

"Low Doc" loans

Position on low doc loans and courts setting aside loans

- Although ASIC was not the credit regulator prior to 1 July 2010, ASIC released a report in 2008 (*Protecting wealth in the family home*) identifying concerns with abuse of low doc lending and associated misconduct by brokers. ASIC's also raised concerns about the risks associated with unregulated mortgage brokers in its report on mortgage broking released in 2005. The Commonwealth government relied in part on both of these reports in making its decision that credit should be regulated nationally, that brokers should be regulated (including through licensing), that responsible lending laws should be introduced, and that the regulation should extend to investment loans for residential property.
- Although some borrowers have succeeded in court to have a loan partly or wholly set aside (e.g. because of predatory lending), these cases have typically involved borrowers with a special disadvantage or have succeeded because of remedies provided under specific state legislation (e.g. the *NSW Contracts Review Act 1984*).
- Although ASIC has had jurisdiction for unconscionable conduct pre- and post-GFC, the courts have imposed a high bar when a party has sought to establish unconscionable conduct. ASIC recently intervened in a case (*Tonto home loans*) where unconscionable conduct was alleged against the lender because of the broker's conduct; although the borrowers and ASIC were successful at first instance, on appeal the court held that the broker was not the lender's agent and the lender had not engaged in unconscionable conduct. The borrowers were provided relief under the *NSW Contracts Review Act*.

Key points

- Ms Denise Brailey, President of the Banking and Finance Consumers Support Association (Inc) has lodged a submission with the Senate Banking Inquiry into the Post GFC Sector. Ms Brailey alleges widespread misconduct by the finance industry in lending to asset rich income poor consumers who could not afford loan repayments for property investment purposes. Similar concerns have been raised in one other submission (Delamere/Opie).

Consumer Credit Legislation

- In 2010 ASIC became the national regulator of consumer credit under the National Consumer Credit Protection Act (NCCP). Prior to that consumer credit was primarily regulated by the states and territories under the Uniform Consumer Credit Code (UCCC).
- The UCCC did not apply to credit for investment purposes (including real estate investment) or impose a specific obligation on credit providers to assess a consumer's ability to repay a loan without substantial hardship. However, from 1 July 2010 the NCCP applies to loans for real estate investment and both finance brokers and credit providers must comply with responsible lending obligations which require them to make reasonable inquiries into and verification of consumers' financial position.
- Although the NCCP has been extended to regulate loans entered into from 1 July 2010 for investment in residential property, it does not cover loans for other investment purposes. It is understood that Treasury is currently consulting with stakeholders about the potential extension of the NCCP to loans for investment and small business purposes.

- Under the UCCC prior to 1 July 2010 (and under the National Credit Code from 1 July 2010) consumers could apply to a Court to reopen a consumer credit contract on the basis it was unjust. One of the criteria a Court may have regard to in determining whether a contract is unjust is whether at the time the contract was entered into the credit provider knew, or could have ascertained by reasonable enquiry, that the debtor could not pay in accordance with its terms or could only do so with substantial hardship.
- From 1 July 2010 consumers can also seek compensation from credit providers and other parties for damages arising from breaches of the NCCP, including the responsible lending provisions. In addition to awarding compensation, a court may also make an order declaring the whole or any part of a contract, deed or arrangement to be void.

ASIC responsible lending reviews - home loans promoted as low doc

- ASIC undertook a review of finance broker's responsible lending practices from July to December 2010 with a focus on home loans promoted as low doc following the introduction of the NCCP. The findings from this review were published in Report 262 in November 2011. The review found that brokers reviewed were aware of the responsible lending obligations and taking steps to comply. The report did however identify areas for improvement in industry practice and made a number of findings which we understand has led to a number of changes within industry.
- ASIC is currently reviewing how credit providers are complying with their responsible lending obligations on loans that are promoted as low doc, and how credit licensees with a large number of representatives are ensuring their compliance with the responsible lending obligations. We note that credit providers' current lending practices are generally tighter than those existing prior to the GFC. Initial data also suggests that the proportion of home loans which are low doc has decreased significantly since the introduction of the responsible lending obligations for ADIs in January 2011.

Unconscionable conduct - ASIC Act/Contracts Review Act (NSW)

- Investment loans are subject to the consumer protection provisions of the *ASIC Act* including those for unconscionable conduct. ASIC intervened in legal proceedings brought by a credit provider to repossess the properties of a number of consumers who had obtained low doc home loans for investment purposes through a finance broker who had falsified the consumers' income details on the loan applications. The NSW Court of Appeal found that the broker was not the agent of the credit provider and that the credit provider's conduct would therefore not be unconscionable under the *ASIC Act*. *Tonto Home Loans Australia Pty Ltd v Tavares* [2011] NSWCA 389 The Court did however find that the contracts were unjust under the *Contracts Review Act 1980 (NSW)*.

Property Investment Advice

- In some cases where concerns have been raised by consumers about low doc loans, the primary issue appears to be the non-performance or fraudulent nature of the investment that the consumer believed they were investing in, rather than the credit contract itself (ie if the investment financed by the credit contract had performed as intended the consumer would have been in a position to repay the loan).