

14 March 2017

Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Secretary

Inquiry into Consumer Protection in the Banking, Insurance and Financial Sector

1 About CCLSWA

- 1.1 CCLSWA is a not-for-profit community legal centre based in the Perth metropolitan area. We advise and advocate for consumers on consumer credit issues and Australian Consumer Law related problems.
- 1.2 CCLSWA operates a telephone advice line service, which allows consumers to seek information and legal advice. CCLSWA also provides:
- Assistance for financial counsellors and other consumer advocates who work closely with disadvantaged and low-income individuals for the resolution of their credit and debt related problems;
 - Community legal education programmes relating to credit and debt issues, and the Australian Consumer Law;
 - Financial literacy programmes to high school students and select groups within the community;
 - Contributions to relevant policy and law reform initiatives; and
 - A training and supervision programme for law student and graduate volunteer paralegals.
- 1.3 In providing these services, CCLSWA aims to create awareness, knowledge and understanding of consumer issues related to banking and financial institutions, and the Australian Consumer Law.

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- 1.4 We seek to assist the Western Australian community with developing just and fair relationships with banks and financial institutions. We also aim to advance public interest and awareness through participating in community legal education and policy and law reform.

2 Summary of our submissions

- 2.1 CCLSWA welcomes the opportunity to contribute to the consumer protection in the banking, insurance and financial sector inquiry (**the Inquiry**). Our submission responds to the Inquiry's terms of reference released on 29 November 2016.

- 2.2 Our submission will address the following parts of this Inquiry's *Terms of Reference*:

“1 (a) any failures that are evident in the current laws and regulatory framework, and enforcement of the current laws and regulatory framework, including those arising from resourcing and administration;

2 (b) the impact of misconduct in the sector on victims and on consumers;

3 (f) the social impacts of consumer protection failures in the sector, including through increased reliance of victims on community and government services; and

4 (h) any related matters”

- 2.3 The scope of the Inquiry is very broad; therefore CCLSWA will tailor the submission to focus on the inadequate consumer protection surrounding individuals who provide guarantees for small business loans. In particular, we argue that these individuals are consumers who are not connected with the business, but they receive no consumer protection under the *National Credit Code (NCC)*. In doing so, we respond to all 4 terms of reference listed above.

- 2.4 CCLSWA has encountered many instances where the small business borrower was unable to meet its repayments and defaulted on the loan, resulting on the individual guarantor being called upon to repay the balance of the loan. When the guarantor contacts CCLSWA for advice, they are often unaware of their obligations concerning guarantees. They are often not involved in the business; however, they have agreed to be a guarantor because of the relationship that exists between the borrower and the guarantor. Consequently, some guarantors are involved in lengthy and costly court proceedings. These cases will be discussed later in the submission and will predominately focus on the relationship that exists between:

- a. parent and adult child; and
- b. husband and wife.

3 Inadequacy of current law and regulatory framework

- 3.1 The current law, comprising of common law, equity and statute,¹ does not adequately protect individual consumers who provide guarantees for small business loans.
- 3.2 Case law suggests that a recurring and highly significant theme in guarantee transactions is the personal relationship between the borrower and guarantor.²
- 3.3 CCLSWA receives many calls from parents who have provided guarantees for loans for their child's business, and for which the parent did not receive any benefit. The client contacts CCLSWA for advice once the bank has sought to enforce the guarantee against them. A typical case would usually involve a parent being approached by their adult child to be a guarantor for a loan for the benefit of the child's business. The transaction would also involve the parents' using the family home or other asset as security for the loan. The parent is usually unaware of the potential consequences of entering into the transaction and, over time, may even forget about the existence of the loan or guarantee. The parent is usually only reminded of their entry into the transaction once the lender seeks to enforce the guarantee. The parent would usually be shocked at receiving notices of demand or court documents, and would seek advice from CCLSWA.
- 3.4 The following case study is a typical case that CCLSWA encounters.

Case study 1 – The Langdons

Mr and Mrs Langdon owned their own home, Asset A. Mr and Mrs Langdon were a migrant couple who spoke limited English and did not read or write in English. Their son, Adam, asked them to be the guarantors for a business loan. The initial loan was for \$600,000. Mr and Mrs Langdon agreed to be unlimited guarantors and gave their family home, Asset A, as security for the loan. The loan was also secured by a property owned by Adam, Asset B.

After 12 months, Adam was unable to repay the loan and agreed with the lender to extend the loan period and increase the loan amount by \$500,000. The lender did not communicate this to Mr and Mrs Langdon. At the end of the extended loan period, Adam was unable to repay the loan and the lender commenced proceedings to enforce the loan including the guarantee provided by Mr and Mrs Langdon.

Mr and Mrs Langdon are currently challenging the guarantee in the courts as the lender is not a member of a free dispute resolution scheme.

As the loan was for business purposes, the NCC did not apply.

¹ *Australian Securities and Investment Commission Act 2001* (Cth).

² See: *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447; *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395; *Barclays Bank plc v O'Brien* [1994] 1 AC 180; *Peters v Commonwealth Bank of Australia* [1992] ASC 57; *Akins v National Australia Bank Ltd* (1994) 34 NSWLR 155.

When asked about their motivations for providing the guarantee, Mr and Mrs Langdon said that their concern for Adam and their wish to assist him because he was their son motivated them to become guarantors. They also indicated that they placed a significant amount of trust in Adam because he was their son. Due to the level of trust they had in their son, Mr and Mrs Langdon did not focus on the financial aspects of the transaction and the potential implications for their family home if the loan was not repaid.

- 3.5 This case supports our views that most individual consumers who provide guarantees belong to categories of people who are traditionally considered vulnerable; and, given their personal relationship with the borrower, generally enter into guarantees for emotional rather than financial reasons. The above case illustrates how this unconditional love, trust and confidence a parent places in their child is the force behind them agreeing to sign on as guarantor.
- 3.6 As the law currently stands, such individuals may seek to deny liability on the basis that they were unduly influenced into entering the loan contract as guarantors; or there was some form of unconscionable conduct when they entered into the loan contract as guarantor. The protections under the NCC would not apply to these guarantors.
- 3.7 The following is a discussion of the current protections available:

3.1.1 Undue Influence

A court may set aside a guarantee if it can be established that the guarantor was unduly influenced into entering into the loan contract. Undue influence is the improper use of the ascendancy acquired by one person over another for his or her benefit, so that the acts of the person influenced are not in the fullest sense of the word, his or her free, voluntary acts.³ Undue Influence looks at the underlying relationship between the parties at the time the transaction was entered into and asks whether the nature of that relationship impaired the quality of consent that was given.⁴

As the law currently stands, to establish undue influence there are two elements which need to be established:⁵

- (1) there must be a relationship capable of giving rise to the necessary influence; and
- (2) the influence generated by the relationship must have been abused. There must have been some improper use.

³ *Union Bank of Australia Ltd v Whitelaw* [1906] VLR 701: See also *Allcard v Skinner* (1887) 36 Ch D 145.

⁴ *Commonwealth Bank of Australia v Armadio* (1983) 151 CLR 447; Cf Common Law duress.

⁵ *National Commercial Bank (Jamaica) Ltd v Hew* [2003] UKPC 51 (30 June 2003) [32] per Lord Millett; *Allcard v Skinner* (1887) 36 Ch D 145, 182-3 (Lindley LJ).

Given that the lender is unlikely to be the person exerting undue influence, the lender must usually be shown to have known or ought to have known about the undue influence exerted on the individual by the person in entering into the loan or guarantee.⁶

To demonstrate that there was undue influence exerted, it must be shown that either:

- (1) the relationship was of a nature where actual undue influence was exerted;⁷
or
- (2) there was a presumed relationship of influence, either as a matter of law or proof of the existence of a special relationship of influence.⁸

Currently, there is no presumption of a relationship of influence between a parent and their adult child regardless of the degree of dependency. Thus, if a parent wishes to prevent the lender from enforcing the loan or guarantee, the parent must demonstrate that there was actual undue influence by the person and that the bank had notice of the undue influence.⁹

Case study 2 – The Langdons continued

Mr and Mrs Langdon had received independent legal advice, and the implications of entering into the guarantee were communicated by the lawyer to Mr and Mrs Langdon. However, the trust and concern Mr and Mrs Langdon had for Adam rendered the legal advice ineffective.

Mr and Mrs Langdon repeatedly cited their trust in Adam and ignored the legal advice. Mr and Mrs Langdon seemed eager to provide the guarantee notwithstanding the implications of default and their knowledge of Adam's lack of employment. Mr and Mrs Langdon also did not consider it likely that their guarantee would be called upon because in their opinion the sale of Asset B would pay off the loan. They admitted to not reading the guarantee before signing it.

It was clear that Mr and Mrs Langdon disregarded the lawyer's advice and ignored the consequences of entering into the transaction. They preferred to believe that the most optimistic scenario whereby Adam would repay the loan and the guarantee would not be called upon would be the outcome.

This case further illustrates that many parents agree to be guarantors due to their unconditional love for their child; even when they understand the nature of the risks

⁶ *Australian Guarantee Corporation Ltd v McClelland* [1993] ASC 56-230, *Royal Bank of Scotland plc v Etridge [No 2]* [2001] UKHL 44.

⁷ *Bank of Credit and Commerce International SA v Aboody* [1990] 1 QB 923; *Barclays Bank plc v O'Brien* [1994] 1 AC 180, 189-90.

⁸ *Johnson v Buttress* (1936) 56 CLR 113, 119; *Bank of Credit and Commerce International SA v Aboody* [1990] 1 QB 923.

⁹ *Johnson v Buttress* (1936) 56 CLR 113, 134.

associated with the transaction into which they are entering. They do so simply because they do not want to damage their relationship by refusing to act as a guarantor.

3.1.2 Unconscionable conduct

A court may set aside a guarantee if the guarantor establishes that there was unconscionable conduct by the lender in obtaining the guarantor's consent to the giving of the guarantee.

Under the common law, the guarantor must first show that:¹⁰

- (1) the guarantor suffered from some special disability or was in some special situation of disadvantage (this may be because of age, sickness, mental incapacity, illiteracy or lack of education);¹¹
- (2) the lender knew or ought to have known of the existence of that condition or circumstance and of its effect on the ability of the guarantor to make a judgment as to the guarantor's own best interests; and
- (3) the lender takes unfair advantage of the lender's superior position by entering into the transaction.

Once the guarantor proves the above elements, the onus passes to the lender to establish that the transaction in the circumstances was fair, just and reasonable.

CCLSWA often receives calls from a spouse, de-facto partner or ex-partner who has felt pressured into signing a guarantee due to the relationship that exists between the 2 partners.

Case law shows that it can often be difficult for a wife to succeed in having a guarantee set aside on unconscionability grounds as in order to succeed, the wife must not have received any kind of benefit.¹²

The following case illustrates a common example CCLSWA encounters where a spouse, de-facto partner or ex-partner has felt pressured into signing a guarantee due to the relationship that exists between the two.

Case study 3: Stella's Story

Stella was married to Alan for many years and they had a son together. After 30 years of marriage, the couple decided to separate.

¹⁰ *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, 462.

¹¹ See *Blomley v Ryan* (1956) CLR 392, 405 which outlines factors indicating a special disability.

¹² *Yerkey v Jones* (1939) 62 CLR 649, 679.

Shortly after Stella separated from Alan, she was contacted by her ex-husband requesting that she provide a guarantee for a \$30,000 loan. Alan assured Stella that the purpose of the loan was to pay off some of his debt, get up to date with his mortgage repayments and to cover travel expenses for a job he had lined up overseas. Stella felt guilty and was subsequently pressured into agreeing to sign the guarantee.

There was a meeting at Stella's home, attended by her ex-husband and Mr Bamboo, her ex-husbands solicitor. At this meeting Stella found out that the loan was actually for \$100,000 which she did not want to agree to, however, once again felt pressured to sign the guarantee. Stella gave a mortgage over her own property securing the loan. She did not receive any independent legal advice before signing the documents, nor did she receive any benefit from the loan and she was not given signed copies of the documents executed at the meeting.

Stella later found out that the loan was actually advanced to 'Upbeats Pty Ltd', Alan's company. Furthermore, the loan was actually a business kicker starter loan rather than a personal loan. Alan defaulted on his repayments and has since disappeared leaving Stella to deal with the lender.

When asked why she agreed to be guarantor, Stella stated that she felt guilty, and that they still had a child together who were at the time living with Alan. Ultimately, Stella succumbed to Alan's request and felt deeply pressured into signing the guarantee.

As the loan was for business purposes, the NCC did not apply to the loan or guarantee. CCLSWA is currently assisting Stella, claiming undue influence, unconscionable conduct and special wives equity. Had the NCC applied, more stringent rules would have applied to the credit provider, Stella would have been required to seek independent legal advice, and would have been given at least 14 days to review the documents before signing them.

3.1.3 *Special wives' equity*

CCLSWA has encountered several instances involving wives seeking to set aside guarantees provided by the wife to either guarantee loans to support a new business venture of their husband or an loans to an existing business. These clients have reported that at the time they signed the guarantee, they did not understand its contents, nor their obligations or the ramifications should they be pursued by the lender. The relationship between husband and wife can be similar to the relationship between a parent and an adult child, in that the personal circumstances, vulnerability, dependency and emotional relationship between the husband and the wife creates a strong reason for the wife to enter into these transactions.

Case study 4: The Jacksons

Mrs Jackson is from the middle east and was married to Mr Jackson. Upon arriving to Australia, Mrs Jackson was totally dependent on her husband as she spoke very little English. While the couple were married, Mr Jackson started a small business; Mrs Jackson did not work in the business nor did she receive any benefits from the business.

Mrs Jackson provided a guarantee for a loan taken out by her husband. However, when she signed the guarantee, Mrs Jackson could not speak English well and due to the complexity of the document, she did not understand its contents. A translator was not used. Mrs Jackson did not have any contact with the credit provider before or after signing the guarantee, and did not receive any documents from them. Several years later Mr Jackson became bankrupt. Mrs Jackson received a letter from the credit provider stating that she was liable under the guarantee.

As the loan was for business purposes, the NCC did not apply.

CCLSWA was able to dispute the claim and lodged a claim with the Financial Ombudsman Service on the grounds of unconscionable conduct and special wives equity. The final determination found the guarantee to be unenforceable. Although CCLSWA was successful, this was a difficult argument to make out, and the dispute resolution process took some time to produce a positive outcome.

The above case illustrates how the doctrine of unconscionable conduct has particular relevance in relation to guarantees given by spouses to support the other spouse's borrowings. The Australian Law stems from the High Court's decision in *Yerkey v Jones* (1939) 62 CLR 649. The principle of 'special wives' equity' in *Yerkey v Jones* gave married woman seeking to set aside guarantees special treatment, when compared to other guarantors; in situations where the husband procures the wife's consent. The principle operates as a rule of evidence, placing the burden on the creditor to establish that the guarantor wife has a full understanding of the transaction.

In the case of *Yerkey v Jones* the High Court decided that a guarantee may be void against a lender if:

- (1) the lender permitted the borrower to obtain the signature of the guarantor; and
- (2) the borrower exercised undue influence over the guarantor in obtaining their signature; and
- (3) the lender was aware of the circumstances giving rise to the relationship of influence; and

- (4) the lender took no measures to counter any undue influence, for example ensuring that the guarantor was aware of the nature and effect of the guarantee.

The High Court affirmed the rule in *Garcia v National Australia Bank* (1998) 194 CLR 395 and held that the principle will apply to a business loan where the borrower is a business controlled by the husband. If the wife is able to prove the elements set out above, the lender has the burden of proving that the transaction was not the result of undue influence but was the free and voluntary act of the guarantor.

While the rule in *Yerky v Jones* and *Garcia* remain, and CCLSWA has been able to successfully apply the principles, the dispute resulted in an extensive dispute resolution process for both parties.

Case study 5: Yuki's Story

Yuki was born in Japan and emigrated to Australia in 2005. Her spoken English is enough to get her by on day to day basis, but her reading and writing skills in English are poor. In 2006, Yuki married Mr Cooper and they had two children. In 2008 Mr Cooper passed away, and Yuki had the home transferred to her name. The family home was and is Yuki's only significant asset.

In 2011, Yuki began dating Mr Price. The couple had been dating for one year and in January 2012, Mr Price suggested that they buy a business – a consulting firm. Yuki left it to Mr Price to speak to Mr Polo (broker), Mr Marco (agent) and Bank Z.

Yuki did not have any experience in consulting, or any business for that matter. Her usual employment was as a cleaner.

In July 2012, Bank Z made an offer for the Business Loan and overdraft to 'Multi S'. Multi S was a company set up by Mr Price in which Mr Price was the sole shareholder, director and secretary. Yuki provided two forms of security for the Business Loan and Overdraft. Yuki signed the Letter of Offer and Guarantee in Mr Marco's (agent) office, in the presence of Mr Marco and Mr Price. Mr Price also signed an individual guarantee and indemnity in favour of Bank Z. However, he did not provide any real or personal property as supporting security for his guarantee.

Yuki met with Mr Marco only once when she signed the guarantee in his office. The meeting lasted 15 minutes and Yuki had a stack of paperwork to sign. Mr Marco only addressed Mr Price and that she felt very rushed. Further, Mr Marco did not give Yuki an opportunity to read the Guarantee (or take it home overnight to read), nor did he say that she could or should seek independent legal advice before signing it.

Yuki had never been a guarantor before and did not understand what giving a guarantee meant.

The consulting business was never profitable and in 2014, Mr Price closed the business down. Mr Price moved out of the family home and disappeared. Consequently, Yuki was left with paying off the loan.

It took CCLSWA two years to negotiate with Bank Z to have the guarantee set aside on grounds of unconscionable conduct and undue influence. While we were successful, it was an extremely lengthy process. Had the NCC applied, the credit provider would have been bound by far more stringent rule, allowing Yuki to seek independent legal advice, and give her at least 14 days to read over the guarantee. This would have allowed Yuki to gain an understanding of what a guarantee was.

3.8 ***Extending the NCC***

- 3.9 The *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**), the NCC which is included in Schedule 1 of the NCCP Act, and *National Consumer Credit Protection Regulations 2010* (Cth) make up the consumer protection law for credit in Australia.¹³ The purpose of the NCCP Act is to regulate credit industry participants and to protect consumers and the economy by encouraging responsible lending and some flexibility in response to financial hardship. Currently, the NCC is applicable to credit contracts that were commenced on or after 1 July 2010, where the borrower is a natural person or strata corporation and the loan is predominately for personal, domestic or household purposes.¹⁴ The NCC also applies to credit contracts entered into on or after 1 July 2010 to purchase, renovate or improve residential property for investment purposes.¹⁵ This means, if the credit is provided for business purposes, or for investment other than residential property investment, the NCC does not apply to the transaction.¹⁶
- 3.10 The term consumer is defined in section 5 of the NCCP Act and includes a natural person or strata corporation.¹⁷ CCLSWA is funded to provide legal advice to consumers. In our view, an individual who acts as a guarantor for a business loan may be a consumer. CCLSWA submits that the NCC should be extended to cover individual consumers who provide guarantees for small business loans, and who are not involved in the business. This is because the consumer is a volunteer, who is providing the guarantee without receiving a benefit from the business, and therefore, should be afforded consumer protection.
- 3.11 Furthermore, beyond licensing, external dispute resolution membership and responsible lending obligations, many of the protections in the Act could assist individual guarantors who are not connected with the small business. For the law to provide effective protection for such consumers, the NCC should firstly recognize such individuals as consumers; and secondly, the NCC should encapsulate the entire

¹³ See also Code of Banking Practice.

¹⁴ *The National Consumer Credit Protection Act 2009* (Cth) sch 1 s 5(1).

¹⁵ *Ibid.*

¹⁶ *Ibid* s 5(4).

¹⁷ *The National Consumer Credit Protection Act 2009* (Cth) s 5.

span of the transaction; from the formation of the contract, its operation, right up to the time of its enforcement or termination.

3.12 If the NCC were extended, it could be applied in the following ways:

- (1) Guarantors would be entitled to the statutory disclosures under s 55(3) of the *NCC*. That is a form 8 'warning box' placed immediately above, and on the same page as where the guarantor signs, or the guarantee would be unenforceable;¹⁸
- (2) guarantors would need to be given a copy of the credit contract before signing the guarantee;¹⁹ and
- (3) guarantors would need to be given a form 9 'information statement' under s 56(1)(b); however this is a breach of the *NCC* that does not render the guarantee unenforceable;²⁰
- (4) guarantors would generally need to be given a signed copy of the guarantee within 14 days after signing.²¹
- (5) the guarantee would not automatically cover any increases in the liability under the underlying credit contract;²² and
- (6) the 'unjust transactions' provisions under s 76(1) of the *NCC* could apply.

3.13 Extending the reach of the NCC to consumers who provide individual guarantees for business loans would provide these consumers with clear protections, and provide them with access to free EDR schemes.

3.14 Furthermore, if the NCC were extended to include individual guarantors who are not connected with the business, it would be clear that CCLSWA would be able to provide legal advice to such consumers. Secondly, as case law illustrates, the legal doctrines in relation to third party guarantees are highly complex and expensive to litigate;²³ therefore, by extending the NCC to individual guarantors of small business, it will be a step towards preventing guarantors from signing up to unjust loans, rather than simply relying on reactionary processes.

4 Conclusion

4.1 The Terms of Reference of this Inquiry concern the regulatory framework for the protection of consumers, including small businesses, in the banking, insurance and financial services sector. CCLSWA submits that this or a subsequent committee should revisit a number of issues facing individual consumers providing guarantees

¹⁸ *The National Consumer Credit Protection Act 2009* (Cth) sch 1 s 55(4).

¹⁹ *Ibid* sch 1 s 57(1)(a).

²⁰ *Ibid* sch 1 s 56(2).

²¹ *Ibid* sch 1 s 57.

²² *The National Consumer Credit Protection Act 2009* (Cth) sch 1 s 61.

²³ See: *European Asian of Australia Ltd v Kurland* (1985) 8 NSWLR 192, *Akins v National Australia Bank* (1994) 34 NSWLR 155; *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.

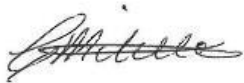
to small business, given that these individuals are consumers but currently receive no consumer protection.

- 4.2 As outlined above CCLSWA submits that legal reform and extension of the NCC is necessary to afford sufficient protection to these consumers.

CCLSWA is grateful for the opportunity to comment on this inquiry. If you have any questions or would like to discuss this matter further, please contact Gemma Mitchell on (08) 6336 7020.

Yours faithfully

Consumer Credit Legal Service WA Inc.

A handwritten signature in black ink, appearing to read 'G Mitchell', written in a cursive style.

Gemma Mitchell
Acting Centre Manager and Principal Solicitor