

# **City Finance Franchising Pty Ltd**

## **SUBMISSION**

**in response to the**

***Consumer Credit Code Amendment Bill 2007  
and Consumer Credit Amendment Regulations  
2007 Consultation Package released on 24  
August 2007***

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## 1. INTRODUCTION

1.1 City Finance Franchising Pty Ltd ("**CFF**") makes the following submissions relating to the Consultation Package on the *Consumer Credit Code Amendment Bill 2007 and Consumer Credit Amendment Regulations 2007* ("**the Consultation Package**").

## 2. BACKGROUND

2.1 CFF first commenced trade in Queensland in the mid 1990s, prior to the commencement of the Consumer Credit Code. It is now a national franchised money lending business with 144 territories throughout Australia. All of CFF's offices offer similar products and have uniform practices.

2.2 CFF is a major player in the "for profit" microlending, or "commercial microfinance" section of the consumer credit market.

2.3 Microlending is an important and growing section of the market, as demonstrated by CFF's continuing growth. The increase may be attributed to many factors, including:

- (a) the hardening requirements of banks to give loans;
- (b) the structuring of the "point scoring" systems used by the mainstream lenders for loan approval; and
- (c) the belief that people in receipt of Commonwealth benefits or have limited income do not have the right to access or have the ability to manage personal finance.

## 3. EXECUTIVE SUMMARY

3.1 CFF is concerned with the proposal's:

- (a) use of the *Bankruptcy Regulations 1966* (Cth) as the starting point for defining "essential household property";
- (b) potential anti-competitive nature of the proposed amendments regarding fees and charges;
- (c) failure of the proposed amendments to take into account smaller credit providers with higher cost bases;
- (d) lack of certainty and definitions for new introduced key terms; and
- (e) lack of any transitional provisions.

## 4. SUBMISSIONS

4.1 CFF's submissions relate to the following key matters:

- (a) Amendment to s15 - Presumption relating to application of Consumer Credit Code ("**Code**");
- (b) Amendment to s46 - Prohibited securities;
- (c) Replacement of s72 - Court may review unconscionable interest and other charges;
- (d) Amendment to s187 - Undecided applications under old s72; and
- (e) Impact on CFF and its operations.

## 5. AMENDMENT TO S15 - MATTERS THAT MUST BE IN CONTRACT DOCUMENT

- 5.1 **(Ambiguity):** CFF is concerned that the term "charges that are in the nature of interest charges" creates ambiguity and blurs the three distinct concepts of "amount of credit", "interest charges" and "fees and charges" already in the Code. We urge caution regarding the introduction of this new term in the Code which would cause confusion and ambiguity to existing terms.
- 5.2 **(Definition - "charges" and "interest charges"):** CFF is concerned about the distinction between the term "charges" and "interest charges". No definition of "charges" is provided in the proposed amendments, nor do the proposed amendments define the difference between "charges" and "interest charges". We urge caution regarding the introduction of this new term in the Code without a clear definition of what each term means.
- 5.3 **(Definition - "nature of interest charge"):** CFF is concerned that no definition of "nature of an interest charge" is provided in the proposed amendments. e.g. are account keeping fees caught within this term? Again, we urge caution regarding the introduction of a new term in the Code without clear definition of what that terms means.
- 5.4 **(Pending High Court case):** The case of *Australian Financial Direct Limited v Director of Consumer Affairs Victoria* [2006] VSCA 245 has been appealed, heard and is currently waiting on determination by the High Court of Australia.

We understand that possibly, an issue in contention was whether a holdback arranged between a credit provider and a supplier of goods or services financed by consumer credit was "interest". We urge caution regarding amending a key section of the Code whilst the High Court of Australia's decision is pending, especially if the decision may have a retrospective effect on the Code.

- 5.5 **Suggestions:** CFF suggests these proposals need to be recast but submits the following should the proposals in fact proceed:
- (a) providing a clear definition and distinction between the terms "amount of credit", "interest charges", "fees and charges" and "charges";
  - (b) providing indicia on what would be in the "nature of an interest charge"; and
  - (c) providing definitions for "charges", "interest charges" and "nature of interest charges".

## 6. AMENDMENT TO S46 - PROHIBITED SECURITIES

- 6.1 **(Bankruptcy - Inappropriate starting point):** In the future, CFF would be supportive of a change that restricted the taking "essential household property" as loan security, provided that:
- (a) there are clear guidelines on what is defined as or classified as "essential household property" and
  - (b) the guidelines and definition of "essential household property" is developed in consultation with industry groups and major players, including CFF.
- 6.2 CFF is concerned that the proposed definition of "essential household property" as derived from the *Bankruptcy Regulations 1966* (Cth) is unsuitable for Code purposes as it:
- (a) is extremely wide and unclear. e.g. it does not distinguish between duplicate items nor items in investment properties;
  - (b) is designed for a different purpose, and accordingly is an inappropriate starting point for the definition of "essential household property". We note that the aim of

the *Bankruptcy Act 1966* (Cth) is to give people declared as bankrupts a "fresh start" compared with the purpose of obtaining security;

- (c) encompasses those assets which are in all likelihood the only assets of many microlender's clients; and
- (d) does not address items not in possession by the borrower,

CFF urges caution in defining "essential household property" based on the *Bankruptcy Regulations 1966* (Cth) definition and without direct consultation with industry groups and credit providers.

6.3 **Suggestions:** CFF submits the following suggestions:

- (a) the term "essential household property" should not derived from the *Bankruptcy Regulations 1966* (Cth) definition, rather consultation should be made with industry groups and credit providers to determine suitable definitions and guidelines.

## 7. **REPLACEMENT OF S72 - COURT MAY REVIEW UNCONSCIONABLE INTEREST AND OTHER CHARGES**

7.1 **(Change in test):** CFF is concerned about the change in test from "unconscionable interest and other charges" to "unreasonable interest and other charges". The basis for this concern is:

- (a) **(definition):** No definition is provided for the term "unreasonable". Further, no indication is given on how the term "unreasonable" should be interpreted. This can be compared to the current use of "unconscionable", where credit providers can rely on precedent court cases and common law to determine its scope and meaning.
- (b) **(subsection - consistency):** There is inconsistency between each subsection of s72. The proposed subsection (5) should be consistent and pick up the wording in subsection (6), namely, subsection (5) should refer to "underlying costs or losses" rather than just to "loss".
- (c) **(classes of credit providers):** The use of "standards of commercial practice generally" in the proposed subsection (7) incorrectly assumes that there is only one class of credit provider. We submit that there are in fact numerous classes of credit providers, including mainstream lenders, non-bank non-mainstream credit providers, payday lenders and non-regulated lenders.

We refer to page 5 of City Finance Franchising Pty Ltd's submission entitled "Managing the Cost of Consumer Credit in Queensland" dated 10 December 2006 in response to the Discussion Paper of November 2006, where we previously explained each class of credit provider in detail.

- (d) **(commercial practice):** Subsection (7) of the proposed amendments should not be looking at "standards of commercial practice generally". Instead, it should reflect wording to the effect of "comparable transactions involving other credit providers of a comparable class".

We submit that, the Court is not the most appropriate forum to determine what is objectively "commercial" under the proposed amendments. We suggest that reference to comparable classes of similar credit providers is fairer as smaller credit providers do not have the same economies of scale available to them in their back office-operations. If left unamended these provisions would have a significant anticompetitive effect.

- (e) **(floodgates):** The change in tests opens the floodgates to uncertainty. This will greatly impact existing credit contracts and retrospectively turn contracts which were "legal" when entered into, into "illegal" contracts when the legislation is enacted. This could result in a significant increase of litigation,
- (f) **(Uncertainty):** The term "unreasonable" will turn on the facts of a case. What may be unreasonable to the credit provider may not be unreasonable to the consumer. There is no indication from whose perspective the Court has to determine "unreasonable" this from? Consumers may always think that any interest charges will be unreasonable.

This may be compared to the current test of "unconscionability" which focuses on whether one party has been taken advantage by another.

Further, it is illogical to assume that what is uncommercial would also be unreasonable, especially from one point of view (i.e. the borrowers).

- (g) **(Driving recover costs below actual costs):** The "unreasonable interest and other charges" test may drive recovery costs below actual costs for smaller lenders. Based on economies of scale, the reasonable costs may be commercially less than actual costs, especially for smaller credit providers. This is anti-competitive and may drive smaller credit providers out of the business.

We urge extreme caution in changing the test from "unconscionable interest and other charges" to "unreasonable interest and other charges".

7.2 **(Interference with private domains of contract):** CFF is concerned that the proposed amendments to section 72 will interfere with a person's general law right to contract. A key part of the "UCCC deal" upon the commencement of the code was the heavy disclosure requirements. As credit contracts are entered into with full disclosure to the borrower, we are concerned that the proposed amendments will put unnecessary prohibitions on a person's general right to contract.

7.3 **(Blue pencil test):** It is an established common law principle that the courts will not re-write a contract, rather they will sever parts of it (blue pencil test). The proposed amendment contradicts this principle and requires the courts to amend (i.e. annul or reduce) parts of the credit contract if it considers it unreasonable.

Further, under common law, courts are usually not prepared to overturn or amend unreasonable contracts, compared to overturning or amending unconscionable contracts.

7.4 **Suggestions:** CFF submits the following suggestions:

- (a) That the old test of "unconscionable interest and other charges" should remain;
- (b) If the test is to be changed from "unconscionable interest and other charges" to "unreasonable interest rates and other charges", then:
  - (i) the wording of section 72(5) is made consistent with section 72(6), namely, section 72(5) should refer to "underlying costs or losses" rather than just to "loss";
  - (ii) the wording of section 72(7) is amended to take into account different classes of credit providers, namely replacing "standards of commercial practice generally" to words to the effect of "comparable transactions involving other credit providers of a comparable class";
- (c) The test of "unreasonableness" is to be determined based on credit providers of a comparable class, rather than commercial practice generally.

## 8. AMENDMENT TO S187 - UNDECIDED APPLICATIONS UNDER OLD S7

8.1 **(Retrospective effect):** CFF is extremely concerned with the possible retrospective operation of the proposed amendments. This is because it will:

- (a) negatively impact and is inequitable on transactions which have already occurred; and
- (b) parties could be liable for transactions which were "legal" when entered into and turned "illegal" when the legislation is enacted. This could result in an ambush of litigation, especially as the Code makes it hard for credit providers to amend a credit contract once executed.

We urge extreme caution in allowing the proposed amendments to possibly have any retrospective effect.

8.2 **(Transition period):** CFF is extremely concerned that there is no transition period for the operation of the proposed amendments. As well as being inequitable, if all the current proposed amendments are enacted, credit providers will be required to dramatically change their business structures, policies, agreements and commercial operations.

Further, significant time will be required for external accountants to be briefed to review and test underlying fee structures and develop new complying cost structures. This will be necessary since currently there are no such review requirements for any credit fees and charges other than establishment and termination fees.

We urge extreme caution in not having a transitional period for the proposed amendments to take effect.

8.3 **Suggestion:** CFF submits the following suggestions:

- (a) a transitional period of between 6 and 12 months be inserted (preferably 12 months to permit an orderly transition into the new arrangements);
- (b) clear indication that the proposed enactments will not have any retrospective effect, especially on agreements entered into before the proposed amendments are enacted.

## 9. IMPACT ON CFF'S BUSINESS AND OPERATIONS

9.1 **(Transparency):** CFF is concerned with the lack of transparency regarding the proposed amendments and any proposed interest rate caps proposed to be inserted at the same time in Queensland. The enactment of interest rate caps and the proposed amendments would have dire consequences on CFF, comparable credit providers and borrowers. This includes the potential of forcing many credit providers to terminate their operations and thus forcing borrowers out of credit.

We refer to our submission entitled "Managing the Cost of Consumer Credit in Queensland" dated 10 December 2006 in response to the Discussion Paper of November 2006 generally, and in particular pages 15, 21 and 23.

9.2 **(Transitional):** As outlined above, CFF is concerned with the possible retrospective effect of the proposed amendments, as well as the lack any transitional provisions. To implement compliance with the proposed amendments, CFF would need at least 6 to 12 months to put adequate business structures, policies, agreements and commercial operations in place.

## 10. CONCLUSION AND SUMMARY

10.1 Thank you for the opportunity of making submissions on this important topic.

- 10.2 If you require any further information or have any queries please contact Paul Dent, Chief Operating Officer of CFF on (07) 3016 1206.
- 10.3 CFF would be pleased to provide further assistance in the development of alternative drafts of provisions the subject of these submissions.