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Dear Sirs

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**Consumer Credit Code Amendment Bill 2007
Consumer Credit Amendment Regulation 2007
Consultation Package**

We refer to the Consultation Package dated August 2007 relating to amendments to the Consumer Credit Code (the **Code**) arising from the Discussion Paper of the Ministerial Council on Consumer Affairs titled *Fringe Credit Providers*.

We make the following submissions on the changes proposed in the Consultation Package. We have confined our comments to matters of drafting or internal consistency, interpretation issues and issues of consistency with the Bulk Electronic Clearing System Procedures. We do not propose to comment on matters of policy, although we have made comments where it appears to us that the relevant draft provision may not achieve the stated or apparent policy objective.

Consumer Credit Code Amendment Bill

Our comments are as follows.

1. Section 4 – New Section 7(1)(A)

This provision raises the practical question of how the credit provider will know what fees and charges might be payable by the debtor to anyone else. The current drafting does not limit the obligation to credit fees and charges of which the credit provider is aware or ought reasonably to be aware. In order to achieve the objective of the change it may be necessary to impose an additional specific obligation on the credit provider to make enquiries (including of the debtor and of any person by whom or through whom the debtor is introduced to the credit provider) about any relevant fees and charges.

2. Section 5 – New Section 11(2)

The new paragraph (b) relies on the credit provider obtaining information. It contemplates that the information might be given to the credit provider, not by the debtor themselves, but by someone else on behalf of the debtor. This is likely to mean, for example, that information about purpose will be collected from or through intermediaries such as finance brokers. The provision as drafted in the Consultation Package may actually make it easier for incorrect purpose information to be supplied.

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In order to achieve the policy objective of the provision it may be preferable to add a requirement that neither the credit provider nor any other relevant person who obtained the information about purpose from the debtor knew, or had reason to believe, at the time the information was obtained that the credit was in fact to be applied wholly or predominantly for a purpose other than the identified business purpose or identified investment purpose. For this purpose "relevant person" could have the meaning given in the current section 11(3). In this way the knowledge of persons associated with the credit provider and of finance brokers would be captured, as it is under the current provision.

3. Section 6 – New Section 15(2) and (3)

While we appreciate that these provisions are intended to mirror section 10(B) of the *Consumer Credit (NSW) Act 1995*, we believe that the expression "in the nature of interest", used without any definition, is problematic. It is not clear whether it is intended to pick up:

- anything which is in the nature of a charge for providing credit (in which case there could be overlap with credit fees and charges, which are addressed separately in the Code);
- only amounts calculated in the same or a similar way to interest (in which case it could pick up any fee calculated by reference to loan amount or outstanding balance, but would not pick up, for example, a lump sum payment payable under a shared equity product which is calculated as a percentage of the increase in value of the security property over the period from drawdown to repayment); or
- only amounts payable by a borrower to a lender if the lender forgoes interest (in which case a lump sum appreciation payment under a shared equity product would be caught, but many other charges levied by fringe credit providers which you may be intending to capture would not be captured).

It appears that the New South Wales Office of Fair Trading believes that an appreciation payment under a shared equity product is "in the nature of interest" as it has issued a Statement of Regulatory Intent and Compliance Policy in relation to shared equity mortgages. That Statement says that it is acknowledged that at the time of entering into a shared equity mortgage the annual percentage rate is not ascertainable. It states that it will be sufficient, when disclosing the annual percentage rate in a contract for a shared equity mortgage, to disclose the method of calculation used to determine the capital gain payable to the lender when the contract ends.

If the new sections 15(2) and (3) are introduced, and it is intended that shared equity mortgage appreciation payments are "in the nature of interest", a similar provision will be needed in relation to the new provisions - in the Code itself, in a Regulation or in a generally applicable statement of enforcement policy. Given that section 15(C) is a key requirement, this is not something on which there should be any uncertainty for industry, and so an amendment to the Code itself would be the preferable option.

For the purpose of determining whether the interest rate cap in New South Wales has been exceeded in the case of a short term credit contract the regulations require interest charges



and all credit fees and charges under a credit contract to be included. However there is no express requirement that amounts payable under the contract which are in the nature of interest are included. This may create some scope for avoidance.

In the context of shared equity products (which are not short term contracts) there is no express requirement that amounts in the nature of interest are to be included for the purpose of determining whether the rate cap is breached, but the requirement for inclusion of these amounts for the purpose of section 15(C) creates some uncertainty in relation to the application of the maximum annual percentage rate.

The same issues arise in the ACT.

Victoria also has rate caps but no requirement that amounts in the nature of interest be taken into account in determining the annual percentage rate for the purpose of the caps.

4. Section 11 – New Section 72

The new Section 72 creates a number of issues including the following.

- (a) Section 72(1)(g) should be "the combination of any annual percentage rate and any one or more credit fees or charges" and the words "the rate or rates or the fee or charge" in the second last line of sub-section (1) should be "the annual percentage rate or any fee or charge".
- (b) In the first line of sub-section (2) the words "the annual percentage rate or rates" should probably be replaced with "any annual percentage rate".
- (c) Sub-section 2(a) refers to a change "made in a manner that is unreasonable". This suggests that the only matter to be considered is the way in which the change is notified or effected, rather than what the change is. It appears to us that, in order to achieve the policy objective in this provision, the words "was made in a manner that" should be deleted.
- (d) In sub-section (3) there is no equivalent of the words "the credit provider's average reasonable costs of those things in respect of that class of contract" which is found in the current section 72(3). This is a significant omission. In our view it is unreasonable for credit providers to be expected separately to cost each and every application and each and every loan settlement. The credit provider should be entitled to make a reasonable approximation of the relevant costs across a class of contracts. We note that the concept of average reasonable administrative costs for a termination or prepayment has been retained in the new sub-section (4) and can see no reason why, in the context of what are effectively administrative costs, there should not be an ability to assess average costs in relation to establishment fees.
- (e) The concept of the credit provider's "loss" is included in the new sub-section 72(5). There has been significant uncertainty about the meaning of the word "loss" in the context of section 72(4). While it seems reasonably clear that it may include a reasonable estimate of the credit provider's loss of bargain, there are issues in determining how that loss should reasonably be estimated.

The use of "loss" in section 72(5) is in our view inappropriate. For example, if a customer misses a series of payments under a credit contract that indicates that

they are having difficulty in meeting their obligations and so may not be able fully to repay their loan and pay interest, fees and charges at the rates and in the amounts provided for in their credit contract. On one view the credit provider could reasonably estimate that their "loss" arising from the default will include some proportion of the principal – that is, this wording would arguably permit a credit provider to determine that because of the default or series of defaults it should make a provision against the loan and that the amount of that provision is its reasonable estimate of the loss arising from the default. On that basis the credit provider would be entitled to recover, by way of a default fee, an amount equal to the amount it had provisioned. That would obviously be an absurd outcome and is not intended. It does however highlight the difficulty with the use of the word "loss" in this context.

- (f) The new sub-section (6) refers to "the credit provider's reasonable underlying costs or losses that gave rise to the fee or charge". It is not clear to us what meaning would be given to "underlying". Further, costs and losses won't, in a technical sense, give rise to the fee or charge. The fee or charge will typically be imposed to cover or recover the cost of an activity or service. The use of "losses" in this provision is likely also to give rise to uncertainty.
- (g) The new sub-section (7) says that the court "may have regard to the standards of commercial practice generally". The expression "standards of commercial practice generally" is in our view highly undesirable. It is not confined to practice in any particular market or market segment, or even to a financial services context. In our view in order to make an assessment against market or industry practices a court would need to take into account a number of matters including the nature of the product, the type of borrower at which the product was aimed and the nature and cost structure of the credit provider. The first time an application under section 72 came before a court the court would need to determine what these words mean and it is likely to have some difficulty in doing so. Until it did, industry generally would have no indication of how a court would be likely to interpret that expression.
- (h) In the new sub-section (8) the words "the combination of the annual percentage rate and any credit fee or charge" should be replaced with "the combination of any annual percentage rate and one or more credit fees or charges". This change is suggested for consistency with the change we have suggested in (b) above to the new section 72(1)(g).

Under sub-section (8) the court may have regard to the annual percentage rate or rates payable under "comparable credit contracts". Sub-section (2) dealing with interest rate changes, while it allows the Court to take into consideration any other matter it thinks relevant, appears only to be directed at considering the change in the context of other debtors borrowing from the same credit provider or conduct by that credit provider in the context of the relevant contract. Sub-section (8) appears to permit a consideration of products offered by other credit providers. There should be consistency in approach.

Further issues arise from the use of "comparable". For example, it is not clear whether you would look solely at the type of product or whether you would need to assess the credit risk being accepted by the lender under two credit contracts in order to determine whether they were comparable. Further, it is not clear how similar the products would need to be to be "comparable". For example, if the issue arose in the context of a credit card product, which card products would the Court consider – only those with the same interest free period and similar rewards or programs (and query how the Court would assess similarities of rewards programs) or would it look at credit cards generally?

5. Section 13 – New Section 150(2)

In paragraph (a) of this new sub-section (2) the word "consumer" should be deleted. The provision is directed at determining whether a lease is a consumer lease and so the generic word "lease" should be used in this context.

Our comments in 2 above in relation to section 11(2) apply equally to the proposed section 150(2).

6. Section 14 – New Section 187

The drafting seems to suggest that an application might be made under the new section 72 in respect of a credit fee or charge levied under a credit contract entered into before that new section came into effect. If this is the intention, it gives the provision retrospective application. In our view that is inappropriate and unreasonable. In our view the new section 72 should only be applied to credit contracts entered into on or after the date on which that section comes into effect, or to changes to fees and charges made after the date the new section comes into effect. Any applications in respect of fees imposed under credit contracts entered into before that date and not varied before that date should be considered under the old section 72. Further, credit providers will need an adequate period of notice before the commencement date of the new section 72 so as to allow them an opportunity to review their credit fees and charges.

Consumer Credit Amendment Regulation

7. Section 5 – Amendment to Forms 3A and 3B

Both items 1 and 2 of the suggested "Information" box are inconsistent with the Bulk Electronic Clearing System (CS2) Procedures (**BECS Procedures**). Under the BECS Procedures, a direct debit service agreement between a debit user (in this context the credit provider) and the person giving the direct debit authority (in this context the borrower) must:

- set out in reasonable detail the procedure for the borrower to stop any debit item or to cancel a direct debit request and advise the borrower that all requests for stops or cancellations may be directed **either** to the credit provider or the financial institution with which the relevant account is held; and

- set out in reasonable detail the procedure available to the borrower to dispute any debits item with the credit provider and the dispute resolution process to apply between the borrower and the credit provider, and advise the borrower that claims may also be directed to their financial institution.

Accordingly it is contrary to the BECS Procedures, and the terms of the debit request service agreement that the credit provider must enter into with the borrower, to suggest that direct debits can only be stopped by contacting the financial institution with which the amount is held, or that complaints can only be made to that financial institution.

If the account from which debits are made is with a bank which has subscribed to the Code of Banking Practice (2003), that bank agrees as follows:

"We will take and promptly process your:

- (a) instruction to cancel a direct debit request relevant to a banking service we provide to you; and
- (b) complaint that a direct debit was unauthorised or otherwise irregular, and will not direct or suggest that you should first raise any such request or complaint directly with the debit user (but we may suggest that you also contact the debit user).

The text in the suggested "Information" box says that the borrower "may" be able to take action to cancel a direct debit. A borrower clearly has the right to cancel a direct debit request under the BECS Procedures and, where either the account institution or the credit provider is a bank, under the Code of Banking Practice. However, the borrower needs to be warned that if they do so that does not relieve them of their payment obligations under the credit contract and they will need to make satisfactory alternative arrangements for payment with the credit provider.

If an information statement of the sort proposed is to be used it should be consistent with the terms of the BECS Procedures. In relation to drafting, the use of the expression "your financial institution" may be ambiguous in this context. The credit provider will be a financial institution and the customer may not understand that this is a reference to the bank or other financial institution with which the account from which payments are to be made is held.

The Consultation Package asks for comments on various options for providing information about direct debits. One of those options is adding a new section 14A to the Code which requires disclosure to be made in writing by a credit provider prior to the credit provider entering into a direct debit arrangement with a consumer. The BECS Procedures already require this. A credit provider who wants to become a debit user needs to either be a member of, or be sponsored into, the BECS system. It will have obligations under the BECS Procedures, or under the debit user agreement entered into with any sponsoring financial institution, to obtain a direct debit request which complies with the BECS Procedures and to enter into a direct debit service agreement which also must comply with the BECS Procedures. As indicated above, the direct debit request service agreement must set out in reasonable detail procedures available to customers to stop debit items or cancel a direct debit request altogether and the procedures available to dispute any debit item and the dispute resolution process to apply between the debit user and the customer.

Please note that these submissions represents the views of the signatories to this letter. They do not necessarily represent the views of all partners of the firm or of the firm's clients.

We appreciate the opportunity to make this submission. If you have any questions in relation to any aspect of it we would be happy to discuss our comments with you further.

Yours faithfully

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