

CONSUMER CREDIT (BILL FACILITIES) AMENDMENT REGULATION 2006

I SUMMARY

Pursuant to s.7(5), the Uniform *Consumer Credit Code 1995* (the Code) does not apply to the provision of credit arising out of a bill facility. However, section 7(5) also allows for the application of the Code, by regulation, to the provision of credit arising out of a bill facility.

The Consumer Credit (Bill Facilities) Amendment Regulation 2006 will apply the Code to credit arising out of a bill facility.

II MAKING A SUBMISSION

All interested individuals and organisations are encouraged to provide comment on the Consumer Credit (Bill Facilities) Amendment Regulation 2006.

Comments in writing should be forwarded to:

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Uniform Consumer Credit Code
Management Committee
Department of Consumer and Employment Protection
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As the amending regulation is comparatively minor and given the urgency of this matter, the closing date for submissions will be expedited to 12 May 2006.

III BACKGROUND TO BILL FACILITIES

Section 7(5) of the Code provides that:

This Code does not apply to the provision of credit arising out of a bill facility, that is, a facility under which the credit provider provides credit by accepting, drawing, discounting or endorsing a bill of exchange or promissory note. However the regulations may provide for the application of the Code to the provision of all or any credit arising out of such a facility.

Bills of exchange and promissory notes facilities are commonly used instruments in the corporate/commercial money market. The Code does not define these instruments however principles on their usage has evolved based on the *Bills of Exchange Act 1909 (Cth)* and general law.

A bill of exchange is an unconditional order in writing to pay a fixed sum of money at a nominated time to a nominated person (or to the bearer or holder of the bill). A borrower, which draws a bill, gets its loan or “credit” by selling the bill. In the corporate/commercial market that sale is usually to a bank.

Promissory notes involve an unconditional obligation to pay a fixed sum of money on a future date. A borrower obtains its “credit” by issuing a note or selling it. The purchase price paid by the purchaser of the note provides the funds to the borrower (or issuer of the note) and in return the borrower agrees to pay the fixed sum specified in the note at a future date. There are various means by which promissory notes can be then be dealt with, including the right to receive interest and the selling at a discount from the face value.

IV NEED FOR A REGULATION

The Department of Consumer and Employment Protection in WA has noted the emergence of fringe providers operating in the WA marketplace using promissory notes. Similar examples have been noted in New South Wales using bills of exchange. In both cases, these credit providers target highly vulnerable consumers including Indigenous consumers and Centrelink recipients.

The profitability of these sorts of businesses increases markedly when borrowers default on their debts, as they often do. In one case the WA Department is aware of, an initial debt of approximately \$300 resulted in a debt of \$4,866 in a relatively short space of time. In this case the revised repayment schedule entered into by the borrower provided for 98 repayments over the period from 1 April 2005 to 19 December 2008.

In June 2005, the Geraldton Magistrates’ Court advised that a fringe provider had lodged 137 applications for judgment summonses in the past 18 months (January 2004 to June 2005). The Geraldton Magistrates’ Court also advised that the number of appearances by clients of this single lender has increased from around two or three per week in early 2004, to the current rate of around 10 to 12 per week. Many clients appear a number of times for the same debt. Further, the Department has received

reports of approximately 14 clients of the same lender appearing each week in both the Bunbury and Joondalup Magistrates Courts.

Based on statistics obtained to date, it can be conservatively estimated that in 2005, there will be at least 7000 appearances by consumers pursued through the courts for repayment of debts owed by these businesses operating in WA.

The use of the bill facilities exemption for consumer credit can be illustrated by the following case study provided by the Office of Fair Trading, NSW. It is understood that this arrangement is based on a 'successful' UK model.

The consumer is provided with finance of \$2,500 to repair her car on the basis of a bill of exchange. The consumer's monthly income is \$1,070 derived from a disability and carer's pension. The bill of exchange forms the basis for the agreement that the credit provider will provide a 'credit facility' equal to the sum specified on the bill of exchange. The bill of exchange specifies the period, the amount (face value) and the interest to be paid per month expressed as a percentage. The bill of exchange is signed by both the credit provider and the consumer. The "credit facility" is conditional upon the consumer providing a signed:

- Bill Facility Agreement;
- Vehicle mortgage; and
- Power of Attorney.

The consumer agrees to repay the sum shown on the bill of exchange by a repayment date specified in the Bill Facility Agreement. This agreement sets out the credit charges and payment date for those charges (in this case, \$375 per month). During the term of the credit facility, the consumer must pay a 180% APR based on the face value of the bill of exchange.

The credit facility is offered for 3 months and can be extended for a further 3 months if the interest is paid on time. The consumer is able to retain the use of the car throughout the term of the credit facility. The documentation makes it clear that the normal protections provided under the Code do not apply. If the consumer fails to pay the interest and/or principal on the due dates, the consumer is required to pay the following:

- Loan application fee - \$50
- Late payment advice letter - \$25
- Termination letter - \$50
- Repossession fees - \$500
- Interest after termination - 15% per month
- Legal fees - as incurred, plus 10% surcharge for admin.

The exploitation by consumer credit providers of the bill facilities exemption is clearly in conflict with the Code's policy objectives of ensuring that all consumer credit is covered.

The proposal to apply the Code to credit arising out of a bill facility was originally part of the fringe lending package of reforms. Given the substantial detriment already being borne by vulnerable and disadvantaged consumers, the Ministerial Council on Consumer Affairs agreed to bring forward the making of the regulation to capture bill facilities.

The costs and benefits to industry, consumers and Government of bringing bill facilities within the Code are summarised in Attachment A which is drawn from the Regulatory Impact Statement proposed as part of the fringe lending reform package.

V THE REGULATION

The Consumer Credit (Bill Facilities) Amendment Regulation 2006 (the Regulation) has been prepared to apply the Code to the provision of credit arising out of a bill facility. The purpose of the Regulation is to ensure that lenders who provide credit by way of a bill facility (including bills of exchange and promissory notes) must comply with the Code's provisions. Bringing bill facilities within the operation of the Code will ensure:

- adequate and appropriate disclosure of material information is provided;
- in those states where interest caps are in place, that these are not being circumvented with APR's in excess of 4000 per cent per annum; and
- debt collection practices abide by the Code's protective provisions including the requisite notice periods and rights in relation to repossession.

The approach behind the drafting of the Regulation has been to provide a straightforward amendment that will apply the Code to credit arising out of bill facilities. In drafting the amendment, consideration was given to the meaning of "credit" and the "amount of credit" for the purposes of section 4(1).

The *Bills of Exchange Act 1909 (Cth)* applies to bill facilities including bills of exchange and promissory notes. Some provisions of the Code will be overridden by the *Bills of Exchange Act*, notably the enforcement provisions, however, it is not feasible to address these issues in the Regulation.

The Regulation exempts authorised deposit taking institutions (ADI's) as they sometimes use bill facilities to lend money to high net worth individuals. If bill facilities generally were regulated by the Code, then facilities offered by banks to high net worth individuals for personal purposes would be caught. This is not the policy outcome that is sought by the making of this Regulation. To ensure that these types of arrangements are not covered by the draft regulation, sub-section (1) specifically excludes bill facilities provided by an ADI. This approach is consistent with regulation 6F of the *Consumer Credit Regulation 1995*, which exempts short term credit provided by ADIs.

ATTACHMENT A

5.2.3. PREVENTING AVOIDANCE OF THE CODE

5.2.3.1 COSTS/DISADVANTAGES – PREVENTING AVOIDANCE OF THE CODE

Costs to fringe credit providers

- Those credit providers who utilise exemptions in inappropriate cases may lose business to those credit providers who are Code compliant as consumers make informed choices (because of the Code's disclosure regime) and decide upon alternative arrangements.
- Fringe providers, who are currently avoiding the application of the Code, may now be subject to the Code and incur increased compliance costs including initial legal advice and training of employees as well as ongoing compliance costs.

Costs to borrowers

- It is possible some negative impacts could be felt by the passing on of initial and ongoing administrative costs (as identified above) to borrowers incurred by lenders in complying with the Code amendments. It is uncertain how many credit providers will incur extra administrative costs, which may then be passed onto consumers.

Costs to mainstream credit providers

- Mainstream lenders may experience less certainty and a small proportion may err on the side of caution, rather than risk legal challenge and assume that the borrower is subject to the Code with the resultant administrative costs associated with Code compliance.
- There would be minimal costs to mainstream lenders as a result of removing the bill facility exemption as most commercial users of bill facilities would not be captured by the Code as the bill facility is not used for personal, domestic or household purposes.

Costs to Government

- There would be initial administration cost associated with amending the Code and educating both consumers and credit providers of the amendments.
- There would be additional enforcement costs to that noted for the status quo in ensuring that the new provisions are being complied with.

5.2.3.2 BENEFITS/ADVANTAGES – PREVENTING AVOIDANCE OF THE CODE

Benefits to fringe credit providers

- Preventing rogue fringe credit providers from bypassing the Code could impact positively on the market's reputation and consumer confidence, leading to increased business.
- Those fringe credit providers who are Code compliant may gain business from credit providers who currently use exemptions because consumers are now better able to compare loans across the consumer credit market based on information disclosed under the Code.

Benefit to borrowers

- If the amendments were effective in preventing lenders from styling consumer credit arrangements to fall outside the ambit of the Code, consumers would be provided with disclosure and other protections and remedies under the Code that are not currently being provided to these borrowers.
- The disclosure requirements under the Code will help borrowers understand and compare loans which will lead to lenders competing with each other forcing prices down for consumers.
- The benefit to borrowers who previously had been given credit pursuant to a bill facility would include that payments are not accelerated to provide for full payment upon a default and debt collection practices abide by the Code's protective provisions including the requisite notice periods and rights in relation to repossession.

Benefits to mainstream credit providers

- Mainstream credit providers may benefit to the extent that they have products which appeal to the same market serviced by fringe credit providers as the Code's disclosure rules mean they will be able to compete on an equal footing with fringe credit products that do not currently comply with this regime.