

Chapter 5

ASIC's role and credit providers

5.1 Before July 2010, the states and territories had primary responsibility for regulating consumer credit. ASIC, however, did have some involvement. Since March 2002, under the ASIC Act, the regulator has had a consumer protection role for credit facilities, which included household and investment and small business credit. ASIC took over this responsibility from the ACCC as part of the reform of business and investment regulation under the Corporate Law Economic Reform Program. This Commonwealth level regulatory function for credit in the marketplace was limited in scope with ASIC's jurisdiction under part 2 of the ASIC Act confined to broad standards of conduct covering unconscionable conduct and misleading or deceptive conduct.¹ ASIC's licensing powers did not extend to brokers who only advised on credit products. At that time, as credit was not considered a 'financial product' for the purposes of the Corporations Act, brokers were not required to have an Australian financial services (AFS) licence.

5.2 In July 2010, ASIC's responsibilities expanded considerably under the *National Consumer Credit Protection Act 2009* (National Credit Act) which imposed licensing requirements, general conduct obligations and responsible lending obligations on credit providers and persons providing credit assistance.

5.3 In this chapter, the committee's main focus is on ASIC's performance and its regulatory role before the National Credit Act came into force. It is concerned with allegations of imprudent lending involving unconscionable conduct, misleading and deceptive conduct, including possible cases of fraud, that occurred after March 2002 but before the new legislation came into effect.

Early indications of irresponsible lending practices

5.4 The period from the late 1990s through to the first half of the 2000s was marked by considerable product innovation in the Australian mortgage market. Reflecting on that period, the Assistant Governor (Financial Markets) of the Reserve Bank of Australia (RBA) explained that lenders sought to cater for a wider range of potential borrowers and found new ways to assess their borrowing capacity. He noted:

Lenders introduced home-equity loans, redraw facilities and reverse mortgages, all of which allowed households to borrow against the equity they have built up in their homes. Lenders also introduced interest-only

1 See for example, Consumer Credit Legal Centre (NSW) Inc, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 39; ASIC, *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress*, March 2008, p. 4; and ASIC, *Submission 45.1*, p. 6.

loans and shared equity loans, which made it easier for households, particularly first home buyers, to purchase their home.

Loan products that better meet the needs of certain types of borrowers, such as those with irregular income streams or those who do not meet the standard lending criteria, were also introduced. Low doc loans, for which borrowers self-certify their income in the application process, accounted for about 10 per cent of newly approved housing loans in 2006 compared with less than ½ per cent in 2000.²

5.5 According to the Assistant Governor, while the overwhelming effect of these changes had been to widen the range of households who could access finance, some of the innovation had resulted in 'an easing in lending standards and an increase in risk for both borrowers and lenders'.³

5.6 The Consumer Credit Legal Centre (NSW) Inc (CCLC) also noted the emergence of 'non-conforming lending' in the home loan market during the early 2000s. It stated that 'while some lenders specifically targeted and priced their products for marginal borrowers, the trend soon spread into the mainstream, with most mainstream lenders including the major banks offering low doc loans'.⁴

Growing use of mortgage brokers

5.7 This period also witnessed growth in the use of financial brokers as intermediaries between borrowers and lenders, which meant that an increasing number of Australians approached mortgage brokers rather than a lender to arrange loans. For example, a 2003 survey by the Australian Prudential Regulation Authority (APRA) on broker initiated loans recorded that 56 institutions indicated that they had used brokers to originate loans (14 banks, 34 credit unions, and eight building societies), which represented approximately 25 per cent of all authorised deposit-taking institutions (ADIs). The survey also predicted a continuation of this trend in the market with 25 institutions indicating at the time that they planned to use brokers for the first time in the next 12 months.⁵

5.8 Based on its results, the survey noted that only a minority of institutions were placing too much reliance on brokers to assess loans and inadequately tracking and

2 Dr Guy Debelle, 'The State of the Mortgage Market', Address to the Mortgage Innovation Conference, Sydney, 30 March 2010, p. 6.

3 Dr Guy Debelle, 'The State of the Mortgage Market', p. 5.

4 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

5 Anoulack Chanthivong, Anthony D. F. Coleman and Neil Esho, *Report on Broker-originated Lending*, Results of a survey of authorised deposit-taking intuitions, undertaken by the Australian Prudential Regulation Authority, January 2003, pp. 4, 5. The survey recorded that the total dollar value of broker-originated housing loans was \$76.3 billion, which represented roughly 23% of all housing loans made by ADIs. Broker-introduced housing loans accounted for 23% of banking industry housing loans, 2% of credit union housing loans, and 35% of building society housing loans.

assessing broker-introduced loans. Even so, it cautioned that independent loan review was necessary to ensure an ADI's credit standards were 'being applied to assess and approve loans'. It advised that an independent review should be 'a fundamental element of risk management'.⁶

5.9 The survey also covered broker remuneration. It found that over half of the institutions (53 per cent) based the broker's remuneration solely on the volume of business generated. According to the survey reviewers, this provided brokers with an incentive to generate loan volume without appropriate regard for risk. Again, the reviewers observed that with such an incentive structure it was critical for ADIs to have procedures in place to ensure their own credit assessment standards were applied rigorously to broker-introduced loans.⁷ Looking back over this period, the CCLC stated that:

Brokers carried none of the default risk worn by lenders and had a strong financial incentive (in the form of commissions) to get as many and as big a loans as possible accepted by the financial institutions and other lenders. The presence of the 3rd party in the transaction also allowed the lender (keen to grab or retain market share) to distance themselves from the transaction and to either genuinely miss, or effectively turn a blind eye, to irregularities in loan applications.⁸

5.10 As noted previously, ASIC assumed Commonwealth-level responsibility for consumer protection in the credit market in 2002 at a time when the use of mortgage brokers was on the rise and lending practices were easing.

Early warning signs

5.11 During the early 2000s, community advocates and caseworkers began to express concerns about the growing incidence of complaints involving brokers. Their experiences led them to conclude that the industry was lightly and unevenly unregulated and contained some high-risk players and unfair practices.⁹ In response to the increasing number of complaints involving brokers, ASIC, on the recommendation of its Consumer Advisory Panel, commissioned the CCLC to examine and report on the mortgage and finance broker industry.

Increasing concerns about broker conduct

5.12 Consistent with the findings of the 2003 APRA survey, the CCLC also registered some troubling trends about this poorly regulated sector of the industry.

6 Chanthivong et al, *Report on Broker-originated Lending*, p. 7.

7 Chanthivong et al, *Report on Broker-originated Lending*, p. 9.

8 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

9 Consumer Credit Legal Centre (NSW) Inc, *A report to ASIC on the finance and mortgage broker industry*, March 2003, www.asic.gov.au, p. 5.

Its report identified a number of features that hindered the development and maintenance of professional standards for broker conduct, including:

- minimal or no entry requirements for participants in the industry;
- the use of commissions as the dominant method of remuneration for brokers;
- a shift in distribution channels used by lenders from branch networks to brokers, with lenders competing against each other to gain access to broker client bases, through increasing the commission they were prepared to pay to brokers;
- a consequent shift in the preparation of loan applications from lenders to brokers, with some brokers prepared to provide inaccurate information about the financial circumstances of their clients, in order to ensure that loan applications met the acceptance criteria of the lender;
- difficulties for lenders seeking to discipline brokers, due to the capacity of brokers to switch the lender to whom they directed client applications for finance;
- a lack of accountability of brokers for poor advice due to the inability of consumers to access alternative dispute resolution forums; and
- some brokers not properly promoting the interests of their consumer clients.¹⁰

5.13 The report recognised that consumers were relatively inexperienced when using brokers and, given the confusing range of loans and providers, could become dependent on brokers for advice. Importantly, the report noted that some brokers were 'prepared to exploit that dependency' and that a number of fringe players in the broker industry systematically adopted unfair practices, and pursued 'their own financial interests over those of their clients'.¹¹ It cited cases involving disputes about the quality of advice provided by brokers which included:

- brokers recommending interest only loans in inappropriate circumstances— case studies indicated that some brokers were making widespread use of 'interest only' loans;¹²
- brokers misrepresenting the savings available from changing a home loan;
- brokers arranging for borrowers to declare, incorrectly, that a loan was for investment rather than personal use (with the result that the consumer lost statutory protections provided under the Uniform Consumer Credit Code (UCCC));

10 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 6–7.

11 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 8, 11.

12 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 30.

- brokers charging excessive fees, or fees in circumstances where the broker was aware that there was little prospect of the borrower being approved for a loan;
- borrowers being placed into a loan where they could only afford the repayments with substantial hardship (81 per cent of the caseworkers surveyed by the CCLC who dealt with broker complaints indicated that they often saw problems of this type); and
- brokers arranging finance for an amount less than that requested by the customer (particularly where the funds were required to complete a property purchase).¹³

5.14 The report noted that these practices resulted in 'higher costs to consumers, an increased risk of default by the borrower, and exposure of their home where this was used as security for the debt'.¹⁴ It also suggested that most consumers would be unaware that by signing a declaration that the loan was for investment purposes, and therefore outside the UCCC regime, they made it significantly easier for the lender to take possession of any security, such as their home, in the event of default'.¹⁵ The report drew particular attention to a most troubling practice:

A significant and, from a regulatory viewpoint, disturbing trend in the broker industry is the incidence of fraudulent mortgage applications. The shift in responsibility for the preparation of the loan application from persons such as bank employees to brokers has seen a shift in the interests of that person, from applying proper risk assessment techniques to earning commissions through having the loan approved. Increased reliance on brokers therefore creates an increased risk of this type of mortgage fraud.

At the soft end, mortgage fraud can involve the broker misrepresenting the consumer's personal or financial information in order for the lender to finance a marginal application for credit. Because brokers have ongoing contact with a credit provider, they become familiar with its lending criteria and can manipulate the content of applications to ensure the loan will be approved. There are a number of ways in which the broker can camouflage the borrower's circumstances, such as not disclosing all liabilities, reducing the number of dependants, or inflating the value of assets.¹⁶

5.15 The report recognised the urgent need for the implementation of interim measures to protect consumers and improve standards of conduct in the broker industry, which included:

- increased and visible enforcement action by regulatory agencies;

13 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 29.

14 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 29.

15 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 34.

16 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 34–35.

- the introduction of improved codes of conduct by industry bodies together with greater monitoring and enforcement of their obligations;
- improved access to industry-based dispute resolution procedures such as the Mortgage Industry Ombudsman Scheme, and ASIC approval (pursuant to Policy Statement 139) of the operation of such schemes, in order to provide greater transparency in the operation and decision-making practices of these schemes; and
- state and territory governments encouraging a greater degree of supervision of brokers by lenders...¹⁷

5.16 A 2003 APRA discussion paper also highlighted the increased use of brokers and recognised that some ADIs were relying on broker valuations and income checking when providing a loan. Instead of verifying the information, certain ADIs were placing greater weight on the security underlying the loan than the ability of the borrower to repay the loan.¹⁸ The paper referred to a particular problem with low doc loans¹⁹ where the potential borrower did 'not provide income details', and the lender did not 'verify the borrower's self-declared income levels and/or self-declared servicing ability'.²⁰

5.17 Clearly, by the close of 2003 some persistent and undeniable alarms were warning of dubious lending practices and the potential for them to spread, especially with brokers receiving commissioned-based remuneration and with the increasing availability of low doc loans.

5.18 Commentary on, and concerns about, the role and conduct of brokers continued for the next few years. According to the RBA's September 2004 *Financial Stability Review*, brokers typically received upfront commissions from lenders for each loan they originated. It observed that most lenders also paid brokers ongoing or trailing commission over the life of the loan, which were generally 'small relative to upfront commissions'. The *Review* noted that this created some incentive for borrowers to periodically refinance with a different lender.²¹

17 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 66.

18 APRA, *Proposed Changes to the Risk-Weighting of Residential Mortgage lending*, Discussion paper, November 2003, p. 2.

19 A loan that requires less financial documentation than that required for other loans. Primarily for borrowers who do not meet the standard loan application criteria, such as the self-employed and other borrowers whose income could not be readily verified.

20 APRA, *Proposed Changes to the Risk-Weighting of Residential Mortgage lending*, p. 4.

21 Reserve Bank of Australia, *Financial Stability Review*, September 2004, pp. 39–40.

5.19 In 2007, the RBA reported that mortgage brokers in Australia had been under discussion for some time. It explained:

In part, this reflects concerns that a small number of brokers may have been associated with predatory lending practices and that their remuneration structures—predominantly high upfront and low trailing commissions—might have adverse consequences for both borrowers and lenders.²²

5.20 In September 2007, the House of Representatives Standing Committee on Economics, Finance and Public Administration tabled a report on home loan lending. Although the report noted the positive results stemming from changes in the housing lending market, it also referred to negative aspects, including instances where lending had been inappropriate. The report cited the concerns of the Credit Ombudsman Service, which had identified:

...a disturbing trend among some lenders, normally fringe lenders, to refinance home loans in circumstances where the borrower has no capacity to repay the loan. These lenders rely solely on the value of the security, not the borrower's ability to meet the repayments. The borrower is invariably in default of their existing loan and is at risk of losing their home.²³

5.21 The House of Representatives' committee recommended that the Commonwealth take responsibility for regulating credit including mortgages.

5.22 By 2008, widespread support for reform was mounting.²⁴ In March 2008, the Council of Australian Governments (COAG) agreed in principle to the Commonwealth taking over the role of regulating mortgage credit and advice to protect consumers. The states' agreement to refer constitutional powers to the Commonwealth paved the way for the introduction of the Consumer Credit Protection Reform Package.

Committee comment

5.23 Prior to 2008, ASIC had been aware of emerging problems in the mortgage brokering industry, including predatory lending and the potential for it to grow. As the years passed, the trend continued but the push for reform was not sufficiently strong until 2008 when agitation for legislative change gathered the necessary force to compel reform. Before the committee considers the effectiveness of the reforms, it examines ASIC response to the problem of predatory lending as it crept into mainstream lending after 2002.

22 Reserve Bank of Australia, *Financial Stability Review*, September 2004, p. 40.

23 See House of Representatives Standing Committee on Economics, Finance and Public Administration. *Home loan lending, Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, September 2007, Parliamentary Paper No. 191/2007, p. 24.

24 Productivity Commission, *Review of Australia's Consumer Policy Framework*, Vol. 1, No. 45, 30 April 2008, p. 28.

ASIC's response to lending practices

5.24 In the following section, the committee looks closely at the nature of this predatory lending, the effects it had on individual consumers, and why, despite the warnings, such practices were allowed to continue. While the committee acknowledges ASIC's limited regulatory function over the provision of credit during this period, its focus nonetheless is on the measures that ASIC could or should have taken to arrest the trend in predatory lending and to protect the interests of retail borrowers.

Previous inquiry

5.25 The committee has previously inquired into poor lending practices as part of its broader 2012 inquiry into the post-GFC banking sector. It took evidence from people claiming that they had been the victims of predatory lending. Ms Denise Brailey, who headed up the Banking and Finance Consumers Support Association (BFCSA), asserted that fraud and maladministration, especially related to low doc loans was prevalent. The allegations were serious and went to matters such as the falsification of application loans.²⁵

5.26 During that inquiry, ASIC informed the committee that it had taken enforcement action regarding low doc loans over a number of years and that it had 'not identified widespread evidence of systemic misconduct in the banking sector along the lines described by Ms Brailey'. At the time, the committee expressed its concern about the obvious discrepancies between ASIC's account and Ms Brailey's claims of predatory lending and fraud. It believed that the matter warranted further investigation and that, upon receipt of allegations that presented an arguable case of wrongdoing, ASIC should undertake its own investigations to establish whether a prima facie case of fraud existed.²⁶

5.27 Following this suggestion, ASIC wrote to Ms Brailey requesting the documentation she had referred to that would support her allegations of misconduct. ASIC obtained and reviewed the documents provided by Ms Brailey but considered that the material did not provide evidence of any breach of the law by lenders.²⁷ According to ASIC, additional information posted on the BFCSA's website did not provide evidence of breaches of the laws administered by ASIC 'or indicate that any of the credit providers were aware of, encouraged, or inserted misleading information in application forms'.²⁸ This current inquiry into the performance of ASIC provided

25 Senate Economics References Committee, *The post-GFC banking sector*, November 2012, Parliamentary Paper No. 448/2012, p. 102.

26 Senate Economics References Committee, *The post-GFC banking sector*, pp. 105 and 107–108.

27 ASIC, *Submission 45.1*, pp. 28–29.

28 ASIC, *Submission 45.1*, p. 29.

another opportunity for people who have suffered loss because of poor lending practices to recount their personal experiences.

Submissions

5.28 The committee received well over 160 submissions from people expressing concerns about the conduct of brokers and lending institutions. Most provided their own account of being caught up in poor lending practices and as a consequence losing their family home, life savings, credit rating and in many cases their health. A significant number of those who wrote to the committee were approaching retirement or had retired. Their experiences align with those cited in the CCLC 2003 report and are consistent with the findings of APRA and the RBA around that time.

5.29 According to the BFCSA, older retirees and pensioners have been the favoured target of white collar crime in Australia over the past two decades.²⁹ In respect of irresponsible lending, evidence before the committee supports this contention. For example, one couple, aged 71 and 64 years, had a loan of \$900,000 approved. They asked how was it possible for the bank to approve such an amount for 'a 30-year term to people of our advanced age when we were Centrelink recipients earning \$23,000 per annum combined'.³⁰ Another couple in their late 60s received a loan of \$360,000.³¹ These examples were not isolated cases of a person or retired couple receiving an annual income of below \$35,000 obtaining a considerable loan over a 30-year term.³² One son noted that his father, on the pension of less than \$30,000 a year and, in his opinion, losing his faculties, was 'granted a loan of \$300,000 to invest in the stock market'.³³ Another retired couple on the aged pension obtained a loan in 2007 of some \$415,000 on a property and \$209,000 on their home. They also received a \$165,000 buffer loan 'to provide some portion of the deposits, and then provide a bit of capital to assist the loans'. In 2009, they got another loan from a different bank to refinance another property. They explained:

We are now aged 75 and 68 and face the very real prospect of losing our home as we have no income apart from the pension. We have sold our shares, a car, spent our invested money and, where we were in a fairly sound financial position with assets over \$1.5m we now have about \$250,000 in equity and this is declining and we have no prospect of any improvement in our situation and find ourselves in an overwhelmingly frightening position.³⁴

29 Banking and Finance Consumers Support Association Inc, *Submission 156*, p. 5.

30 Ms Ann Marie Delamere, *Submission 3*, p. 1.

31 Name withheld, *Submission 27*.

32 See also *Submissions 19, 25, 27, 103, 178 and 265*.

33 Mr and Mrs Graeme and Nat Powell, *Submission 8*, p. 1.

34 Name withheld, *Submission 55*, p. 1.

5.30 Another couple informed the committee that:

...we are about to lose our family home and everything we have worked towards for over 40 years to secure a self-funded, comfortable retirement. Instead, we are broken mentally and physically and are now looking at a life of dependence on the old aged pension and an unnecessary drain on the public purse (the very thing we have worked our whole lives to avoid!).³⁵

5.31 In their words:

We thought and trusted our 'Professional' Financial Planner, the Broker and the Lender on the understanding that they operated under strict legislation and Codes of Practice in 'a very stable Australian Banking System' as it was explained to us at the time. This misplaced trust has destroyed our lives.³⁶

5.32 The loan offers were directed at people who could borrow on the equity in their home or other assets. According to one couple who were 'spruiked into buying investment properties for their retirement':

...we were 58 years old, we were asset rich and income poor after 40 years of hard work, we owned our factory premises our business and business equipment, savings and we had a small loan on our house. The banks said we could afford these low doc loans...These loans were never affordable, our income was exaggerated, our assets were overstated, our rental income was overstated. At 58 we got 30 year loans, we would have to work until we were 90 years of age, there has to be something wrong. We used our savings, everything we earned, buffer loans, selling our vehicles and equipment and after 7 years of stress we cannot pay anymore, it was a transferral of our wealth to the banks. This has happened all because we placed our trust in the banks, and ASIC protects the banks.³⁷

5.33 While consumers have a responsibility to attend to their own interests, a number of submissions spoke of unconscionable or misleading and deceptive conduct on the part of brokers and lenders. Welcome Australia Limited told the committee of the deliberate targeting of asset rich-income poor 'Australians with the intention of reaping financial gain that would invariably and knowingly lead to the loss of the victim's home'. It referred to campaigns directed at retirees, many of whom were living solely on the pension, enticing them to mortgage their homes 'while offering them the world'. According to Welcome Australia:

The majority of these retirees have no idea as to the true picture of what is actually taking place, for once they sign that contract the money begins to flow, to the bankers, the financial institutions and the property speculators,

35 *Submission 67* (Confidential).

36 *Submission 67* (Confidential).

37 Name withheld, *Submission 93*, p. 1.

while the investor/retiree begins to witness the dissolution of their asset, their family home.³⁸

5.34 Retired couples were not the only targets. One submitter stated that he was 55 years old and had recently lost his job; even though the submitter indicated in writing that he was unemployed, he was successful in obtaining a \$480,000 loan.³⁹ Another was a newly widowed 56-year-old woman who was not working, receiving a widow allowance and in poor health due to the stress and grief of losing a partner, when she refinanced her mortgage with a major bank. She later discovered that her income was recorded incorrectly in the loan application form and stated that, had she been earning that amount, she 'would never have had a need for a mortgage'. Arguing that the bank had taken advantage of, and defrauded, her, she wrote:

Now aged 64, no longer a home owner for the first time in 34 years, robbed of a chunk of my rightful equity, not enough now to buy anything outright unless miles away from family friends...⁴⁰

5.35 A third case, but again only one of many, was a single mother who was studying and working part-time. She had been fortunate to have received an inheritance which had allowed her to buy her own home and to feel 'fairly secure'. She then explained:

I was naive about investments and finances and believed what people with experience told me. I was told by a broker that I should invest in property, which I did with a low doc loan. I now clearly realise that I was never in a position to be able to pay back a loan as I did not have the income. I now have massive loans, no savings and have mortgaged my house. Life is now a struggle month to month to pay the loans.⁴¹

5.36 A person on a disability pension, now forced to rent out her home and live at her daughter's house, was among the many who wrote to the committee.⁴² In some other instances, the banks approved unaffordable loans to people 'who could hardly read and write' or who had a poor command of the English language.⁴³

Disclosure

5.37 Many of the people who wrote to the committee were clearly hard working Australians who over their lives had built up a nest egg so that they could support themselves comfortably in their retirement. As one couple remarked:

38 Welcome Australia, *Submission 230*, p. 3.

39 Name withheld, *Submission 46*, p. 1.

40 Name withheld, *Submission 158*, p. 3.

41 Ms Kirsty Torrens, *Submission 180*, p. 4.

42 Name withheld, *Submission 16*.

43 *Submissions 52 (Confidential) and 183*.

We have both worked all our lives in good jobs, paid our bills and our taxes and raised our family, and had finally taken time out to relax when we were approached with this bank scam. However, we were completely sucked in by the scam and particularly when we were told the bank was the Commonwealth which we had always associated with being a good Australian citizen.⁴⁴

5.38 Many asked the same question—how could they find themselves in such a predicament? As one submitter put it:

How did I [end] up with \$530K debt when I had no income when Low Document Loan was approved to me...I will be facing a Bankruptcy as my house is only worth \$430K.⁴⁵

5.39 For some, there was a definite sense that the banks had betrayed them. One submitter, who referred to herself as 'a loyal customer of 35 years', did not suspect that the bank would take advantage of long standing customers.⁴⁶

5.40 Another common complaint involved the failure to inform the borrower about the loan documents; important details of the loan structure; and how the loan arrangements would or could affect the borrower's circumstances.⁴⁷ A most disturbing element, however, involved information contained in the loan application forms being deliberately fabricated after the applicant had signed the documents or in some cases signatures themselves being forged. Indeed, most of the people who wrote to the committee about being the victims of predatory lending also referred to forged loan application forms and the failure of the respective lending institution to verify the information.⁴⁸ Falsified information included: inflated income details; over-valued and over-stated assets; fake Australian Business Numbers (ABNs); embellished employment details; and false income tax details. For example, one couple listed the anomalies in their application:

Our actual total income has been changed and in fact overstated by almost \$200,000, contrary to documented proof that was provided at the time, in the form of tax returns and other official documentation.

No dependants included. In fact we have 2 children both at home, one at school.

44 Name withheld, *Submission 29*, p. 1.

45 Ms Hifumi Robbie, *Submission 15*, p. 1.

46 Name withheld, *Submission 158*, p. 3.

47 *Submissions 15* and *52*.

48 Many submissions used their own experiences which taken together provided some sense of the nature and extent of the practice. For example, see *Submissions 3, 5, 7, 9, 12, 13, 14, 15, 16, 17, 19, 20, 21, 23, 24, 26, 27, 28, 32, 39, 48, 51, 52, 58, 64, 66, 68, 69, 71, 72, 93, 101, 104, 105, 131, 158, 171, 177, 183, 185, 195, 207, 218, 220, 221, 317, 320, 322, 351, 353, 378, 380, 381, 382* and *401*.

The actual value of our assets has been changed and in fact overstated, contrary to documented proof that was provided at the time.

The actual cost of our expenses has been changed and in fact understated, contrary to documented proof that was provided at the time.

The actual cost of our expenses has been changed and in fact understated, contrary to documented proof that was provided at the time, in the form of official documentation.⁴⁹

5.41 According to this couple, after they had signed and submitted the original documents to the bank, changes were made to the loan application form by person or persons unknown to them and without their authority, permission or knowledge.⁵⁰ A 73-year-old self-funded retiree and a permanent carer to his son provided another example that typified the range and extent of falsification of a loan application form:

My income was altered from about \$34,000 p.a. to \$75,000 p.a.

My 1999 Toyota worth about \$6000 was valued at \$25,000.

My employment record was false. I had retired in 1995 and since then was never self-employed as a tutor as claimed falsely in the [loan application form].

My superannuation and \$325,000 in non-existent shares were fabricated.

I have never had an accountant or ABN as claimed.

A Family Trust was fabricated and I have never been a sole trader.

My home was overvalued by \$100,000.

I had signed a different declaration. I never signed the affordability statement/self-employment forms claimed to be held on file.⁵¹

5.42 Again the submitter told the committee that the bank had 'never checked details with me to prove that I could service the loan'.⁵² Another couple told the committee that they were 'absolutely shocked' to find that their details had been 'grossly falsified' and incomes 'hugely inflated'. They believed that the alterations were made by the bank after they had signed the forms. They explained further:

We never had contact with the bank as this was done through a broker, if the lender had made just one phone call to us to check that these details were correct the loan would not have been approved and we wouldn't be in this position.⁵³

49 Name withheld, *Submission 14*, pp. 1–2.

50 Name withheld, *Submission 14*, p. 2.

51 Name withheld, *Submission 60*, p. 1.

52 Name withheld, *Submission 60*, p. 2.

53 Name withheld, *Submission 27*, p. 1. See also, *Submissions 28, 36, 52, 66, 67 and 72*.

5.43 For some, this practice was 'incomprehensible' and that no 'sane person would have continued with these loans had they been aware of the level of tampering required to get them approved'.⁵⁴ One such submitter, who was receiving WorkCover payments, told the committee that her employment details had been altered but that the bank did not 'bother to collect any taxation returns to verify the income'.⁵⁵ Another submitter informed the committee that the bank had never contacted his father's accountant to ascertain his financial position. He asked a question posed by so many others:

Would it not be a financial provider's responsibility to perform at least the most basic due diligence before providing a large loan to anyone, let alone an 80 year old man?⁵⁶

5.44 One couple remarked that while the bank never phoned them or made inquiries into their ability to repay the loan, it did go 'to great lengths to get a valuation' on their property.⁵⁷ Another could not understand why banks could undertake credit checks but not check income.⁵⁸

5.45 The committee suspects that there are many other people who, too embarrassed or disheartened by their experiences, have not come forward to reveal their own stories of improper lending practices. Indeed, the CCLC told the committee that it used to see such cases with 'alarming regularity'.⁵⁹

5.46 Many of the people who contacted the committee spoke of their sense of deep shame in succumbing to predatory lending. They felt humiliated and defeated by the whole business, which commonly had dragged on for years, draining their energy, damaging their personal relations as well as their physical and mental health. One submitter spoke of the indignity in finding herself in such desperate straits:

I am ashamed of the position I am in because of bank approved low doc loans, there is fraud and forgery on our low doc loans, these loans ought to have been rejected, they were never affordable from the beginning, the depression, the stress, the fighting with my family, all our life savings gone, because of low doc loans.⁶⁰

54 *Submissions 68 and 69.*

55 Name withheld, *Submission 66*, p. 1.

56 *Submission 52 (Confidential)*. See also *Submissions 67, 75 and 101*.

57 Name withheld, *Submission 29*, p. 1.

58 Name withheld, *Submission 72*, p. 1. See also Mr Edmund Schmidt and Ms Cynthia Lawrence, *Submission 265*.

59 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42.

60 Name withheld, *Submission 226*, p. 3.

5.47 A 64-year-old pensioner who at first declined to accept an offer of a loan but subsequently was persuaded to borrow a much larger amount than initially requested summed up his situation:

I am the victim of a Low Doc Loan which has sucked my life away and placed me on the brink of suicide. The poverty, sadness, despair and hopelessness which have been caused by my attempting to keep up repayments on a Low Doc loan which should never have been granted are real, cruel and horrible.⁶¹

5.48 Another stated that, on reflection, he was encouraged to think beyond his circumstances. He realised that a more prudent decision, which he started with, 'was to purchase an affordable property but was convinced otherwise by an offer presented as a 'sensible and tax effective way to increase my superannuation'.⁶²

5.49 People spoke of having to live on the breadline just to try to repay the money after having worked all their lives; paid their bills and taxes; and raised their family.⁶³ The fear of losing their home was particularly alarming. One couple in their late 50s stated they 'should be planning retirement not worrying constantly if we will have a roof on our heads next week or next month'.⁶⁴ One submitter, the sole carer of his son, feared that there would be no financial support or home for him.⁶⁵

5.50 Many borrowers who wrote to the committee also felt let down by ASIC. They believed that the system was unjust and consumer protection non-existent.⁶⁶ One submitter noted:

I am left thinking that a consumer purchasing a domestic refrigerator has more consumer protection than a bank customer negotiating a loan over an asset that's taken a lifetime to acquire.⁶⁷

5.51 Another, who also argued that the Australian government appointed ASIC to protect consumer interests against misconduct by the financial institutions, stated that ASIC seems to be 'in bed with the banks'.⁶⁸ In numerous cases, borrowers argued they had mounted a strong case of maladministration in lending but that when they contacted ASIC for assistance, it failed to act on their complaint in any effective way.⁶⁹ Mr Timothy Chapleo voiced a common view:

61 Name withheld, *Submission 344*, p. 1.

62 Name withheld, *Submission 46*, p. 1.

63 See for example, *Submission 29*.

64 Name withheld, *Submission 21*, p. 2. See also *Submission 27*.

65 Name withheld, *Submission 60*, p. 2.

66 Name withheld, *Submission 43*, p. 1.

67 Name withheld, *Submission 39*, p. 1.

68 Mr Spencer Murray, *Submission 23*, p. 1.

69 See for example, *Submission 71*.

If they cannot be of any real value in policing rogue business and large organisations such as financial lenders and enforcing corrective measures then what value are they in a role that should see them being able to have some real ability to protect members of our society from unfair and bad elements in business.⁷⁰

5.52 The few cases cited so far only hint at the extent of the problem and the number of people who believe that they have been the victims of predatory lending. In many cases these people were desperate to stem the losses and salvage whatever they could from the financial mess they found themselves in and in particular to save or regain their family home. Their trust in the banking system has been shattered and their confidence in ASIC as an effective regulator destroyed.

Loan application forms—anomalies and discrepancies

5.53 The committee has recounted the stories of many borrowers who found themselves in dire circumstances because of irresponsible lending practices. In account after account, submitters expressed their shock at discovering that their forms had 'been manipulated to suit the purpose of the loan'.⁷¹

5.54 The stories of altered loan application forms are hard to believe. The reported extent of these manufactured application forms raises many questions about why the practice was allowed to continue seemingly unchecked for so many years. As noted earlier, a 2003 ASIC-commissioned report referred to this matter as did both APRA in 2003 and the RBA in 2004. Yet the practice continued for several more years until finally the states agreed to refer powers to the Commonwealth and new credit laws were passed.

5.55 Many who obtained their loan through a broker indicated that the lender did not contact the borrower to check the details in the loan application form or take measures to verify the accuracy of the information. They claim that had the lender done so, it would not have approved the loan.⁷² Some were convinced that the banks were required by law to ensure the affordability of the loan: that it was the bank's responsibility to confirm that the information contained in the loan application form was accurate.⁷³ One submitter stated that the bank 'did not protect us by communicating with us or checking any of the paperwork as a prudent lender would be expected to do...'⁷⁴

70 Mr Timothy Chapleo, *Submission 7*, p. 1.

71 Name withheld, *Submission 12*, p. 2. See also Financial Ombudsman Service, *Determination: Case number 323234*, 17 December 2013, p. 3.

72 *Submissions 27, 28 and 29*.

73 *Submissions 36 and 68*.

74 Name withheld, *Submission 72*.

5.56 In this regard, it should be noted that the 2003 Code of Banking Practice states clearly that before a bank offers or gives a credit facility, or increases an existing credit facility, it would 'exercise the care and skill of a diligent and prudent banker' in selecting and applying credit assessment methods and in forming an opinion about the borrower's ability to repay it.⁷⁵

Loan calculator

5.57 It would appear that in most, but not all, cases before the committee, it was the broker who altered or inserted incorrect information in the loan application form. Many of the borrowers argued that the broker did not act on their behalf but was in effect the agent of the bank. In their view, the lender paid the broker, who often had access to the lender's computer systems, and 'was instructed by the lender on how to get various loans across the line and operated under the lender's systems and instructions'.⁷⁶ Ms Brailey cited the use of a service calculator as evidence that brokers were indeed agents of the banks. She stated:

I want to highlight that everything is predicated on a service calculator... All 11,000 brokers have a screen in front of them. They must put the base income in the top corner. At the bottom, it spits out a figure. The broker is then taught by the business development managers at bank level. They come out to your office and teach you how to use it. They ask the broker to write that figure on the loan application form in their own handwriting. So he or she writes \$180,000, when the figure was \$50,000. That, in a nutshell, is how that fudged figure emerges.

The service calculator is a tool—it is a weapon.⁷⁷

5.58 ASIC argued, however, that ultimately the person who entered the incorrect information or tampered with the loan application form was the one responsible for the act:

If an individual, whether a finance broker or a borrower, falsifies information in order to make a loan fit a calculator, it is the individual who has engaged in misconduct, not the person who has made the calculator available.⁷⁸

5.59 That is, the lender was not held responsible for the misuse of the calculator by the broker, even though the lender may have supplied the calculator and provided advice and instruction on its use.

5.60 While the courts have tended to accept that brokers were not agents of the banks, the lending institutions do not come out of this period blameless. The banks

75 Australian Bankers' Association, *Code of Banking Practice 2003*, subsection 25.1.

76 *Submission 67* (Confidential).

77 *Proof Committee Hansard*, 20 February 2014, p. 46.

78 ASIC, *Submission 45.1*, p. 29.

and other lending institutions must have been aware of the dubious practices employed by some of the brokers arranging loans but chose to ignore them. Moreover, in some cases, the lending institutions clearly failed not only to exercise the skill and care of a diligent and prudent banker but were negligent even complicit in deceiving their customers. It should be noted that in its 2009 report on financial services and products, the Parliamentary Joint Committee on Corporations and Financial Services expressed some doubt about the degree to which banks acted 'ethically, appropriately, morally and prudently in their decisions to grant loans to some Storm customers'.⁷⁹

Committee view

5.61 It would seem that on the face of the evidence, some lenders, irrespective of the loan application form, should not have approved certain loans: they were unaffordable and likely to fail. In other cases, again irrespective of the loan application form, the borrower should have taken care before signing the actual loan contract to make sure that the repayments were sustainable and would not jeopardise the assets securing the loan.

5.62 Even so, the fact that this practice of manipulating information and faking signatures was allowed to continue for so long reflects badly on the brokers, the lenders and the regulator. It highlights the vulnerability of unwary and trusting borrowers, who were taken advantage of by unprincipled and self-interested brokers and lenders.

ASIC's role and limitations

5.63 Many submitters were of the view that the regulator did little to prevent predatory lending. ASIC informed the committee, however, that it made 'strategic use of the jurisdiction it did have'. It took court action; provided guidance to industry in areas where practice was poor; developed resources, tools and information for consumers of credit; and undertook surveillance activities where it saw problems in the industry. Moreover, ASIC endeavoured to understand the causes and effects.⁸⁰ For example, ASIC took the following action with regard to deceptive and misleading conduct:

- 2004—accepted an enforceable undertaking from mortgage broker Structured Solutions;
- 2006—took civil and criminal action against mortgage broker Tonadale Pty Ltd and Kelvin Sheers;
- 2006—obtained orders against mortgage brokers Sample & Partners Pty Ltd; and

79 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, Parliamentary Paper No. 321/2009, p. 35.

80 ASIC, *Submission 45.1*, p. 7.

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- 2009—took action against Whyte Corporation Pty Ltd.⁸¹

5.64 As well as citing these few cases, ASIC drew attention to the difficulty of bringing the lender to account for the misconduct of the broker. It noted that ASIC intervened in the Tonto Home Loans Australia Pty Ltd matter to argue that, 'in the circumstances, the brokers should be considered agents of the lender and that the actions of the lender were unconscionable'. The courts did not accept ASIC's submissions. ASIC explained:

The Supreme Court of New South Wales Court of Appeal ultimately held that the broker was not the agent of the lender and, as a result, that the lender's conduct was not unconscionable, but that the relevant contracts were unjust under state legislation.⁸²

5.65 ASIC informed the committee that:

The courts have found that, barring special circumstances, a mortgage broker is the agent of the borrower, and not the lender. This poses significant challenges for establishing unconscionable conduct where a broker is involved in the transaction, because:

- the broker's actions are attributed to the borrower. For instance, if the broker has manipulated the loan application, unbeknownst to the borrower and the lender, the action is taken to be that of the borrower, and not the lender; and
- the knowledge of a broker cannot necessarily be imputed to a lender. In these circumstances, as the lender typically deals with the broker and may not have any direct contact with the borrower, it is difficult to establish that the lender has sufficient knowledge of the borrower's circumstances for the lender's conduct to be unconscionable.⁸³

5.66 It appeared to ASIC that dishonest or fraudulent conduct had been 'more commonly found in relation to mortgage and finance brokers rather than lenders'.⁸⁴ The committee was told, however, that even where bank offers were alleged to have fabricated the loan forms, ASIC was reluctant to take action.⁸⁵ In specific reference to the provision on unconscionable conduct in the ASIC Act, ASIC explained that as the provision covers a broad range of situations, the courts have 'generally applied it to address the most extreme classes of conduct in all cases'. It explained further:

...the prohibition therefore does not provide a nuanced remedy that addresses the complexities of a transaction where problems may arise

81 ASIC, *Submission 45.1*, p. 6.

82 See ASIC, 'ASIC intervenes in low doc loan proceedings', *Media Release*, no. 09-39AD, 6 March 2009.

83 ASIC, *Submission 45.1*, p. 6.

84 ASIC, *Submission 45.1*, p. 26.

85 Ms Rosie Cornell, *Submission 285*.

because of the different interests of a consumer, a provider of an investment product, a lender and any finance broker.⁸⁶

5.67 ASIC noted further that borrowers who elected to pursue matters in court faced the same barriers as ASIC in establishing that a lender's conduct was unconscionable.⁸⁷ Additional difficulties borrowers could face when taking action against the broker were also recognised by ASIC:

Although a borrower may have a remedy against a finance broker for unconscionable conduct, the ability to obtain such a remedy, and value thereof, may be reduced in circumstances where the borrower is in financial hardship, due to an inability to repay the loan, and may be facing separate enforcement or legal action in relation to their home.⁸⁸

5.68 Thus, under the laws that existed before 2010, the people who were deceived by their brokers and abandoned by their lenders, had little prospect of success in the courts even though a lay person would clearly have understood the conduct of the broker or lender as unconscionable.

Fraud

5.69 As mentioned earlier, most complaints centred on the loan application form and the inaction by ASIC to deal with what the complainant considered was blatant fraud. In responding to alleged fraud occurring before the commencement of the National Credit Act, ASIC advised that the relevant state and territory police forces were the 'more appropriate authorities to investigate'. It noted that state and territory police had investigated some matters.⁸⁹ ASIC stated further that it appeared that dishonest or fraudulent conduct had been 'more commonly found in relation to mortgage and finance brokers rather than lenders'.⁹⁰

Guidance, education and warning notices

5.70 ASIC also informed the committee that it offered guidance for consumers through financial literacy material available on its website on managing credit and loans and debt. It also worked with industry, consumer groups and the external dispute resolutions schemes to improve practices. ASIC cited its work in fostering:

- the development of a code of practice applicable to brokers and non-bank lenders; and

86 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 4.

87 ASIC, *Submission 45.1*, p. 26.

88 ASIC, *Submission 45.1*, p. 6.

89 ASIC, *Submission 45.1*, p. 26.

90 ASIC, *Submission 45.1*, p. 26.

- enhancements to the codes of practice of both the banking industry and mutual sector.⁹¹

5.71 As noted earlier, however, the banks already had a Code of Banking Practice requiring them to 'exercise the care and skill of a diligent and prudent banker'.⁹²

Committee view

5.72 ASIC had available to it persuasive and less formal measures to stop unscrupulous practices. In this regard, the committee believes that ASIC did not take the opportunity to intervene in a far more direct and public way. It did not send a strong message regarding its concerns about irresponsible lending practices to lenders. Nor did ASIC do enough to alert Australian consumers to the risks associated with low doc loans, their vulnerability to irresponsible or even fraudulent activity, and of the need to protect their own interests. Such early and decisive publicity may have educated the community about ASIC's limited ability to protect their interests and minimised the damage.

Individual complaints and ASIC's responsibility

5.73 The CCLC argued that the role of a large national regulator is 'to respond to systemic and serious breaches of law within the industry that it regulates'. According to the CCLC, the expectation that ASIC would investigate and take action in complaints prior to the new credit laws was 'unreasonable':

ASIC cannot be expected to resolve each individual consumer dispute, nor would it be in the public interest. ASIC should carefully consider how to respond to all potential breaches of the law, but should not necessarily undertake a formal investigation of every individual complaint that comes to its attention.⁹³

5.74 Furthermore, the CCLC highlighted that even in the face of 'extensive poor conduct' in lending in Australia, the laws then were limited and cases 'very difficult to win'.⁹⁴ It stated:

...prosecuting a case in relation to the conduct of an individual entity under the ASIC Act (without the credit laws) is a resource intensive exercise and will not necessarily result in the players being banned from the industry now. It will certainly not turn back time, nor enable consumers to keep assets they could not afford in the first place, or to retain assets used for security when the funds have been expended for the consumer's benefit.⁹⁵

91 ASIC, *Submission 45.1*, p. 8.

92 See paragraph 5.56.

93 CCLC, *Submission 194*, p. 16.

94 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

95 CCLC, *Submission 194*, p. 15.

5.75 According to the CCLC, 'expending resources investigating conduct that has already been identified as a problem and has been the subject of major law reform is also clearly of limited value'.⁹⁶

5.76 The committee understands that ASIC's role between 2002 and 2010 when the new credit laws came into force was limited. The fact remains, however, and is a potent lesson for the regulator, that despite all the warning signs, ASIC remained in the background while borrowers found themselves exposed to unscrupulous lending practices and at risk of losing their homes and life savings.

Conclusion

5.77 The committee understands that ASIC receives a large number of complaints and reports of alleged wrongdoing and that it cannot possibly deal with such a large volume of individual complaints. But it also believes that individual complaints can provide early markers of a broader problem that ASIC should monitor and address. In this particular case of irresponsible lending, each single complaint was symptomatic of a more widespread and growing problem.

5.78 The one compelling lesson to be learnt from the many cases of predatory lending that occurred between 2002 and 2010 is that ASIC must be more proactive and more assertive in stepping forward and exposing poor practices as soon as they surface. The committee concludes that ASIC should have done more to:

- alert the public to the dangers of irresponsible lending and of the practices of some brokers that put their clients' interests at risk;
- inform consumers about the need to protect their interests when entering into a loan: to make sure that it was affordable and warn them of the pitfalls of particular loans such as low doc loans;
- educate the public about the importance of requesting and reading key documents and the dangers of signing incomplete documents;
- identify that a systemic problem was emerging or already entrenched in the industry that needed decisive action to prevent further consumer harm;
- take a stand against and investigate fraudulent activity such as the allegations of doctored loan documents including forged signatures and fabricated information, and of possible unconscionable conduct (enticing vulnerable people to take out unaffordable loans);
- engage the banks in serious conversation about their duty to 'exercise the care and skill of a diligent and prudent banker', as stated in subsection 25.1 of the Code of Banking Practice, and urge them to adhere to this undertaking;

96 CCLC, *Submission 194*, p. 16.

- join forces with ASIC-approved external dispute resolution schemes to combat the misuse of loan service calculators and loan application forms, and any behaviour in the credit industry that went to unconscionable conduct; and
- improve the way it conversed with borrowers who were seeking the regulator's assistance.

5.79 Some recommendations that would have flowed naturally from the evidence presented in this chapter have been made redundant by recent reforms. There are others, however, that remain relevant but are developed and appear in later chapters. Noting ASIC's existing work on financial literacy, the committee, for the moment, makes the following recommendation.

Recommendation 1

5.80 The committee recommends that ASIC develop a multi-pronged campaign to educate retail customers about the care they need to take when entering into a financial transaction and where they can find affordable and independent advice or assistance when they find themselves in difficulties because of that transaction.

New credit laws

5.81 Due to the national credit reforms implemented in 2010, many of the unscrupulous practices identified in this chapter should now be unlawful and people involved in the provision of credit, including intermediaries such as brokers, subject to tighter regulation. In the following chapter, the committee considers the new credit laws and their effectiveness in protecting consumers from irresponsible lending practices.

