://www.choice.com.au/viewArticle.aspx?id=104205&catId=100405&tid=100008>.

‘business purposes’ or ‘investment purposes’, not personal purposes. Evidence given to the court in the *Cook* case suggested that the loan involved there was a ‘Ponzi’ loan.¹¹⁵

Other characteristics of such loans include excessive charges on the principal sum borrowed, higher rates of interest and very high default rates, and extremely short terms of 6 to 12 months. In many cases seen by the COSL, the borrower defaults very quickly, even within the first month, pushed by the even higher repayments now due. The COSL has surmised that predatory lenders never intend or expect the borrower to repay the loan and the whole aim is to put lots of commissions and charges onto the loan, thus ensuring a quick return when the house is invariably lost by the borrower.¹¹⁶

A Commercial

A commercial on the ‘Mortgage Masters’ website claims that if –

*‘you have got equity in your home, Mortgage Masters can refinance all your loans and consolidate them into one low monthly payment. ... At Mortgage Masters we’ve been able to help hundreds of people change their financial position, even if they had a bad credit rating – and now we want to help you. ... [W]hen the banks say “no”, we say “No Problem”’.*¹¹⁷

A Happier Case

On a more positive note, CHOICE also found a case where the consumer was happy about his experience with a mortgage broker. Y said that the broker did all the leg work and paperwork after the first bank declined him for valuation reasons. The broker found the report and knew what lenders were more flexible for renovation projects. Y said that although the rate ended up being similar to what Y could negotiate, the time saved and problems solved saved the contract.¹¹⁸

¹¹⁵ *Permanent Mortgages Pty Ltd v Cook* [2006] NSWSC 1104, paras 78-84. Evidence by Dr S Keen, Associate Professor of Economics and Finance at the University of Western Sydney.

¹¹⁶ COSL, Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry.

¹¹⁷ Taken from the case studies in the Consumer Action Law Centre Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry.

¹¹⁸ CHOICE, ‘Mortgage brokers investigated’.

6.2 RECENT INTERNATIONAL DEVELOPMENTS

Obviously, predatory lending practices and unscrupulous mortgage brokers are not peculiar to Australia. The difficulties facing Australian borrowers have been, to some degree, exacerbated by events in the United States. In March 2007, Wall Street reacted negatively to revelations that one of the largest US home lenders was under criminal investigation. There were reports of big losses on shares in the sub-prime mortgage market.¹¹⁹ Gavin Graham, who assists in managing over \$6 billion of investment for the Guardian Group of Funds, told the media that US lenders have been pushing home loans at people who have not got any hope of repaying them and the warning signs of major defaults have been coming for some time. It appears that defaults in the US sub-prime loan sector (similar to ‘non-conforming’ loans in Australia) are above 20%.¹²⁰

Problems facing the US mortgage market and borrowers, and the flow-on to the housing sector where building has slowed, have had some impact in Australia. Some commentators have argued that there are parallels between the two countries but the effects here may not be as great as in the US where sub-prime lending has a much bigger share of the mortgage market and where the loans tend to have riskier features.¹²¹ The RBA and APRA have commented that, in Australia, non-confirming loans made up only around 2% of new loans in 2006 compared with 20% in the same period in the US. The 90-day arrears rate for those loans in Australia was 6.5%, well below that in the US.¹²²

Further, ‘stress tests’¹²³ conducted by the International Monetary Fund, APRA, RBA, and Treasury of the five largest banks (accounting for around 65% of home

¹¹⁹ Stephen Long, ‘US housing defaults raise recession fears’, *PM – ABCOnline*, 6 March 2007.

¹²⁰ Stephen Long, ‘US housing defaults raise recession fears’. See also, USA, House Committee on Financial Services Press Releases: ‘Financial Service Committee Approves Comprehensive Mortgage Reform and Anti-Predatory Lending Legislation’, 6 November 2007; House Passes Historic Mortgage Reform Legislation, 15 November 2007, http://www.house.gov/apps/list/press/financialsvcs_dem/press1115072.shtml.

¹²¹ Stephen Long, ‘US housing defaults raise recession fears’, interviewing David Tenant of the Financial Counselling and Credit Reform Association.

¹²² Joint RBA & APRA Submission, Attachment 1.

¹²³ Simulating various economic events such as large falls in house prices, a marked rise in unemployment and higher costs of funding.

loans) in 2005 and 2006 confirmed the resilience of the Australian banking system: while bank profits fell, banks remained profitable and well capitalised.¹²⁴

In recent months, however, Australian borrowers have faced a number of interest rate rises, particularly as the cost of credit has risen (meaning an increase in interest rates even above the rates imposed by the Reserve Bank).¹²⁵ As of February 2008, the official RBA cash rate stands at 7%, fuelled by inflationary pressures.¹²⁶ Facing the possibility of a US economic slowdown, the Federal Reserve Bank cut official interest rates in the US by 75 basis points in early 2008.¹²⁷

The lenders that will face the biggest difficulties in obtaining credit will be those that raise money for new home loans largely through securitisation (whereby, as explained earlier, existing loans are sold into global credit markets where the cost of credit has risen sharply in recent months). Whereas banks fund much of their lending through their deposit holdings, it is non-bank lenders who will feel the biggest impact because these lenders tend to engage in securitisation and do not have deposits to draw on.¹²⁸ Thus, banks will be better insulated against the big credit costs because of their ability to utilise deposits. Nevertheless, the larger banks recently raised their standard variable rates independently of the RBA.¹²⁹ In December 2007, central banks across the world acted together to inject cash into financial markets to counteract the shortage of credit.¹³⁰

A high profile example of the impact of the credit crunch on non-bank lenders came in late August 2007 when RAMS fell into difficulty and had to raise its home loan rates twice in six weeks. The rise applied to both full-documentation and low-doc loans but the latter incurred a larger rise. It is reported that its troubles surfaced when, unable to source loan funding from deposits, RAMS used funding

¹²⁴ Joint RBA & APRA Submission, p 10, referring to other studies as part of the Financial Sector Assessment Program.

¹²⁵ Stephen Long, 'Credit crunch likely to hit Australian investors, borrowers', *ABCNewsOnline*, 15 August 2007.

¹²⁶ See, for example, Jessica Irvine, 'More mortgage pain ahead', *brisbanetimes.com.au*, 11 February 2008.

¹²⁷ Rainer Buergin, 'G7 tips \$450 billion write-offs from subprime crisis', *brisbanetimes.com.au*, 11 February 2008.

¹²⁸ Stephen Long, 'Credit crunch likely to hit Australian investors, borrowers'.

¹²⁹ Michael Madigan, 'Banks defy critics – St George, Bank West, Westpac follow hike', *Courier Mail*, 12 January 2008, p 9.

¹³⁰ Rainer Buergin.

from short-term debt markets which became locked up in global credit 'meltdown'.¹³¹ Westpac offered a rescue package of \$140 million to buy RAMS' branches, brand name and any business coming to it from 15 November 2007 and promised a loan to help it refinance some debt.¹³² On 25 November 2007, RAMS shareholders voted to sell the brand and franchise operations to Westpac.¹³³

In seeming defiance of international trends, there are reports from one of the country's largest mortgage brokers that its figures indicated that borrowers were not deterred by RBA interest rate increases in 2007 with figures for November showing an increase in the number of home loans over the previous month. However, almost a quarter of borrowers were opting for fixed-rate loans.¹³⁴

7 REGULATION OF THE HOUSE LENDING MARKET

Credit is a state responsibility while other financial services, such as insurance and investment, are regulated under Commonwealth legislation. As noted earlier, there is very little specific statutory regulation of the mortgage broking industry in Australia, with Western Australia being the only state to require brokers to have a licence.¹³⁵ The Australian Capital Territory, New South Wales and Victoria have broker specific legislation and, in the case of the NSW Act, a number of measures regulating broker behaviour. In terms of lenders themselves, since deregulation of the lending market, only ADIs' lending standards are regulated by APRA and the RBA whereas non-bank lenders are not subject to prudential oversight.

7.1 COMMONWEALTH OVERSIGHT

Under the [Australian Securities Investment Commission Act 2001 \(Cth\)](#) (*ASIC Act 2001*) ASIC is the body responsible for oversight of financial products and services such as quality of advice requirements (including licensing).

¹³¹ 'Disquiet as RAMS lifts rates twice', *Sydney Morning Herald Online*, 6 October 2007.

¹³² 'Disquiet as RAMS lifts rates twice'.

¹³³ Danny John, 'Not a bleat from RAMS investors', *brisbanetimes.com.au*, 26 November 2007.

¹³⁴ Jessica Irvine, 'Fixed-rate home loans go through the roof', *Sydney Morning Herald Online*, 17 January 2008.

¹³⁵ The ACT has a registration requirement but not for licensing of brokers. No qualifications/education conditions apply.

Under the *Corporations Act 2001 (Cth)*, providers of personal financial advice and products must have an Australian Financial Services (AFS) licence pursuant to the Financial Services Reform (FSR) regime.¹³⁶ The FSR regime enables the uniform regulation of most financial products, such as superannuation and share investments; sets up a single licensing system; requires financial service providers to belong to an external dispute resolution (EDR) scheme (discussed earlier); and imposes disclosure obligations. The *Corporations Act 2001* does not designate credit as a ‘financial product’, thus mortgage brokers are not subject to the ASF licensing obligations and ASIC’s powers do not extend to overseeing credit products and related advice.

However, the *ASIC Act 2001* does, in relation to corporations generally, prohibit unconscionable, misleading or deceptive conduct; false and misleading representations; and breaches of implied warranties in contracts between brokers and consumers (e.g. exercise of due care and skill).¹³⁷ ASIC has a role to play to that extent and, in the context relevant here, in relation to unfair conduct in home lending practices.¹³⁸ The Act does not, however, prescribe detailed disclosure obligations or requirements in relation to credit – such as considering the consumer’s individual circumstances and giving reasons why the product chosen is suited to the consumer’s needs – or contain measures compelling brokers to assess a consumer’s capacity to service a loan. The reality is that any control or reprisal against brokers is ‘reactive’, such action taken only after the unfair or misleading or unconscionable conduct has already occurred.¹³⁹

As just explained, ASIC’s regulation of brokers is somewhat limited. It does have the power to target mortgage brokers for engaging in misleading, deceptive or unconscionable conduct but ASIC itself does not believe that this power is sufficient to protect consumers who are hurt by other problems in the credit market, which, as a Commonwealth agency, it cannot regulate.¹⁴⁰

¹³⁶ The *Financial Services Reform Act 2001 (Cth)* has been in operation (for the most part) since March 2002.

¹³⁷ See *Home Loan Lending Report*, pp 33-34.

¹³⁸ See the ASIC Submission to the House of Representatives Standing Committee’s Home Loan Lending Inquiry, July 2007, *Submission No 15*, <http://www.aph.gov.au/house/committee/efpa/banklending/subs/sub015.pdf>.

¹³⁹ Ministerial Council on Consumer Affairs (MCCA), National Finance Broking Regulation, *Discussion Paper*, [http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/902A3645B1C8C14C4A256F8100075547/\\$File/National%20Finance%20Broking%20Discuss%20Paper.pdf](http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/902A3645B1C8C14C4A256F8100075547/$File/National%20Finance%20Broking%20Discuss%20Paper.pdf).

¹⁴⁰ Stephen Long, ‘ASIC calls for credit crackdown’, *PM – ABCOnline*, 20 August 2007.

Unlike financial advisors, mortgage brokers do not have to hold a licence requiring them to provide relevant and appropriate advice to clients or risk having their licence cancelled. This also means that they do not have to be members of an ASIC-approved EDR scheme, such as the COSL. Nevertheless, many brokers do join such EDR schemes (and the MFAA requires its members to do so as does the other main industry association, the Finance Brokers Association of Australia).

7.2 STATE/TERRITORY FAIR TRADING LAWS AND THE UNIFORM CONSUMER CREDIT CODE

The prohibitions under the *ASIC Act 2001* against misleading and deceptive and unconscionable conduct and the like are mirrored in state and territory Fair Trading legislation. Fair Trading Acts apply generally to all businesses operating within the relevant jurisdiction, including mortgage brokers.¹⁴¹ In Queensland, the relevant law is the [Fair Trading Act 1989 \(Qld\)](#). Again, there are no specific obligations imposed on lenders or mortgage brokers to assess consumers' personal circumstances and match the product to the consumer. The Queensland OFT has the relevant oversight of brokers but, again, action can be taken in relation to conduct only once it has occurred and detriment has already been caused.¹⁴²

Credit provision is regulated under the [Uniform Consumer Credit Code](#) (UCCC) in all states and territories and covers some broker behaviour in terms of advertising credit products and representations regarding entry into contracts.¹⁴³ While providing a standardised approach to the regulation of credit transactions, not all aspects of mortgage broking activity are covered by the UCCC.

Under the UCCC, credit providers have various disclosure requirements regarding consumers' rights and obligations and the details of the credit arrangement, such as the rate of interest and fees.

The UCCC enables rearrangements to be made if the borrower's circumstances change for the worse (e.g. job loss, ill health) to assist the borrower to make their repayments if the borrower does reasonably expect to be able to repay under the new arrangements. The ways that the contract can be changed are: extending the period of the contract so the amount of each payment is reduced; postponing repayments for a specified period; or both the foregoing. If the lender will not

¹⁴¹ Other laws that apply to businesses generally in each state and territory also apply to mortgage brokers even though not specifically directed at that industry.

¹⁴² Queensland OFT, *Regulatory Impact Statement*, p 5.

¹⁴³ See the [Consumer Credit Code](#), which is an Appendix to the [Consumer Credit \(Queensland\) Act 1994 \(Qld\)](#).

change the contract, the borrower can apply to the court to make the variation.¹⁴⁴ The court can also reopen unjust transactions under s 70. However, given the hassle and expense of bringing legal proceedings, it is not common for borrowers to make applications to the court for variation or to reopen an unjust contract.¹⁴⁵

Some consumer bodies also consider that the UCCC has not really delivered on consumer protection in this area because there are no positive obligations on credit providers to respond to requests by borrowers for rearrangements.¹⁴⁶

Further, it seems that, under the UCCC, there are no legal requirements on lenders to assess a borrower's capacity to repay the loan.¹⁴⁷ On the other hand, the Code of Banking Practice (Banking Code), a voluntary industry code forming part of the bank and borrower contract, imposes such an obligation on banks and is enforceable as a term of the contract between the bank and the borrower.¹⁴⁸ The Code Compliance Monitoring Committee (set up under the Banking Code) considers that the Banking Code has worked well to encourage banks to develop and implement processes to improve how they deal with customers in hardship. It said that banks have generally seemed committed to helping customers through financial difficulties (although some communication based failures had been dealt with by the Committee).¹⁴⁹

The Queensland OFT reports that the range of complaints received, and the responses by brokers to surveys conducted by the OFT, indicate that some brokers fail to address a borrower's personal circumstances or the range of products

¹⁴⁴ See the UCCC website, 'How will the code help you?', <http://www.creditcode.gov.au/display.asp?file=/content/consumer.htm>. See also, ss 66, 68 of the Code. See also *Permanent Custodians Limited v Upston* [2007] NSWSC 223.

¹⁴⁵ Queensland OFT, *Regulatory Impact Statement*, p 10.

¹⁴⁶ See for example, Consumer Credit Legal Centre (NSW) Inc, Submission to the House of Representatives Standing Committee's Home Loan Lending Inquiry, July 2007, *Submission No 4*.

¹⁴⁷ *Home Loan Lending Report*, p 35, citing Care Financial Counselling Service and Consumer Credit Legal Centre, *Submission No 4*. However, under s 70(2)(1), knowing or failing to reasonably ascertain the borrower's lack of capacity to repay is one of the grounds the court may consider in determining if the contract is unjust.

¹⁴⁸ Code Compliance Monitoring Committee, Submission to the House of Representatives Standing Committee's Home Loan Lending Inquiry, July 2007, *Submission No 19*.

¹⁴⁹ Code Compliance Monitoring Committee, *Submission No 19*.

available, possibly due to incompetence or misrepresentation. This is manifested through arranging loans that are a poor choice for the borrower.¹⁵⁰

Importantly, because of its consumer focus, while home loans are covered, credit for business purposes is not protected under the UCCC. Thus, it has become known that, to avoid obligations under the UCCC and the protections offered to consumers, some unscrupulous lenders and/or brokers have borrowers complete a form stating that the loan is ‘for business/investment purposes’ even when it is clearly for a private home loan.¹⁵¹ Instances of this were seen earlier in this Brief. Borrowers who are desperate to keep their home may be prepared to sign false declarations that the loan is for an investment and that they are able to service it.¹⁵²

7.3 WESTERN AUSTRALIA

Western Australia is the only jurisdiction to require mortgage brokers to be licensed.

Section 26 of the [Finance Brokers Control Act 1975 \(WA\)](#) requires that any person carrying on business as a finance broker (the definition in s 4 is broad enough to cover mortgage brokers as such persons are involved in ‘negotiating or arranging loans’) must hold a licence. An employee of a licensed broker does not usually need a licence but a person who is a contractor to a broker requires a licence in their own right.¹⁵³ Undertaking finance broking activities without a licence is an offence attracting a fine of up to \$50,000.¹⁵⁴ The overseeing Government Department, the Department of Consumer and Employment Protection, conducts a proactive compliance program which includes onsite visits to broking businesses.¹⁵⁵

To secure a licence, the applicant must be a fit and proper person, have appropriate educational qualifications, and hold professional indemnity insurance. All finance

¹⁵⁰ Queensland OFT, *Regulatory Impact Statement*, pp 4, 6.

¹⁵¹ As seen earlier in some of the given examples. *Home Loan Lending Report*, p 36, citing Consumer Action Law Centre, *Submission No 15*.

¹⁵² COSL, *Submission No 18*.

¹⁵³ See the WA Department of Consumer and Employment Protection website, ‘Finance Brokers’, <http://www.docep.wa.gov.au/consumerprotection/financebrokers/Pages/Licensing.html>.

¹⁵⁴ WA Department of Consumer and Employment Protection website, *Finance Broking Newsletter*, June 2006, p 1.

¹⁵⁵ *Finance Broking Newsletter*, p 3.

brokers must comply with the mandatory Code of Conduct. A revised Code commenced in June 2007, introducing significant new safeguards for borrowers.¹⁵⁶

Brokers who breach the requirements of the Act, the Code, and/or their licensing conditions are subject to disciplinary action under s 83 of the Act which includes fines and, in serious cases, loss or suspension of licence by the State Administrative Tribunal.

The laws require that contracts – which must be in writing – between a broker and borrower must disclose certain matters such as any fees, commissions etc. that are received from the lender. There is a prohibition against receiving up-front fees from the borrower, although fees can be charged provided they are in accordance with the law. The maximum amount payable is fixed by *Government Gazette* notice and should be set out in contract between broker and borrower and the fee is payable only upon securing the loan unless particular circumstances apply: see s 44.

7.4 AUSTRALIAN CAPITAL TERRITORY

In the Australian Capital Territory, mortgage brokers must be registered pursuant to Part 3 of the [Consumer Credit \(Administration\) Act 1996 \(ACT\)](#) – but require no educational qualifications to set up shop. However, registration can be cancelled if a broker has been convicted of fraud or dishonesty or has become bankrupt or infirm (s 51).

No commission or fee can be demanded of the borrower unless there is an agreement in writing setting out certain particulars about the credit to be obtained. The commission received must be in accordance with the terms of the agreement with the borrower. Fees can be demanded from the borrower only after the loan has been provided. It is an offence if the broker does not comply with these requirements and, if a court finds the broker guilty of the offence, it can order a refund to the borrower of amounts received. While the contract must disclose any commission payable by the borrower, it does not have to reveal any benefits received from the lender. Under the Act, the broker must not make any false representations about loan provision matters (see s 35-37).

The Commissioner for Fair Trading may investigate breaches of the legislation and undertake disciplinary action against even those brokers who are not registered or whose registration has been suspended. The Commissioner can issue a reprimand, issue notices, impose penalties of up to \$5,000, and apply to suspend or cancel

¹⁵⁶ See 'Finance Brokers' webpage at <http://www.docep.wa.gov.au/consumerprotection/financebrokers/Pages/Licensing.html>.

registration (see Part 3, Div 3.4). Depending upon the nature of the conduct, the Commissioner may commence civil or criminal proceedings under the relevant legislation.¹⁵⁷

7.5 NEW SOUTH WALES

New South Wales has fairly comprehensive broker specific legislation – as Part 1A of the [Consumer Credit Administration Act 1995 \(NSW\)](#).¹⁵⁸ However, the Act does not impose an obligation for brokers to hold a licence. A breach of the Act, however, may result in the broker not being able to undertake his or her broking activities.

The main controls on brokers are that they must enter into a written contract with a borrower before the broking commences, setting out various particulars such as the amount of credit required, repayment details, interest rate payable etc. (s 4C). The provisions regarding the broking contract are quite broad and not all the requirements are explained here.¹⁵⁹ The contract must include a statement that the recommendations provided are not necessarily drawn from all lenders that offer the relevant type of credit – the only jurisdiction to require such a statement. The [Consumer Credit Administration Regulation 2002 \(NSW\)](#) requires (under s 2C) that the contract contain a statement to the effect that the lenders identified are not necessarily all the lenders who offer loans of the nature sought by the borrower.

The contract must also specify the amount of any commission payable by the borrower, the amount of any commission payable by the lender, and if any benefit will be received from any other person. The broker must not demand or receive commission if the amount of credit secured is not the same as the amount stated in the contract or if certain other features – such as repayment arrangements or the rate of interest – do not match what is specified in the contract. Further, the broker must not demand more commission than the amount disclosed in the contract (or calculated by the method specified in the contract). In certain cases, however, the broker can charge a fee if the borrower decides not to enter into a loan agreement. Up-front fees are prohibited (see Part 1A, Div 3).

The Regulation (s 2D(1)(b)) provides that if the broker will receive benefits etc. from different lenders, the contract with the borrower must indicate the highest and

¹⁵⁷ Hon S Corbell MLA, Attorney-General, Answer to Question on Notice, *ACT Legislative Assembly Hansard*, 14 December 2006, p 4260.

¹⁵⁸ As amended by the *Consumer Credit Administration Amendment (Finance Brokers) Act 2003* (NSW) inserting Part 1A.

¹⁵⁹ See ss 4C-4G of the Act.

the lowest amounts of such benefits the broker would receive from a lender if that lender were to provide the loan to the borrower. The Regulation (s 2D(1)(c)) also requires various other matters to be disclosed, such as whether or not the broker can determine or recommend conditions of the loan arrangement.

Action can be taken against a broker. Borrowers can access the Consumer, Trader and Tenancy Tribunal for breaches of the Act (s 4J). These include the broker not complying with the terms of the contract, acting unjustly, or overcharging. The Tribunal can, if it considers that the broker has engaged in the foregoing conduct, order the broker to do or not do something, pay a certain sum to the borrower, or make other appropriate orders. Brokers can also be prosecuted for offences under the Act and, if the broker is found guilty, the court can order refunds of fees to the borrower. In addition, the Director-General of the Department of Fair Trading can take disciplinary action against brokers such as issue reprimands or have the broker make amends to the borrower. In more serious cases, the Director-General can prohibit the broker from operating for a time or indefinitely.¹⁶⁰

7.6 VICTORIA

While Victoria adopts a somewhat similar approach to NSW, the requirements of the applicable legislation, Part 4A of the [Consumer Credit \(Victoria\) Act 1995 \(Vic\)](#), are not as detailed. Again, there is no licensing requirement but a broker may be disqualified from operating in certain circumstances set out in the Act (e.g. guilty of fraud or dishonesty in the last 10 years; disqualified under broker or credit legislation etc.: see s 37E).

Disclosure obligations apply but are not as comprehensive as those under the NSW legislation. The contract with the borrower, as well as setting out certain particulars like the amount of credit required, must disclose whether any fee is payable by the borrower, and the amount thereof (as is the case in NSW, ACT and WA). The fee must be similar to what was agreed in the contract and there is a ban on charging an up-front fee. The broker can seek a fee in respect of reasonable costs and expenses if the client does not accept the loan or terminates the broker agreement in certain circumstances.¹⁶¹

¹⁶⁰ See, particularly, Parts 3 and 4 of the Act. See also NSW Department of Fair Trading website – Consumer Credit/ Finance Brokers, <http://www.fairtrading.nsw.gov.au/corporate/legislation/consumercreditfinancebrokers.html>.

¹⁶¹ See Part 4, Div 4 of the Act.

Brokers can face disciplinary action for breaches of the legislation,¹⁶² including accepting fees other than in accordance with the contract with the borrower. If a broker demands or receives fees other than those to which they are entitled, he or she commits an offence and can be subject to a fine or three months imprisonment for a first offence.

Borrowers can approach the Victorian Civil and Administrative Tribunal to recover improperly charged fees from brokers (ss 37N-37O).

7.7 SUMMARY

There is no national broker specific regulation of mortgage broking, with ASIC only having general control in respect of the ‘deceptive and misleading conduct’ provisions of Commonwealth legislation. State legislation is inconsistent and has tended to lag behind the problems relating to the growth and complexity of the industry.¹⁶³ Moreover, only WA requires mortgage brokers to hold a licence and only NSW, Victoria and the ACT have broker specific legislation – which differs in a number of respects in each jurisdiction. Queensland, the Northern Territory, Tasmania and South Australia do not have any legislation specifically directed at mortgage brokers, with the only real protection for consumers being found under the UCCC or the ‘deceptive and misleading conduct’ provisions of the Fair Trading Acts.¹⁶⁴

It has been suggested that there are some limitations in the application of broker specific legislation. A significant one is that in NSW, Victoria and the ACT, the coverage of the broker specific legislation is the same as the coverage of the UCCC so that the laws will apply mainly to those contracts which relate to credit provided for personal or domestic use. Thus, the application of the legislation can be circumvented in the same way as unscrupulous brokers have sought to avoid the application of the UCCC – by pressurising the borrower to sign a declaration that the loan is for business purposes.¹⁶⁵

Another restriction on the legislation applying to brokers is that not all states and territories require disclosure of financial benefits received by lenders, and only NSW requires brokers to reveal whether independent advice is being offered by

¹⁶² See Part 4, Div 5 of the Act.

¹⁶³ Annabel Hepworth and Damon Kitney, ‘Mortgage brokers face tough fines’, *Australian Financial Review*, 28 September 2007, pp 1, 12.

¹⁶⁴ Queensland OFT, *Regulatory Impact Statement*, p 10.

¹⁶⁵ MCCA, National Finance Broking Regulation, *Discussion Paper*, p 29.

them. It does not seem that it is required in any jurisdiction that the broker inform the borrower how the borrower's capacity to repay has been assessed.

Most mortgage brokers around Australia are members of the MFAA – which imposes a system of industry self-regulation. This means that most mortgage brokers therefore possess the relevant qualifications, experience and skills and are bound by a Code of Practice and disciplinary rules. However, some brokers have not sought MFAA membership while some have been 'expelled' from the MFAA and continue to operate regardless. These are the fringe operators that the MFAA fears are bringing the industry into disrepute.

Many people may not realise that, unlike some other financial service operators, mortgage brokers in most jurisdictions are largely unregulated. Consumers who are not careful to check the qualifications and MFAA accreditation of their broker can be caught out by an unscrupulous or unqualified operator who is neither a MFAA member nor covered by any specific legislation.

The chief executive officer of the MFAA, Phil Naylor, has said he would welcome Commonwealth legislation to regulate both 'predatory lending' and mortgage and finance brokers but, at the very least, all credit providers should be compelled by law to belong to an ASIC-approved EDR scheme (as currently required by the MFAA Code of Practice for its members). This would allow borrowers without the means to engage in litigation with predatory lenders to seek compensation.¹⁶⁶ The MFAA's Code of Practice has recently been amended to make it a breach for any MFAA member to deal with a lender who is not a member of an ASIC approved EDR scheme.¹⁶⁷

7.8 MINISTERIAL COUNCIL ON CONSUMER AFFAIRS

In November 2007, the [National Finance Broking Scheme Consultation Package](#) was released for public comment by the Finance Broking Working Group of the Ministerial Council on Consumer Affairs.¹⁶⁸ The Ministerial Council has been

¹⁶⁶ Letter to the Office of the Treasurer from Mr Phil Naylor, chief executive officer of the MFAA.

¹⁶⁷ MFAA website, 'MFAA Acts on Predatory Lending'. Compulsory EDR scheme membership was considered as a reform option by the House of Representatives Standing Committee's Home Lending Inquiry: see *Home Loan Lending Report*, pp 44-46.

¹⁶⁸ Chaired by New South Wales (Office of Fair Trading) and comprising representatives from all states and territories as well as the Commonwealth Treasury and ASIC. See the NSW OFT website at: <http://www.fairtrading.nsw.gov.au/pdfs/corporate/nationalfinancebrokingscheme.pdf>. An intergovernmental agreement to maintain consistency and currency of the laws will also be formulated.

working on the formulation of nationally consistent regulation of mortgage brokers and predatory lending for some years and the draft model national Bill included in the Package seeks to provide a national framework for such regulation.¹⁶⁹ In October 2004, a consultation [Regulatory Impact Statement](#) was released recommending national regulation.¹⁷⁰ Revised proposals, taking into account issues raised in submissions, were included in a regulatory impact statement considered by the Ministerial Council at the end of 2006. The draft Bill is in the form proposed to be introduced in New South Wales. Other jurisdictions may have similar but not identical provisions for certain administrative functions.¹⁷¹

A key feature of the new laws will be a single licensing regime enabling brokers to operate across jurisdictional boundaries. It is intended that an application for a licence will be made in the applicant's resident jurisdiction. While each jurisdiction will have slight differences in their application processes, a licence will enable a broker to operate in all jurisdictions.¹⁷²

Coverage of the legislation will extend beyond that of the UCCC. It will include small business broking transactions and include all credit unless the business entity has more than 100 employees (if it is a manufacturing business) or, otherwise, 20 employees; or the credit sought is more than \$2 million. It proposes to regulate all types of broking structures including mortgage brokers, finance brokers, franchised organisations, and aggregators.¹⁷³ Loans provided for investment in domestic property will not be considered to be business loans and, thus, receive the same protection as consumer loans.¹⁷⁴

The proposed definition of 'broker' will be similar to that in the *Consumer Credit Administration Act 1995* (NSW) to include intermediaries who supply goods and services and who negotiate or obtain credit for purchasing such goods and services. It will also cover brokers who structure their organisations to avoid the

¹⁶⁹ Public submissions on the exposure draft closed on 15 February 2008.

¹⁷⁰ 'National Finance Broking, *Discussion Paper – Regulatory Impact Statement*, 2004, [http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/902A3645B1C8C14C4A256F8100075547/\\$File/National%20Finance%20Broking%20Discuss%20Paper.pdf](http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/902A3645B1C8C14C4A256F8100075547/$File/National%20Finance%20Broking%20Discuss%20Paper.pdf) .

¹⁷¹ *Consultation Package*, p 7.

¹⁷² *National Finance Broking Scheme Consultation Package (Consultation Package)*, 'Overview of Legislation', pp 3-4.

¹⁷³ *Consultation Package*, p 3.

¹⁷⁴ *Consultation Package*, p 5.

legislation.¹⁷⁵ The ‘Summary of Finance Broking Exposure Bill Provisions’¹⁷⁶ provides an example of a person providing a ‘finance broking service’ as an individual who refers consumers on to other intermediaries to secure credit. The definition also embraces persons who provide advice and assistance as well as acting as an intermediary between the consumer and lender if the purpose of the advice is to secure a loan.¹⁷⁷ Provisions of the legislation regarding disciplinary proceedings and consumer remedies will apply also to former finance brokers.

It is proposed that the new legislation will include the following matters:¹⁷⁸

- a robust licensing regime that will allow only reputable, skilled brokers to transact with consumers.¹⁷⁹ Police record/probity checks and examination of recorded unjust conduct will form part of the application process and applicants will have to be members of an approved EDR scheme;
- prescribed educational requirements and a minimum skill level that will be required to obtain a licence. Brokers will have to continually improve their skills in order to maintain their licences;
- a requirement that an applicant must have and maintain professional indemnity insurance at the prescribed level;
- a prohibition on advertising or engaging in broking activities unless the person has a licence or is authorised by a licensed broker to engage in broking.¹⁸⁰ A maximum penalty (possibly around \$22,000) will apply for a breach of this provision;
- a provision that brokers will be the ‘agent’ of the consumer;
- a requirement that, before an agreement is entered into for the broking service, the broker must give the consumer certain written information (which will include things such as the available loans, any fees payable by the consumer

¹⁷⁵ *Consultation Package*, p 3. Some exemptions will apply.

¹⁷⁶ Included in the *Consultation Package* on pp 7-28.

¹⁷⁷ *Consultation Package*, p 7.

¹⁷⁸ See *Consultation Package*, ‘Overview of Legislation’, pp 3-5.

¹⁷⁹ Certain disqualifying circumstances will prevent individuals, corporations and partnerships from becoming a broker. These disqualifications are among various grounds upon which a licence application can be refused.

¹⁸⁰ A process by which licensee brokers can appoint representatives to provide broking services on his or her behalf will be established. The authorisation process will include various probity checks. Licensees will be responsible for the conduct of their representatives and will be, in the circumstances specified, liable for their conduct: see *Consultation Package*, pp 10-11.

- and/or the lender and a statement alerting the consumer to the fact that an agreement must be entered into before the service is provided);
- an obligation on the broker to ascertain the consumer's credit needs and capacity to repay the loan; and to disclose to the consumer the names of the lenders through which the borrower can access credit as well as details about what costs the consumer will face. The broker must also ensure that the consumer can actually afford the credit proposed to be obtained (which will require consideration of the consumer's credit history, not just the consumer's income and expenditure, in case there has been a pattern of default in the past);¹⁸¹
 - requirements about what must be contained in the broking agreement;
 - an obligation, once the broker has considered suitable loans, on the broker to provide the consumer with a comparison of costs and features of each loan;
 - disclosure requirements about the commission that the broker will receive from each lender in relation to each loan as well as other matters similar to those currently applying under the NSW legislation;
 - an obligation imposed on brokers to have a reasonable basis for recommending that the particular product is suited to the consumer's needs;
 - a prohibition on brokers being able to charge an up-front fee and a requirement that the loan must be substantially similar to what is stated in the broking agreement before a fee can be charged. However, the broker will be able to claim a fee for securing the loan even if the consumer does not accept the loan;
 - a prohibition on brokers demanding, receiving or accepting credit application fees or establishment fees unless paid in the manner prescribed.

General offences are proposed to include: listing of consumers with a credit reference agency (adverse credit reporting) for non-payment of fees; and the lodgement of a caveat over a consumer's property to obtain fees claimed to be owing.¹⁸²

It is proposed that consumers will have access to a court or tribunal where the broker is in breach of the legislation or the broking agreement or has engaged in unjust conduct. Compensation can be ordered as well as other relief such as refunding a fee.¹⁸³

It also appears that where a lender applies to a court for possession of a family home but there are proceedings on foot against a broker (either in a court or

¹⁸¹ A breach of these requirements will incur a fine.

¹⁸² *Consultation Package*, pp 16-17.

¹⁸³ *Consultation Package*, pp 17-18.

through an EDR scheme), the court will be able, in its discretion, to order a stay of proceedings until the dispute is settled.¹⁸⁴

It is proposed that there will be a range of options available to government agencies in disciplining brokers for professional misconduct. The general penalties include one or more of the following: a caution; a compensation order in favour of a consumer who suffers loss; a fine of up to \$25,000 for an individual and \$50,000 for a corporation; a declaration that a broker is a 'disqualified person'. Conditions such as further training or supervision requirements might be imposed by the regulatory authority of the jurisdiction in which the broker is licensed.¹⁸⁵ If the broker's conduct would justify the cancellation of his or her licence, the licence can be immediately suspended upon the issue of a 'show cause' notice.¹⁸⁶

The proposed legislation will also make provision for the establishment of a compensation fund to provide a fallback if the professional indemnity insurance requirements do not work satisfactorily, or if the insurance becomes unavailable or unaffordable. However, it is not intended that the compensation scheme will be established unless there is a need for such.¹⁸⁷

In August 2007, the then Federal Treasurer warned the states to quickly progress uniform legislation to regulate 'high-risk' lenders or hand over their power to regulate these lenders to the Commonwealth.¹⁸⁸ This was followed by the recommendation of the House of Representatives Home Lending Inquiry Committee that the Commonwealth take over the regulation of brokers. This would mean that brokers would need to be licensed and have the same oversight by ASIC as financial advisors currently have.¹⁸⁹

¹⁸⁴ *Consultation Package*, pp 5, 18.

¹⁸⁵ *Consultation Package*, pp 19-20.

¹⁸⁶ *Consultation Package*, pp 5-6, 19-20.

¹⁸⁷ *Consultation Package*, pp 6, 20-24.

¹⁸⁸ 'Costello warns states on high-risk loans', *ABCNewsOnline*, 19 August 2007.

¹⁸⁹ *Home Loan Lending Report*, pp 40-42, citing evidence from stakeholders including from the RBA's Assistant Governor, Dr P Lowe; Mr G Renouf of *Choice*; Mr M Tolar, Australasian Compliance Institute.

8 HOUSE OF REPRESENTATIVES STANDING COMMITTEE INQUIRY INTO LENDING PRACTICES

In September 2007, the Commonwealth Parliament's House of Representatives Standing Committee on Economics, Finance and Public Administration (the Committee), tabled its report on the Inquiry into Home Loan Lending Practices and the Processes Used to Deal with People in Financial Difficulty. The [*Home Loan Lending Report*](#) is the product of the resolution of the bipartisan Committee in May 2007 to undertake an inquiry into, and report on, home loan lending practices and issues involved in housing loans.¹⁹⁰ The Committee received 26 submissions and conducted a 'round table' attended by key industry and government stakeholders.¹⁹¹

The key recommendation by the Committee was that the Commonwealth Government should assume control of the credit industry, including the regulation of mortgage brokers and non-bank lenders.

In his Foreword to the Report, the Committee Chair, the Hon Bruce Baird MP, commented that the significant changes to the practices in, and structure of, the housing lending market over the past decade and the increase in the number of households taking up loans have led some people to argue that there has been widespread irresponsible lending. However, Mr Baird commented, the data do not support that assertion, the figures showing that while loan arrears have recently risen, they are still low by international and historical standards.¹⁹² Nevertheless, the increasing number of cases where lenders and/or brokers are reportedly engaging in predatory behaviour targeted at vulnerable consumers caused the Committee to recommend the tightening of the regulatory framework for lenders and subjecting mortgage brokers to the same licensing controls imposed on traditional lenders, particularly regarding their responsibilities towards borrowers and their disclosure obligations.¹⁹³

¹⁹⁰ *Home Loan Lending Report*, <http://www.aph.gov.au/house/committee/efpa/banklending/report/fullreport.pdf>. The Committee has power to initiate inquiries into aspects of annual reports of agencies which stand referred to it. The relevant annual reports used in this case were those of the Reserve Bank of Australia and the Australian Prudential Regulation Authority.

¹⁹¹ *Home Loan Lending Report*, p 2. Due to the short timeframe of the inquiry, the Committee did not call for public submissions or undertake extensive public hearings. Attendees at a 'roundtable' included bankers, insurers, regulators and consumer groups.

¹⁹² *Home Loan Lending Report*, Chair's Foreword, p iii. See also, Joint RBA & APRA, *Submission No 7*, p 6.

¹⁹³ *Home Loan Lending Report*, Chair's Foreword, p iv.

After a discussion about the new landscape for house lending in Australia and the emergence of non-bank lenders, a number of observations were made by the Committee. These are discussed below.

Defaults and Repossessions¹⁹⁴

- The RBA and APRA consider that most Australian households are in good financial shape, supported by the strength of the economy;¹⁹⁵
- incomes have continued to grow strongly over the past few years, even when allowing for increased mortgage payments (and are higher now than at the last peak in around 2000).¹⁹⁶ However, the data does not show the other reality – that some households are in financial difficulty;
- changes in the home loan market have had positive and negative impacts with an example of a positive effect being that low-doc loans have allowed the self-employed access to affordable loans;
- on the downside, there is a growing concern that consumers are getting themselves into unaffordable mortgages which some people argue has been facilitated by reduced lending standards. However, there is a counter-argument that higher income earners can afford to service a mortgage of more than 30% of gross income (which is the common point at which a household is said to have ‘mortgage stress’);¹⁹⁷
- in relation to recent loan arrears, evidence to the Inquiry showed that, while there has been an increase in loan arrears in recent years, the level remains low by historical standards (0.47% of loans).¹⁹⁸ In macro-economic terms, the higher rate of arrears for non-conforming loans (6.5%) is not significant but there is concern for the borrowers involved;
- it is difficult to determine the number of repossessions of homes as the data available from courts is not easy to access nor straightforward in terms of indicating the number and types of properties being repossessed. The Committee recommended (Recommendation 1) that the Australian Bureau of Statistics begin collecting and publishing annual data on housing repossessions

¹⁹⁴ *Home Loan Lending Report*, Ch 3. Unless evidence to the Inquiry is cited, the information under this heading comprises comments and findings by the Committee on pp 15-22.

¹⁹⁵ *Home Loan Lending Report*, p 15, citing RBA & APRA, *Submission No 7*.

¹⁹⁶ *Home Loan Lending Report*, p 15-16 and Figure 3.1 sourced from RBA & APRA Submission.

¹⁹⁷ *Home Loan Lending Report*, p 16.

¹⁹⁸ *Home Loan Lending Report*, p 17 referring to evidence from RBA and APRA and Figure 3.2 sourced from RBA & APRA Submission and ANZ Bank, *Submission No 12*.

and disaggregate it to make it possible to ascertain matters such as loan type and primary cause of repossession.

Causes of Mortgage Defaults and Repossessions¹⁹⁹

- It appears that, in the vast majority of cases, ADIs and non-bank lenders engage in appropriate lending practices but both are increasingly more willing to take on different levels of risk;
- the practice of predatory lending is disturbing and borrowers need to be protected by a regulatory framework;
- apart from predatory lending incidences, many cases of loan default are less likely to be the lender's fault. Events such as job loss, death of a spouse or marital breakdown can have a large effect on ability to service a home loan. Further, people appear to have an increasing propensity to assume consumer debt to buy personal items and, once in default, may seek to consolidate this unsecured debt into their mortgage. Evidence tends to suggest that the risk of mortgage default becomes more likely in such circumstances;
- some lenders argue that they would be better able to ascertain a potential borrower's financial position and level of debt if there were mechanisms to enable them to find out what other commitments the borrower has. Positive credit reporting has been advocated but there are privacy concerns attendant upon such reporting;²⁰⁰
- financial literacy plays an important role in consumers being able to select an appropriate loan product. The Financial Literacy Foundation may assist in improving consumer financial literacy.²⁰¹

Credit Regulation and Consumer Protection²⁰²

- The current regulatory framework is not coping with new lending practices that have emerged;
- most financial services and products are regulated by Commonwealth laws and authorities and ASIC administers licensing and has responsibility for other oversight. However, ASIC's jurisdiction does not extend to credit products and

¹⁹⁹ *Home Loan Lending Report*, Ch 4, see pp 30-31.

²⁰⁰ The Committee noted that the Australian Law Reform Commission is currently reviewing credit reporting as part of its review of privacy laws and is suggesting a more positive credit reporting system that allows positive and negative credit histories to be considered: see http://www.alrc.gov.au/media/2007/mr1207_credit.html.

²⁰¹ As discussed earlier in this Research Brief. See <http://www.understandingmoney.gov.au/>.

²⁰² *Home Loan Lending Report*, Ch 5, pp 47-49.

services (as discussed earlier). The states' and territories' UCCC is the primary instrument for credit regulation. While it provides standardised requirements for credit products and services, it has been contended that there are, as noted earlier, various shortcomings. In addition, unscrupulous lenders can avoid the UCCC by forcing consumers to complete a false declaration that the loan is for business purposes when it is clear the loan is a home loan;

- the current EDR scheme membership is voluntary for credit providers (such as mortgage brokers) not required to have an Australian Financial Services licence;
- the possible regulatory reforms to remedy concerns include: amendment of the UCCC to strengthen some of its requirements, to include small business and investment loans, and to make EDR schemes (such as the Credit Ombudsman Service) membership compulsory. However, amendment is a task that can take time;
- the states and territories appear close to releasing a draft Bill to require uniform national regulation of mortgage brokers but the broking industry and consumer advocates have been frustrated by the time taken for it to emerge;
- the Committee recommended that the best approach to reform would be to harmonise regulation within the financial sector by shifting responsibility for credit regulation to the Commonwealth Government. This would involve defining credit as a 'financial product' for the purposes of the *Corporations Act*. The consequences would be that providers of credit products and services – including mortgage brokers and lenders – would be subject to rules about quality of advice and disclosure and would have to hold an Australian Financial Services licence. Predatory lenders and brokers providing inappropriate products and advice would be subject to ASIC sanctions and possible loss of licence. It was recognised, however, that merely bringing credit products and services under the *Corporations Act* would not be a complete solution as there are unique features of credit products and services that may require the amendment of other Commonwealth laws or new legislation to be enacted. Further, some stakeholders had concerns about whether the Commonwealth regulatory framework was already working properly in relation to financial services;²⁰³
- when licence holders become members of an EDR scheme – a mandatory requirement – those schemes will have more power when making determinations against a member. Thus, if the member does not comply, they could be expelled which could put their licence in peril;
- EDR schemes seem to be an effective and low cost means of resolving consumer problems but there might be a need to raise schemes' jurisdictional

²⁰³ *Home Loan Lending Report*, p 41, citing, for example, evidence from Mr R Venga, Credit Ombudsman Service.

monetary limits to allow more complaints to be dealt with. For instance, the Credit Ombudsman Service's limit regarding the amount in dispute is currently \$250,000. Sometimes the value of the loan might be in dispute.²⁰⁴

*Implications of Changing Lending Practices*²⁰⁵

The Committee also considered the implications of changing lending standards and practices for the broader Australian economy and financial system. It drew the following conclusions:²⁰⁶

- in terms of the financial system, it seems that due to good prudential supervision, the ADI sector can cope with significant economic downturns but less is known about whether non-bank lenders will be able to do so. However, their smaller size and structure should mean that non-bank lenders pose less risk to the stability of the Australian financial system;
- the fact that household debt has increased could exacerbate future shocks to the Australian economy. While this worries some commentators, the RBA counters those concerns, noting that household assets have risen alongside debt levels so that the net wealth of Australian households is now 640% of disposable income;
- the sub-prime mortgage problems in the US are having global economic effects, including on Australia, mainly felt in the repricing of risk to more 'normal' levels. However, while there were big losses in the world equity markets in past months, it seems that the markets have stabilised;
- Australia's sub-prime lending market – i.e. non-conforming lending – is less aggressive and not generally attended by 'risky' features seen in the US sub-prime market. However, these matters do emphasise the importance of prudent lending practices and the need to stamp out predatory lending.

8.1 REACTION TO THE COMMITTEE'S REPORT

As would be expected, reaction to the *Home Loan Lending Report* was mixed. The Housing Industry Association appeared to believe that adoption of the Report's approach would be to introduce even more 'red tape' into an already highly regulated industry rather than suggesting ways of giving any real help to consumers through education and advice. On the other hand, the Australian Bankers'

²⁰⁴ See also *Home Loan Lending Report*, pp 45-46.

²⁰⁵ *Home Loan Lending Report*, Ch 6.

²⁰⁶ *Home Loan Lending Report*, pp 58-57.

Association and the MFAA seemed to welcome the report, particularly its approach to dealing with predatory lending.²⁰⁷

In the wake of the global credit shortage, Australasian Compliance Institute head, Mr Martin Tolar, said that the Report was timely because the increased cost of funding for non-bank lenders would be likely to cause lenders to bolster their profits by signing more mortgages.²⁰⁸

9 QUEENSLAND'S PROPOSED CODE OF CONDUCT

In May 2007, the Queensland Government decided that it would proceed with plans to regulate mortgage brokers ahead of the proposed national regulation of the industry.²⁰⁹

There is no mortgage broker or finance broker specific legislation in Queensland. Regulation of the industry is carried out by ASIC under the *ASIC Act 2001* (Cth) at the federal level and by the Office of Fair Trading (Queensland OFT) through the [Fair Trading Act 1989 \(Qld\)](#) at the state level. The powers of the relevant authorities under these laws are, as previously discussed, confined to punishing unconscionable, misleading or deceptive conduct; false and misleading representations; and breaches of implied warranties in contracts between brokers and consumers (e.g. exercise of due care and skill). There are no real disclosure obligations or specific requirements for brokers to match products to the consumer's circumstances. Further, action can only be taken once the detriment to the consumer has already occurred.²¹⁰

While the UCCC covers some aspects of brokers' conduct and has some consumer protection measures, it does not cover all broking operations. Generally speaking, it covers advertising of credit products and representations regarding the credit contract. As noted earlier, some unscrupulous brokers circumvent the application of the UCCC by getting consumers to sign a 'business purpose' declaration. A

²⁰⁷ The various responses were quoted in the Australian Parliament's Committee Bulletin – Fortnightly Coverage of Committees of Both Houses, Vol 18(12), 11-30 September 2007.

²⁰⁸ Jessica Irvine, 'Call for crackdown on suspect home loans', *brisbanetimes.com.au*, 18 September 2007.

²⁰⁹ Hon Margaret Keech MP, Minister for Tourism, Fair Trading, Wine Industry Development and Women, 'Queensland cracks down on unscrupulous finance brokers', *Queensland Media Statement*, 1 May 2007.

²¹⁰ Queensland OFT, *Regulatory Impact Statement*, p 5.

further problem is that the remedies available tend to require legal action which many consumers find prohibitive and time consuming.²¹¹

Mortgage brokers and finance brokers are represented by industry bodies, the MFAA and Finance Broker Association of Australia (FBAA), respectively. A further source of regulation of brokers is the industry Codes, such as the MFAA Code of Practice, discussed earlier. The Codes impose mandatory minimum education and qualification and behaviour standards on brokers (including disclosure obligations and requiring brokers to assess consumers' capacity to service the loan). Non-compliance with the Code may result in expulsion from membership of the association. Members must also belong to an EDR scheme. While quite comprehensive in its protection for borrowers, it is a self-regulatory system and membership of both the FBAA and MFAA is entirely voluntary.²¹²

In April 2007, the Queensland OFT released the [*Regulation of Finance Brokers in Queensland - Regulatory Impact Statement*](#) (RIS) for public comment.²¹³ The RIS assessed the proposal to regulate Queensland finance brokers (which would appear to cover mortgage brokers) through a Code of Conduct. Section 88A of the *Fair Trading Act 1989* (Qld) enables a Regulation to prescribe a Code of Conduct in relation to a particular type of supplier or person and consumers. The Code would thus be mandatory, having effect as a Regulation under the *Fair Trading Act 1989* and would provide interim regulation of the industry to ensure that Queensland consumers are not targeted by 'rogue' brokers before the national legislation is implemented. This national regulation may not occur until 2009.²¹⁴

It is intended that the new regime will be one that will ease the transition between there being currently no regulation on brokers to the national regime which will impose licensing obligations and other requirements. The Code will be consistent with the national legislative provisions that will be based on a model that has been carefully examined by all levels of government and industry and consumer representatives.²¹⁵ Around 75% of Queensland brokers are members of the MFAA and FBAA and bound by mandatory Codes that impose quite comprehensive minimum standards, disclosure requirements and obligations regarding consumers'

²¹¹ *Regulatory Impact Statement*, p 10.

²¹² *Regulatory Impact Statement*, p 11.

²¹³ See [http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/88C107897D31C5EC4A2572B30081C11C/\\$File/Regulatory%20Impact%20Statement%20-%20Finance%20Brokers.pdf](http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/AllDocs/88C107897D31C5EC4A2572B30081C11C/$File/Regulatory%20Impact%20Statement%20-%20Finance%20Brokers.pdf).

²¹⁴ *Regulatory Impact Statement*, p 9.

²¹⁵ *Regulatory Impact Statement*, pp 8-9.

circumstances. Consequently, the RIS believed, those brokers should not find it terribly difficult to adhere to Queensland's legislatively based Code of Conduct.²¹⁶

The RIS considered the changing nature of the finance market and the various problems that have emerged regarding mortgage brokers and finance brokers. Many of the issues identified, such as overcharging of fees, misinformation and misrepresentations, have been discussed throughout this paper. The RIS considered the current regulatory environment, the shortcomings of existing legislation, and the Codes of Practice to which members of the FBAA and the MFAA must adhere and the limits of this self-regulation due to its voluntary nature.²¹⁷

The RIS considered three options. The first option – keeping the status quo and relying on existing non-specific laws such as the *Fair Trading Act 1989*, the UCCC, the *ASIC Act 2001* and the industry Codes of Practice – was rejected. It was considered that the current laws and self-regulatory schemes offered insufficient protection for consumers and did little to help them to effectively choose the best loan product or broker. It is those brokers who are not members of the MFAA or FBAA and not bound by any industry standards that tend to cause consumer detriment. The second – public education initiatives aimed at increasing consumers' bargaining power – was rejected as such initiatives were considered to be unlikely, of themselves, to assist consumers.²¹⁸

The third and preferred option was for a mandatory Code of Conduct, authorised by the *Fair Trading Act 1989*. It is proposed by the RIS that the Code will be a Regulation, considered to have more flexibility than an Act in being able to adapt to changing needs and practices.²¹⁹

The proposed Code will contain the following features –²²⁰

- a definition of 'broker' to include intermediaries who are suppliers of goods and services and who negotiate or obtain credit for buying goods and services;
- a requirement for brokers to disclose costs and services before negotiating a broking agreement with the consumer. The RIS considered that this requirement and other disclosure provisions of the Code will help consumers to determine the independence of the advice they are receiving. Disclosure

²¹⁶ *Regulatory Impact Statement*, pp 19, 21.

²¹⁷ *Regulatory Impact Statement*, pp 4-6.

²¹⁸ *Regulatory Impact Statement*, p 16-18.

²¹⁹ *Regulatory Impact Statement*, p 13.

²²⁰ *Regulatory Impact Statement*, p 14.

obligations could also act as a protection for brokers against a consumer who might make a complaint that the broker misled them about a product. It was believed that most brokers, as part of their compliance with industry Codes, would already be providing disclosure about services and commissions;²²¹

- a need for the broking agreement to contain specified details of the consumer's credit needs. The RIS commented that clarification of consumer credit needs before a loan is arranged should reduce incidences of confusion and misunderstanding leading to the provision of inappropriate products;²²²
- an obligation on the broker to provide a statement of reasons after the credit/loan is sourced, explaining why the credit/loan recommended is appropriate for the consumer's needs. The RIS observed that this measure should reduce consumer confusion about certain products and thereby reduce complaints against brokers which can arise from consumer ignorance or misunderstanding;²²³
- a prohibition on brokers from accepting an up-front fee or any commission from the consumer before securing credit and from lodging a caveat over a property to secure payment of a commission or other fee due from a consumer;
- a requirement that brokers observe confidentiality and privacy obligations;
- an obligation on brokers to be part of an internal dispute resolution scheme. As the MFAA and FBAA currently have dispute resolution processes and schemes, this should not be a huge adaptation for brokers who are members of these associations; and
- a requirement for brokers to inform consumers about the existence of the Code and how complaints are dealt with.

Breaches of the Code will expose the broker to the enforcement provisions in the *Fair Trading Act 1989* such as a requirement to give enforceable undertakings, and to comply with injunctions and orders for compensation.²²⁴

The RIS considered that the standardisation of disclosure regimes and a statement of reasons obligation will ensure that most consumers are well informed of their choices before they commit to a product, thereby reducing the chance that they will be provided with an inappropriate product or insufficient services. This may result in fewer complaints to the Queensland OFT and also, lead to improved industry

²²¹ *Regulatory Impact Statement*, p 19.

²²² *Regulatory Impact Statement*, p 19.

²²³ *Regulatory Impact Statement*, p 19.

²²⁴ *Regulatory Impact Statement*, p 20.

reputation. There should also be a positive impact on market efficiency and competition.²²⁵

²²⁵ *Regulatory Impact Statement*, pp 18-19.

APPENDIX – GLOSSARY OF ACRONYMS

ADI	Authorised Deposit-Taking Insitutions
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
COSL	Credit Ombudsman Service Limited
EDR	External Dispute Resolution
FBAA	Finance Broker Association of Australia
FSR	Financial Services Reform
MFAA	Mortgage & Finance Association of Australia
Queensland OFT	Queensland Office of Fair Trading
RBA	Reserve Bank of Australia
UCCC	Uniform Consumer Credit Code

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