

# **NATIONAL FINANCIAL SERVICES FEDERATION INC.**

*The peak organisation representing micro and alternative finance  
providers throughout Australia.*

**Comments on the proposal for a new regime  
associated with pre-contractual documentation,  
under the Consumer Credit Code.**

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## *Introduction*

The National Financial Services Federation Inc. (the Federation) is pleased to provide the Uniform Consumer Credit Code Management Committee with the following submission, concerning the consultation drafts of the Consumer Credit Amendment Bill 2005 and the Consumer Credit Amendment Regulation (No...) 2005, addressing the issue of pre-contractual disclosure for consumers of credit.

In the formulation of this submission, we have been guided by the following policy considerations:

1. That the proposals are an attempt to streamline the essential pre-contractual information provided to credit consumers.
2. That such information is designed to offer comprehensive, easily understood explanation to consumers.
3. That the ultimate documentation will not replace the complete and detailed information in the credit contracts.
4. That there will be specific key disclosure requirements which, hopefully, will decrease an existing tendency to attempt over-compliance.
5. That such documentation will assist in reducing the concern that some lenders may be providing excessive documentation at present, in a manner contrary to the principal of providing clear and comparable information.

## *Comments in Detail*

The following is provided, in accordance with the invitation to stakeholders issued by UCCCMC.

1. a) Will the proposed amendments improve the consumer's ability to understand the key features of the credit contract?
  - i) The introduction of the two new documents, without a diminution in the existing number of documents, will be perceived by most customers as an increase in the complexity of the documentation associated with their loan. Surveys conducted by the writer, on behalf of other clients, prior to the formation of the Federation, indicate that in excess of 90% of customers already have difficulty with the complexity and/or number of documents required, with most being reluctant to read the current documentation. Their focus is only on obtaining their loan and how much, in dollar terms, it will cost them for each repayment. Independent research, conducted by Mr Paul O'Shea, consumer law expert, practitioner and academic, confirms these findings.

This customer focus may be somewhat appeased by the proposed *financial summary table*, but it must be accepted that the introduction of the proposed two pages will, with relatively few exceptions, be met with customer disinterest.
  - ii) The apparent intention of maintaining Section 14(1)(b) of the Code, being provision of the current *Information Statement*, is disappointing. Exploration as to whether the proposed *summary of other information* could be merged with the detail required in the *Information Statement* might be useful.

- iii) We believe that it would be useful to amend Section 14(1) of the Code to recognise the reality, which is that lenders do not have a separate pre-contractual statement at present and simply use a copy of the contract to satisfy this requirement. The current practice of presenting a copy of the contract, as part of the pre-contractual process, will be maintained by almost all lenders. It would therefore be realistic to recognise this practice as a mandatory requirement for all lenders, within the pre-contractual framework. Consequently, it might be useful for the replacement to Section 13 to make it absolutely clear that a copy of the contract is an integral part of the pre-contractual statement.

We accept that describing the *summary of other information* as “a bridge between the *financial summary table* and the credit contract” (Proposed amendments 05) is an appropriate analogy. However, no bridge is conceptually understood without inclusion of the areas joined by the bridge’s span.

Given that the *summary of other information*, as discussed below, will substantially refer to the contents of the contract, we believe that it is artificial and confusing to propose excluding a copy of the contract from the documents included in the proposed *pre-contractual statement*. Such an exclusion would require an amendment to the current Section 14(4).

- iv) With the new documentation, lenders’ staff will face a dilemma. At present, most staff in contact with customers methodically go through the contract, to explain it to the customer and to highlight the relevant parts. It is hard to assess, without the opportunity for testing, whether the same approach would be useful with the new documentation and whether a staff member going through the *financial summary*, the *summary of other information* and the contract, in such a way, would raise the problem of information overload for the customer. The customer’s perception of information overload, in regard to the current mandatory documents, is already most apparent.

b) If not, what improvements could be made?

- i) Exploration of the possibility of merging the *summary of other information* document with the *Information Statement*.
- ii) Recognising that it may be impossible to keep either of the two new documents to one A4 page only and still satisfy the Commonwealth regulation re. typeface/font size of 10 points.

2. a) Will the *financial summary table* provide the right ‘snapshot’ of the credit product?

- i) Given that the central focus for credit consumers, as indicated above, is what it will cost them/what they have to pay back, the proposed *financial summary table* will not provide the right ‘snapshot’ if:
  - it does not provide a very clear indication of the total amount payable in dollar terms. We note that continuing credit contracts with flexible drawdown opportunities provide a difficulty here. We acknowledge that the repayment amount is

useful but prescribing the total amount repaid provides a comparison opportunity for potential borrowers.

- it does not indicate Government fees and charges – both if applicable, or not applicable. Where applicable, such fees and charges are seen, by customers, as simply part of the total cost of the contract and their appropriate assessment of their ability to repay must include such fees and charges. Relying on the counter staff to verbally advise of such government fees and charges is not enough. Such information should be in writing and integrated with the other cost information.

- ii) There is also another problem, the *financial summary table*, as currently proposed does not, or may not, embrace all backend fees (see clause 4(b) below).

b) Are there any matters that should be included in the table, or not included?

- i) Because it can be presumed that a number of customers will focus on the proposed *financial summary table*, being a table which is easier to read, and not on the extended financial details, other conditions that may be contained in the contract could be overlooked. Given this problem, it may be useful to consider extending the *financial summary table* to include a summary of all financial detail associated with the contract. We believe inclusion of the default costs should be considered a critical element, as it is often these costs that are controversial when incurred.
- ii) We would also encourage proscription for each repayment amount to be listed for all contracts. Such has universal application and should not be considered as being limited to contracts with an interest free period and “standard” credit contracts, as discussed in the commentary at pages 10 and 11.
- iii) An expansion of the opportunity to include fees and charges as being calculated on a monthly basis, rather than an annual basis, in recognition of the fact that most short term loans are for periods of less than 12 months, would be useful. Annualising the charges without qualification, in such circumstances, may lead to customers thinking that they are being charged more than they actually are.
- iv) A comprehensive listing of backend fees, as discussed in response to 4.b) below, should be included.

3. a) Will the *summary of other information* be useful for consumers?

- i) We note that 13B(8) requires the lender to provide a general warning at the beginning of the *summary of other information*, encouraging the customer to read it in conjunction with the *financial summary* and the contract. Again, we note that this constitutes only oblique, as opposed to direct, recognition of the contract being part of the pre-contractual documentation. Given the challenge of encouraging customers to read and understand, a more direct reference to providing the contract might be preferable.
- ii) It is noted that the commentary, at page 11, explains the rationale for this summary as being to “provide information on those aspects of the product that consumers should be aware of before entering into the contract”. This rationale raises two concerns. First, how

much of the summary will simply be perceived, by the consumer, as being repetition of the contractual conditions. Secondly, how confusing is the summary, when the customers are also expected to read the *information statement*.

- iii) Regardless of whether a merged document is adopted, the issue of the *summary of other information* being limited to one A4 sheet, is a significant, practical challenge unless clause 3(b)(ii), indicated below, is accepted.

If we consider the proposed Sections 13B(4)(d), (e) and (g), 13B(5)(c) and 13B(7)(a) of the proposal, there is an imperative that the summary be considered in conjunction with the credit contract. As currently drafted, the need to reflect on the two documents, at the same time, is a challenge for customers not used to such discipline.

- iv) In assisting both first time and repeat customers and notwithstanding any other concerns, we do believe that it would be useful to include, in the *summary of other information*, the proscription contained in the Regulation (Clause 7(a)), being “a brief description of any special features of the credit contract...”. This would alert consumers to what might be a unique feature in the current credit contract being offered.

b) If not, in what way can it be improved?

- i) Given the rationale for the *summary of other information*, as discussed immediately above, and given the apparent purpose of the *information statement*, it may be more coherent for the consumer to be confronted with a merged document, rather than two different documents.
- ii) In recognition of the concerns in (iii) and (iv) above, it may be more appropriate to simply have the *summary of other information*, constituting an index to the terms and conditions included in the contract.

4. a) 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?

- i) We are not comfortable that there is sufficient definition included in the proposed legislation and regulation.
- ii) We believe there might be an opportunity for a third categorisation of fees and charges.

b) If not, what improvements can be made?

- i) It might be useful to fully embrace those definitions as included in the briefing note on page 7. In composing such definition, we believe that it is useful to note that ongoing fees and charges are not directly related to some action of the borrower, following the commencement of the contract.
- ii) We would propose the inclusion of a third category - backend or concluding fees. A notable example of such a fee is the charge imposed for the release of security when a loan is repaid. Such a charge can be foreseen with certainty, at the time the loan contract is entered into, but is neither an upfront or an ongoing fee or charge.

5. a) Are the proposals sufficiently flexible to cope with innovations in credit products?
  - i) Without the opportunity to be involved in a test program, it is hard for us to assess sufficient flexibility.
- b) If not, what changes need to be made to ensure flexibility?
  - i) Again, we are not able to assess without an opportunity to test.
6. Does the implementation of the proposed amendments have unforeseen consequences for consumers or credit providers?
  - i) We would emphasise that the proposals, as they stand, do not diminish the amount of paper provided to the customer and they do not streamline the manner in which information, in total, is provided.
  - ii) Not considered in the proposal documentation is the extra cost associated with providing two further documents which, as the reader would expect, will be passed on to the customer. This cost will include professional fees for initial drafting, the extra paper and ink associated with the printing and significant, given its ongoing nature, the extra time that will be employed, by counter staff, to explain the new regime to the customer.
  - iii) A non-financial cost associated with the proposal is the likelihood that, because of the increase in documentation, the propensity of consumers to not read the documentation will also increase.

### *Conclusion*

The draft proposal is a most welcome move in the right direction and the Federation will be pleased to assist in the achievement of the stated goals. However, without at least some amendment, it may be unlikely that the proposed regime will satisfy policy considerations 1, 2, 4 and 5, as listed in the introduction to this document.

Further, it is noted, in the introduction at Page 03 of the invitation to provide a submission, that "Disclosure is a pivotal part of the protection given to consumers by the Code. It is therefore crucial that it should be as relevant and meaningful as possible". The Federation shares that view. However, in the paragraph above, it is indicated that "There are no plans to test the new scheme by simulation or survey prior to its implementation".

We do hope that, since the invitation was distributed, some further thought has been given to testing the new scheme. Our members continuously report the challenges of matching theories, regarding consumer credit provision, and the realities of dealing with the consumer at the outlet counter. We do ask that some testing be undertaken and the Federation will be pleased to offer assistance in this regard.