



**AUSTRALIAN BANKERS' ASSOCIATION INC.**

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Ms Pamella Criddle  
National Project Officer  
Uniform Consumer Credit Code Management Committee  
Department of Consumer and Employment Protection  
Locked Bag 14  
CLOISTERS SQUARE WA 6850  
By email: [credit@docep.wa.gov.au](mailto:credit@docep.wa.gov.au)

Dear Ms Criddle,

**Pre-contractual Disclosure under the Consumer Credit Code**

Thank you for the consultation package "Pre-contractual Disclosure under the Uniform Consumer Credit Code Consultation Package" received on 30 December 2005 and for the opportunity to comment.

The Australian Bankers' Association is the peak national representative body for 26 banks authorised by the Australian Prudential Regulation Authority to carry on the business of banking in Australia. The ABA's membership comprises the four major banks, regional banks and a number of foreign banks. In addition, the ABA's members hold Australian financial services licences issued by the Australian Securities and Investments Commission pursuant to the financial services reform legislation contained in Chapter 7 of the Corporations Act 2001(FSR).

**ABA does not support proposed "streamline" amendments**

The ABA does not support the proposed "streamline" amendments set out in the consultation package for the following reasons:-

- (1) The proposed amendments differ in one material respect from recommendation 1.1 of the December 1999 Post Implementation Review Final Report (PIR) into the Consumer Credit Code (UCCC).
- (2) The PIR recommendation was made over 6 years ago but there are no plans to test the relevance of the new disclosure model by simulation or survey prior to implementation despite the potential costs to be imposed on industry.

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- (3) Alternative, up to date pre-contractual disclosure models have not been considered.

## **1. Material departure from PIR recommendation 1.1**

The ABA does not agree with the statement in the consultation package material that the proposed amendments reflect the policy intention of PIR recommendation 1.1. The PIR stated that the proposed summary document would replace the current pre-contractual disclosure document. Specifically, the PIR provided that the pre-contractual disclosure document could be separate from the contract document or be part of the contract document (as is currently the case).

Regulation 13(5) currently permits the financial table to be set out on the front of and as part of other prescribed pre-contractual disclosures comprised in the proposed contract document or as a separate document.

The proposed summary document referred to in the consultation package states specifically that it should "*be considered a separate requirement, requiring a separate document*".

This is a material departure from what was proposed in PIR recommendation 1.1.

This departure is material because it will entail credit providers producing a separate document and developing a new process requiring the separate document to be supplied to the customer independently of the proposed contract document.

Apart from system formatting changes, the proposed summary disclosure document will require consequential changes to staff procedural manuals and additional staff and representatives training to ensure that they understand that both documents have to be provided to the customer. The risk of non-compliance is increased where the documents are separate.

It is unclear to the ABA why the proposed simplified financial table cannot be provided as part of the proposed contract document as is currently the case. The decision not to test the form of disclosure with customers assumes that customers will find the new summary sheet of greater benefit than the current pre-contractual information.

## **2. The proposed summary sheet will not be consumer tested**

PIR recommendation 1.1 was made in 1999 in the context of a consumer credit market significantly different from the market we see today. Important changes that have occurred since 1999 include

- (1) The significant growth of finance brokers that have become an important source of comparative and other essential information for consumers with proposed national finance broker regulation delivering additional protections for consumers;

- (2) Much greater internet access by customers to conduct comparative shopping across credit providers websites;
- (3) Increased information sources for customers through "infomediaries" such as Cannex and Info Choice;
- (4) Entry of a much wider range of non-bank lenders including many self titled "non-conforming" lenders; and
- (5) Widespread financial literacy programs to assist customers with understanding and choice of credit product.

It should be clear to policy makers that there is a significant risk in taking forward a substantially altered UCCC pre-contractual disclosure regime based on a 5 year old recommendation with no plans to test the new disclosure by simulation or survey prior to implementation. To do so ignores past regulatory experiences that have not worked in the interests of customers. Two recent examples can be cited. First, the recent review of the mandatory comparison rate regime (MCR) has failed to produce convincing evidence that the customer benefit from the regime has outweighed the cost to the credit industry. It is noted in the Preliminary Impact Statement dated January 2006 prepared by Hawkless Consulting Pty Ltd that that the regulatory development process that led to the introduction of the MCR in 2003 was not based on written policy papers and a regulatory impact statement was not prepared at the time. Hawkless also observed that no data is available that illustrates the scope of the problem that existed prior to the introduction of the MCR.

Secondly, the Commonwealth's financial services reform legislation in Chapter 7 of the Corporations Act 2001 is a further example of a disclosure regime that at best was inconvenient and at worst of disadvantage to consumers. Extensive refinement of the regime based on consumer and industry experience has been necessary.

The ABA believes that evidence supports the view that the pre-contractual disclosure needs of customers vary considerably. This was a finding of the PIR and research conducted by the ABA in 1997 "*Uniform Consumer Credit Code Research; Key Results (Australian Bankers' Association 1997)*".

Currently there is no research to indicate what is essential and non-essential information to customers. Without demonstrated research or analysis, what is contained in the consultation package appears to be mere assumptions of those needs.

There is emerging theory advanced by consumer advocates based on "behavioural economics" that disclosure fails those consumers that are pre-disposed to act on their own judgments irrespective of what is disclosed to them or whether they are prepared even to read the disclosed material.

A central question for the credit industry is whether the industry is going to be required to reconfigure pre-contractual disclosure documentation and procedures after implementation of the consultation package proposals with the real

possibility of a further round of costly changes when the information needs of customers are better understood.

The ABA is strongly of the view that such a scenario must be avoided.

### **3. Alternative, up to date pre-contractual disclosure models have not been considered.**

A policy basis for PIR recommendation 1.1 was the view that pre-contractual disclosure was complex, excessive and often unhelpful to customers.

The consultation package proposals purport to address length and complexity. However, the proposed combined summary sheet would include more information than its Regulation 13 predecessor.

The untested assumption is that the existing pre-contractual disclosures are unhelpful to customers and that the information to be contained in the proposed pre-contractual disclosures will be of greater assistance to customers and used by them and will outweigh the cost to industry in making the necessary systems and documentary changes.

The ABA observes that no other, more up to date, simpler pre-contractual disclosure models have been considered. For example, learning from the FSR experience, new section 1012D (7A) of the FSR was introduced as a result of the Commonwealth Government's FSR refinement package to address the problem of excessive length of disclosures of the costs of financial products. Section 1012D (7A) provides a disclosure regime for certain basic deposit products and related non-cash payment facilities as a substitute for a product disclosure statement. The rationale for section 1012D (7A) is that existing codes of practice, for example the Code of Banking Practice, already provide for comprehensive disclosures. The ABA is not advocating the approach taken under section 1012D (7A) is necessarily suitable for consumer credit. However, this approach is an example of a new approach to the regulation of disclosure. The model under section 1012 D (7A) is simple by permitting certain costs to be disclosed upon request by the customer after the customer has been asked whether they require further costs information. If the customer wants this further information the financial services provider must provide that information. Importantly, the information must be provided in a clear concise and effective manner.

The consultation package model does not include consideration of pre-contractual disclosures that include a mix of prescribed and optional on request disclosures.

This omission demonstrates the absence of a solid research basis that identifies what information customers need and will use and other information that is of less importance to them.

The same applies in relation to the other existing categories of information that must be included in the financial table under Regulation 13. There is no research or customer testing proposed to justify altering those categories of information.

Although, the opportunity to address the length of disclosures through a refinement in the extent of disclosures of credit fees and charges has been taken.

Turning to the suggested questions to direct the focus for submissions:-

**4. Will the proposed amendments improve the consumer's ability to understand the key features of the credit contract? If not, what improvements could be made?**

It is not possible to answer this question or the supplementary questions without research that shows what factors and information will work in improving a customer's understanding of the features of the credit contract. There is little in the way of current empirical evidence to suggest that generally customers have insufficient understanding of their credit contracts. The fundamental policy consideration is what information will customers use, how should that information be presented and how will they use it for their understanding of the aspects of the credit contract that they want to understand. At present there is little to suggest that the existing pre-contractual disclosures would be any less helpful to customers in understanding their credit contract.

It is noted that the PIR was conducted in 1999 when the UCCC had been in operation for approximately 3 years. Since then the UCCC has operated for another almost 7 years and it could be expected that customers have become more familiar with the current pre-contractual disclosure regime. More so, because on average customers who took out loans in 1999 will have turned over their loans by now.

Banks have informed the ABA that they receive very few complaints or criticism from customers relating to the levels and complexity of pre-contractual disclosure. This could be due to the changes in the consumer credit market since 1999 and the increased information resources that are now available to consumers. Research would help to establish if this is the case.

More specifically, there is a substantial amount of information provided to consumers in a pre-contractual context when the inclusion of related financial products disclosures is taken into account. The proposal for a separate pre-contractual disclosure summary sheet would add another document to the paperwork.

Where now the financial table and proposed contract document may form a single document consumers can see that the single document discloses all the contractual terms. The proposed two-step disclosure risks consumers being uncertain as to which document sets out the complete details of their contractual arrangement.

There is also the risk that a customer will make decisions on the basis of the summary sheet without reading the proposed contract. Separating the documents increase the chances of this occurring.

Separation into two documents risks differences arising between the contract and the summary sheet if, for example while the customer dwells over the summary sheet before requesting the contract. Where both the financial table and proposed contract document are combined in a single document the risk of differences between the two is obviated. This raises the question of if changes occur, for example an interest rate change between the provision of the proposed pre-contractual disclosure and the final contract, will the credit provider be required to supply a second summary sheet even though the final contract will reflect the change?

The proposed pre contractual summary sheet information is not aligned with the way the same information may be expressed in the contract. For example, monthly service fees are required to be displayed as "an amount per annum". However, in the contractual disclosures and for the purposes of compliance with the Code of Banking Practice fees and charges are usually expressed as amounts payable, for example, monthly. Describing fees and charges as annual amounts in the summary sheet could confuse customers.

It is unclear whether disclosure of the term of the loan is to be required as "25 years" where loan repayments are calculated over a contractual term of say 25 years but the customer is free to terminate the loan earlier. Presumably, in the absence of default, the credit provider is not free to terminate the loan unless the loan is an "on demand" facility. It is assumed that the correct disclosure is intended to be "25 years". However, it is questionable what real value this has for the customer when the statistical probability is that the customer will retain the loan for only about four years.

Also, the requirement to state a loan term is not required in the credit contract.

These issues point to the need for a better research based understanding of what information is important to consumers so that they will use it. This should form the basis of a regulatory impact assessment so that the compliance costs to industry are understood from a cost and benefits perspective.

**5. Will the Financial Summary Table provide the right "snapshot" of the credit product? Are there any matters that should be included in the table or not included?**

These questions again rely, in part, on an understanding of what information matters to customers about the credit product as distinct from the contract. However, as already mentioned, there is no clear understanding of this.

Also, there are other aspects of the credit relationship that will be more important to some customers than others. For example, a portfolio facility where there is an ability to switch loan portfolios from one to another may involve switching fees that are payable only if that option is exercised. Similarly, with redraw facilities that permit redraws of repayments made in advance of the contractual minima, fees may be applicable. The proposed model would see disclosure of these fees excluded from the summary financial table and relegated to the summary of

other information. This assumption of what is or is not essential information for the customer could lead to the result that customers may not investigate the rest of the contract for fees that are more relevant to them. The separation of the summary sheet from the contract increases the chances of this result eventuating.

The ABA is concerned with the proposal for disclosure of the minimum (monthly) repayment calculated on a fully drawn credit limit on a revolving credit facility. Customers who might otherwise draw down prudently on their credit facility could be tempted to draw down far greater amounts relying on their ability to meet the minimum repayment only and being unable to repay the whole or a substantial part of the balance drawn down.

Pre-contractual disclosure of the minimum repayment also confuses the financial literacy message on the relationships between budgeting, spending and cost.

A message highlighting payment only of the minimum payment on a revolving credit facility is considered an unhelpful message to give to customers.

Also, Reserve Bank of Australia data shows that at any one time about 63% of credit card limits are unutilised.

## **6. Will the Summary of other information be useful for consumers? If not, in what way can it be improved?**

The concept of a snapshot of further information that is contained within the loan contract may be useful. However, the answer to this question depends again on an understanding of what information and its presentation is useful for customers.

The amount of information and explanation to be included in the summary of other information and the limitation of the disclosure to one page makes including all this information on one page potentially unachievable if legibility requirements under the UCC are to be complied with.

There will be an added obligation and cost on credit providers to update the summary of other information where changes to the credit contract result in different page and paragraph numbering, a problem not currently experienced with the existing Regulation 13 pre-contractual disclosures.

In cases where the contract is not delivered at the same time as the summary sheet (there is no requirement for the contract document to be provided with the proposed summary sheet) the customer will be unable to apply the references to the contract in the summary sheet until the contract is received. One advantage of the existing regime is that the contract document and the pre-contractual disclosure can be a single document.

There is some uncertainty over the requirements for disclosure of other information for example in proposed section 13(B) (4) (f) if there are circumstances where a credit fee may be waived. It is assumed that this is

intended to apply to fees where the contract provides for this event rather than fees that a credit provider may waive after hearing representations from the customer and exercises discretion accordingly.

**7. Are the definitions of “ongoing credit fees and charges” and “upfront credit fees and charges” sufficiently concise to enable credit fees and charges to be allocated between these categories? If not what improvements can be made?**

It seems that the concept of “retained credit fees and charges” under existing Regulation 13 is to be abandoned creating an increased amount of disclosure of fees and charges at the pre-contractual stage.

Also the definition of “upfront fees” may allow credit providers to avoid disclosure by deferring the payment of such fees until after the time of the first regular payment under the contract.

Also, with credit card contracts although an annual credit card fee is made and so becomes an “ongoing” credit fee the annual fee is debited to the credit card account before the first regular payment under the credit card contract is made. It should be clear for the purposes of disclosure that the debiting of the annual “ongoing” fee is not treated as “payable” before the first regular payment under the contract is made after the statement of account is received by the customer.

**8. Are the proposals sufficiently flexible to cope with innovations in credit products? If not, what changes need to be made to ensure flexibility?**

Whenever there is prescriptive disclosure there is the risk that the disclosures will become outmoded as product innovation occurs. The proposals are designed for traditionally structured credit products and therefore risk becoming outmoded.

In contrast, more recent disclosure models are outcome or principles based such as under the FSR and the requirements for product disclosure statements.

The ABA repeats its concern that a more flexible and up to date regime for pre-contractual disclosure has not been investigated or the proposed model tested with customers.

Also a concern already mentioned is whether the information required for the summary of other information can be confined to one side of an A4 page.

**9. Does the implementation of the proposed amendments have unforeseen consequences for consumers or credit providers?**

On a general view, in the absence of research and customer testing the risk of unintended adverse consequences for customers is increased. The example of the pre-disclosure of the minimum repayment amount on a revolving credit facility is mentioned.

There is also the potential for the distinction between "up front" and "ongoing" fees to be confused or exploited.

### **Other Considerations**

There will be substantial compliance costs to banks in changing the existing pre-contractual disclosure model involving re-design legal advice a sign of, IT systems and staff training. Typically for changes of the order under consideration the costs can be expected to easily exceed \$20 million for banks alone.

In the current regulatory environment estimates of time needed to implement the changes range up to 24 months. It should be noted that it is expected in this period that major anti-money laundering laws will be implemented that will become an overriding compliance priority for all credit providers. Other regulatory developments include Basel II, further FSR refinements, proposed unfair contract terms legislation and the recently introduced electronic commerce legislation under the UCCC that credit providers will be keen to take up as soon as they can.

It is crucial that proposed changes, if made, are fully researched and tested to ensure that if industry is to be put to the task of making the necessary changes the risk of having to repeat the exercise some time later because the changes failed to deliver their objectives is obviated.

This should include a robust regulatory impact assessment with a costs and benefits analysis. The ABA doubts that a proper costs and benefits analysis can be undertaken in the absence of research and consumer testing. At a time when the Council of Australian Governments is investigating ways of reducing the regulatory burden on the private business sector a thorough regulatory impact assessment is considered to be a necessary pre-condition to advancing the proposals in the consultation package.

### **Concluding Comments**

The ABA requests that after stakeholder responses to the consultation package have been received a further process of consultation is undertaken to include canvassing alternative policy approaches to the implementation of PIR recommendation 1.1.

Also, there are a number of technical interpretation issues that will require discussion and clarification before any legislation is settled. For example:-

- (1) will it be permissible for additional information to be included in column 3 over and above the prescribed information to avoid the customer not being misled by oversimplified information;
- (2) in disclosing the APR, is a reference rate disclosure permissible;
- (3) would disclosure where the contract permits the customer to change from a fixed to a variable rate include -
  - where the contract provides for this to occur automatically,

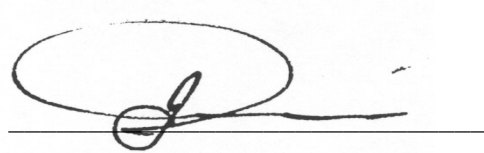
- where the customer's right to alternate between fixed and variable rates is included in the contract.
- where the customer is able to ask for a variation to their loan contract; or
- all of these circumstances?

Member banks have raised a number of other questions on the proposed disclosures for the summary sheet.

The ABA recommends that a meeting of officials and credit providers and their representatives is convened to discuss and clarify a range of technical issues that the proposed summary sheet presents.

The ABA would be pleased to participate in further consultation.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Gilbert', is written over a horizontal line. The signature is stylized with a large loop at the beginning and a long, sweeping tail.

**Ian Gilbert**