

30 March 2006

Submission

To the

Ministerial Council on Consumer Affairs

On Proposed Amendments to the

Consumer Credit Code

Relating to

Pre-Contractual Disclosure

By The

Banking and Financial Services Committee

Of the

Queensland Law Society



EXECUTIVE SUMMARY OF SUBMISSIONS

1. Future consultation packages should also contain sample compliant documents.
2. The Ministerial Council should fund and instruct UCCCMC to conduct empirical testing on sample documents, compliant with the proposed amendments, in order to test their effectiveness and how they might be improved.
3. Regulation 13A should provide that the *financial summary table* be headed as such in centrally placed large font capital letters.
4. Regulation 13A should provide that the *financial summary table* be headed by a warning in a font and form prescribed by the regulations which identifies it as being provided as a requirement of the Code. An example follows:

This financial summary table is required by section 13A of the Consumer Credit Code. It contains important information about your credit contract.
You should read it before entering into the contract.

5. There are a number of drafting and clarification issues outlined in part 4 of this submission which require attention if the proposed amendments are to work in practice.
6. The Commencement Date should be 18 months after proclamation.
7. MCCA should resolve that its member states commit adequate resources to enforcement of the new provisions.

1. Introduction

The Queensland Law Society (“the QLS”) welcomes the production by the Uniform consumer Credit Code Management Committee (“UCCCMC”) of its Consultation Package “Pre-Contractual Disclosure and the Uniform Consumer Credit Code” (“the Consultation Package”).

The UCCCMC officials involved are to be congratulated for so substantially advancing recommendations of the Post-Implementation Review of the *Consumer Credit Code* (“the Code”). Given that it is now six years since that review reported, such work is timely and hopefully indicative of new found attention by governments to the *Code*.

The QLS generally supports the type of reform proposed in the Consultation Package and, in particular, the adoption of the “Schumer Box”. The arguments in favour of “Schumer Box” style disclosure were effectively canvassed in the earlier review but it is worth noting that this type of disclosure has been also recently recommended for timeshare sales contracts by the Parliamentary Joint Committee on Corporations and Financial Services.¹

The Consultation Package document is particularly useful and the production of two sample compliant Financial Summary Tables for two different kinds of credit product is a new and most helpful development in *Code* reform consultation processes. It is an approach which the QLS supports and encourages.

Our submission has five parts, as follows:

Part 1: This Introduction

Part 2: The need for empirical testing

Part 3: Self-identification of the financial table as a statutorily prescribed disclosure

Part 4: Drafting issues and matters of definition that will require clarification and amendment to make the proposed regime workable in practice.

Part 5: A short response to the issues of commencement and enforcement.

¹ Parliamentary Joint Committee on Corporations and Financial Services, *Timeshare: The Price of Leisure* (Commonwealth of Australia, September, 2005) pp 62-63

2. The need for empirical testing

2.1 Why?

Page 3 of the Consultation Package says that: “There are no plans to test the new scheme by simulation or survey prior to its implementation.” We strongly urge the Ministerial Council to fund UCCCMC to conduct such research either directly or by engaging an appropriate agency, such as a University, to do so.

The reasons are clear. Empirical research, some of it funded by UCCCMC itself (in the case of the *Malbon Report*)² helped identify some of the problems in the existing *Code* disclosure regime to which these proposals are directed. Experimental work by Paul O’Shea at the University of Queensland casts substantial doubt on the effectiveness of the existing disclosure regime.³ Neither of these authors nor the QLS suggest that disclosure does not work at all but that it needs to be improved in demonstrably effective ways.

The best way to demonstrate effectiveness is to test it. This is also the best way to make good use of the sample financial tables produced by the authors of the Consultation Package by adding to them and then submitting them to an empirical process. We may well agree with the authors of the Consultation Package that the sample documents look “better” than those produced in compliance with the existing regime but, in the absence of structured, scientific testing, this agreement is only based on an intuitive reaction. Intuition is no basis for policy or legislative change.

2.2 What?

There are a variety of possible empirical research formats which could be useful in this context. Experiments similar to the previously published O’Shea research on three contract types (home loan; continuing credit; and linked credit) with an “n” of 300 participants or so would produce a simple set of statistics which compared the comprehensibility of the new formats with the existing code and, using the “embedded document” technique, with the “no disclosure” situation. It would answer the question: “Is it better?” This would be a good way to assess the new *financial summary table*.

² Malbon J, *Taking Credit, Report for the Consumer Credit Code Post-Implementation Review*, (Tasmania, Department of Justice and Industrial Relations, September 1999), <http://www.creditcode.gov.au> viewed 4 February 2005 which was the basis for Malbon J, “Shopping for Credit: Empirical Study of Consumer Decision-making” (2001) 29(1) ABLR 44

³ O’Shea, P and Finn, C “Consumer Credit Code Disclosure: Does it work?” (2005) 16 JBFLP 5; Elizabeth Lanyon supports the proposition that “disclosure aims need to be broadened” and that there should be a reassessment of “what level of detail or precision is most helpful to consumers” See Lanyon E, “Changing Direction? A Perspective on Consumer Credit Regulation”, Keynote Address, Australian Credit at the Crossroads Conference, 8 November 2004, Melbourne, p 16;

New technologies are now available to map the dynamics of document comprehension by the participants (consumers) in order to better understand how they use the document and, therefore, how they could be improved. The improvements could be incorporated into new document formats which could be tested to discern any further improvements in comprehension.

The technology is available to examine more closely, again in the experimental environment, the cognitive dynamics of document comprehension. Using a combination of miniature video cameras attached to headsets, digital video recordings and specialist software, researchers can track where participants are looking as they seek the answers to particular questions. We can thus achieve a better understanding of exactly where consumers think the answers should be.

Likewise, focus groups and general surveys could be directed at the questions originally asked by Justin Malbon in his “Taking Credit” project, namely, “What do consumers want?” The *summary of other information* documents are going to be less amenable to experimental testing (and certainly more expensive due to time) and may well be more usefully the subject of well-prepared focus group discussions.

All of these processes can be aimed at not only assessing the proposed formats but improving them.

2.3 Why Now?

It has taken six years to bring these recommendations to this stage. It is now ten years since the *Code* became effective and twelve years since its adoption by the states. It is unlikely that the Ministerial Council and UCCCMC will be able to revisit these measures for a number of years.

Well funded, an empirical testing project for the proposed amendments is likely to take between 3-6 months. This is a relatively short period of time in context. Industry is likely to need at least 18 months to “tool up” for the changes and the effects in the market place may not be capable of proper assessment for some time after that.

Taking time now will prevent wasting it later.

2.4 Relative Costs

Our consultations with the University of Queensland indicate that a small scale experimental study on the effectiveness of the documents is likely to cost between \$40,000 to \$50,000. A larger study employing these techniques as well as focus groups and surveys is likely to cost approximately \$100,000.

The estimated cost to industry of compliance with the proposed changes is in the hundreds of millions of dollars. A significant proportion of this outlay will flow on to consumers in the cost of obtaining credit. Governments, through MCCA and UCCCMC have already devoted substantial resources to this project with more to come.

A simple cost/benefit analysis demands that prior to spending millions more, some few thousands are spent to check if the proposed changes make any difference, how much they improve the situation and how they themselves might be improved.

3. Identify the *financial summary table* as a statutorily prescribed document.

3.1 Self-identification

It would appear from the proposed regulations that there is no requirement that the *financial summary table* be even named as such. See proposed Regulation 13A. Despite this, the *summary of other information* is required to contain a “prominent statement warning the debtor that the summary of other information contains only partial information and is to be read with the financial summary table” See proposed Regulation 13B.

This is potentially confusing for consumers. Regulation 13A should provide that the *financial summary table* be headed with just those words centrally placed in large font capital letters.

3.2 Identify as a Statutory Requirement

Further, this highlights the necessity to draw the attention of debtor/consumers to the *financial summary table*. The Malbon research, referred to before, casts doubt in several places on whether consumers actually even read the existing *Code* prescribed financial table disclosure let alone their credit contracts.⁴

The QLS suggests that one way to draw the attention of consumers to the new *financial summary table* is to identify it clearly as a statutorily prescribed document. To identify it as a requirement of a statute, namely the *Code*, will enhance its importance to the consumer and encourage them to read it.

We are familiar with the experience of the *Property Agents and Motor Dealers Act 2000* (Qld) which provides for warning statements on the front of all residential real estate contracts. These statements (which must be in a prescribed form) are clearly self-

⁴ Malbon, op.cit, paras 10.1 to 10.2.1

identified as a statutory requirement and contain large type face warnings in bold fonts. They graphically and dramatically draw the attention of prospective buyers to their contents.

We submit that a similar notice, in a form prescribed by regulation, be placed at the top of the *financial summary table* and the *summary of other information*. An example could be:

This financial summary table is required by section 13A of the Consumer Credit Code. It contains important information about your credit contract. You should read it before entering into the contract.

4. Drafting and Clarification Issues

4.1 Reg 13A and B

As discussed above, Reg 13B requires a warning about the *financial summary table* but there is no requirement that the table be identified as such. In the absence of such identification, consumers may be confused. We refer to our earlier submission.

4.2 Reg 13B(2)(b)

This provision refers to a "person" which is not a term used in this context elsewhere in the *Code*...are these persons "debtors"? if so, then simply describe them as such.

4.3 The limit (in clause 13(1))

The limit (in clause 13(1)) of two A4 pages for the statement is commendable, but might not always be practicable for some facilities, where (for example) there are fairly precise provisions detailing when concessional interest rates might apply etc. If there is to be a limit on the length of the table, then financiers should be given the ability to include a broad outline of a particular provision, and to cross refer to the full details in the text of the facility agreement. This is only dealt with in the context of some specific details.

4.4 The requirements in 13(2)

The requirements in 13(2) that a statement be "easily legible" (when there are existing legibility requirements), and that it be "clearly expressed" and set out to "make it clear as to what the information relates" are simply too broad to be of any use, from a legislative perspective. Clear to whom?

4.5 Section 13(3)

Section 13(3) should be permissive, rather than requiring a full table of information for each of several facilities, when the majority of the information may be common to all facilities.

4.6 Facility Type?

What is "a brief description of the type of facility" in 13A(2)? Is "loan facility" enough, or does it need to be "loan facility with interest payable at the bank's standard variable rate plus a margin of 2% p.a., but with an initial 6 month fixed interest rate which is determined on the day of drawdown and will be 2%p.a. lower than the standard variable rate on that day, but that rate is only available if....."etc, to distinguish it from a dozen other variations that the bank has as "loan facilities"? Is it enough to describe it as the "Easibank New Start for First Homebuyer Loan", because that's what the bank is calling it this month?

4.7 Reference to Conditions

In 13A(4), if the change from variable to fixed and vice versa is subject to conditions, can it be said that the contract "permits" such a change? Does one need to refer to conditions? Do those conditions need to be set out?

4.8 Reasonable estimate

What is a "reasonable estimate" under 13A(8)(b)? The first line speaks of "each repayment" and the next line speaks of "the maximum repayment amount" - is this the aggregate amount, or individual repayment amounts that is being referred to? The whole thinking here seems to be based on an assumption of the most basic of personal loans, where weekly or monthly payments can be predicted. Sophisticated home loans and other such products don't all neatly fit into this mould.

4.9 Calculation of term of loan

The alternative of "until cancelled by either party" is the only choice to insert if the term of a loan cannot be calculated - not appropriate in many cases.

8. Clause 13B helpfully requires a warning that the table only provides "partial information", but then requires the credit provider to set out "details" of various things. There is no helpful exoneration for leaving out a detail which the credit provider

considers to be incidental, but the consumer may say (retrospectively) was important to him or her. Some sections compound the dilemma for credit providers, by referring to "a brief description", suggesting that, elsewhere, details need to be more fulsome.

5. 5. Commencement and Enforcement

5.1 Commencement

As discussed above, we would anticipate industry will need at least an 18 month period to "tool up" its documents and procedures to comply with the proposed amendments. The *Code* provided for a period of over two years between its initial passage through the parliament of the "template" state, Queensland, on 1 September 1994, and its commencement date of 1 November 1996. The *Financial Services Reform Act 2002* also provided for a two year transitioning period.

Although not as comprehensive as these, the proposed amendments will still require significant drafting, testing and training by industry in order for them to be compliant with its provisions. To force industry to undertake this task in a hurry is to risk large scale non-compliance, subsequent enforcement issues and unnecessary costs and disruption.

5.2 Enforcement

The QLS agrees that the new disclosure requirements should not be the subject of the civil penalties provisions of the *Code*. This does leave, however, their enforcement to the relevant state fair trading agencies which are frequently under-funded to perform this function.

Poor enforcement will lead, in our view, to inconsistent compliance particularly by those sections of the industry at which such reforms are principally aimed. By bearing the costs of compliance, the more responsible elements of the industry will be at an unfair market disadvantage. This is anti-competitive.

More importantly, consumers of non-mainstream financial services are often the most vulnerable and in the most need of more accessible and accurate pre-contractual disclosure. Differential performance by an industry facing rare if non-existent enforcement will only further damage the position of low income and marginalised consumers.

In Queensland, we have had the salutary experience of some high-profile prosecutions of fringe credit providers operating in flagrant breach of the *Code*. This involved the commitment of significant resources by the Office of Fair Trading ("OFT") but resulted in:

- The removal from the market of a credit provider whose conduct was damaging to low income and vulnerable consumers;
- Significant media coverage which enhanced the standing of the OFT and its minister;
- A strong message being sent that the provisions of the *Code* would be enforced.

We urge MCCA to adopt a policy of requiring the member states to adequately fund their enforcement agencies to ensure compliance with the new provisions by all sections of the industry.