

11 October 2007

Fringe Credit Project
Fair Trading Policy Branch, Policy Division
Office of Fair Trading
Department of Justice and Attorney-General
GPO Box 3111
BRISBANE QLD 4001 per email: consumercredit@dtftwid.qld.gov.au

Dear Sir/Madam

**Fringe Credit Measures – Consumer Credit Code Amendment Bill 2007 and
Consumer Credit Amendment Regulation 2007**

Thank you for the opportunity to provide comments on the *Ministerial Council on Consumer Affairs' (MCCA) Consumer Credit Code Amendment Bill 2007 and Consumer Credit Amendment Regulations 2007 Consultation Paper (August 2007)*.

This is a joint submission by the *Abacus – Australian Mutuals (Abacus)*, the *Australian Bankers Association (ABA)* and the *Australian Finance Conference (AFC)* as the peak industry bodies for Australia's mainstream credit providers. A listing of our members accompanies this submission.

This submission is in two parts. The first sets out our opposition to many of the proposals with a focus on the poor targeting of these measures at mainstream credit providers, the substantive failings of the planned new s.72 and the inadequate consultation process preceding its development. The second part is a Schedule that examines each of the specific amendments proposed in the Draft Bill and provides some analysis and comments on policy, operational and compliance issues.

Executive summary

As the peak bodies for mainstream credit providers, we are disappointed with the proposals. Our organisations support efforts to effectively target and reduce poor practice by fringe lenders and stamping out predatory lending activities. We would like to work with Government on options to address fringe credit abuses. But these wide-ranging proposals, however, are neither targeted nor practical. The proposals are not confined to fringe lending. Instead they seek to add unnecessary layers of new regulation to the general market. The proposals represent a missed opportunity to deal more effectively with issues in fringe lending and an unnecessary burden on mainstream credit providers.

Our submission does not support the key changes contained in the Draft Bill because of –

- *Policy failings* – The regulatory changes are too broad, affecting the whole credit market. The market failures have only been demonstrated to occur among fringe credit providers, not the well functioning mainstream market. There are contradictions to core policy objectives of the Consumer Credit Code (Code).

- *Poor process* – The four year gap in consultation on proposals that have consistently been represented as targeting the fringe credit provider market.
- *Economic impact* – No analysis of the Draft Bill has been undertaken of the economic impact, given the miniscule size of the fringe market relative to the mainstream market.

We strongly recommend further consultation on the Draft Bill, given its significance and its impact on operational systems and processes for mainstream lenders.

Proposed scope

Our major concern is that these proposals do not target fringe lenders but apply to the mainstream. One-size-fits-all regulation is entirely inconsistent with emerging consensus about reducing regulatory burdens and red tape by properly targeting intervention at areas of genuine detriment. Moreover, to further regulate the mainstream when consumer agencies already have criminal and/or civil powers to prohibit or curb the players or practices on the fringe is unsatisfactory policy. We believe agencies should exercise those powers in a strategic way targeted at unsatisfactory conduct in the fringe market rather than resort to further industry-wide regulatory responses.

Mainstream credit providers take their legislative responsibilities seriously and devote significant effort, time and resources to adhering to their high compliance standards and regulatory obligations. Compliance with these measures for mainstream providers is driven by a responsible and conservative approach rather than by the absence or threat of regulatory action, which might characterise the approach among fringe lenders, particularly when agency enforcement activity is limited. Mainstream credit providers operate in a highly competitive and disciplined market.

For some time, we have worked with MCCA to amend the Code to address malpractice by less reputable fringe and predatory lenders in the market. MCCA's strategic agenda shows as a priority in September 2005 it required changes to the Code to include "*the provision of additional protections to clients of fringe credit providers*". However, the current 2007 proposals go significantly beyond the fringe market and will apply to all credit providers and, in their most notable deviation, to all fees and charges.

We are firmly of the view that many of the proposed amendments are inappropriate, wrongly directed at mainstream credit providers and likely to have a significant and anti-competitive impact on the market, which will directly affect the choices available to all consumers. This proposed scope of the Draft Bill is out of all proportion to the size of the fringe credit provider market relative to the mainstream market.

The inadequate policy development and consultation process

The following sets out some historical background. This is intended to highlight the significant new direction and intention of the Draft Bill compared with the limited and targeted propositions originally put forward by MCCA.

In August 2003, MCCA released for consultation its Discussion Paper on *Fringe Credit Providers*. This paper clearly and deliberately divided the credit market into mainstream and

fringe credit providers. The former comprising banks, credit unions, building societies and national finance companies and the latter a more ill-defined group of credit providers that operate on the fringe of the market (such as payday lenders).

This division clearly signalled that the proposed reforms were to be targeted specifically at fringe lending activity.

Recognising growth in the fringe market and a corollary risk for consumers reliant on those lenders, the Code was amended in 2001 to specifically extend its scope to address some practices within the fringe market. Primarily this involved a two-stage process, firstly amending the Code to capture short term high return lending and, secondly, plans for further reform to respond to unacceptable behaviour and practices in the fringe market.

Some examples of areas requiring further treatment were set out in the 2003 Discussion Paper. They included the imposition of fees that translated to exorbitant rates of interest, taking security over essential household furniture ('blackmail securities') and a refusal to disclose annual percentage rates.

The 2003 Discussion Paper put forward a number of policy options including a voluntary or self-regulation model for fringe lenders and amending the Code. This last option was favoured and included proposals that sought to bring fringe lenders within the Code on the same basis as participants of the mainstream credit market.

The 2003 Discussion Paper included the following instructive statement about the limits of the planned stage-two reform proposals:

Although the amendments would segment the application of the Code between high cost loans and other loans, it is felt that it is necessary as the problems associated with fringe credit providers do not extend to mainstream credit providers. The amendments are targeted directly to enhance the "truth in lending" objective of the Code by specifically addressing problems isolated to the fringe credit market¹.

By October 2003, the mainstream industry had made its submissions in response to the Discussion Paper. Generally, these responses welcomed the distinction between the mainstream and fringe credit market participants although comments were offered on properly defining the fringe market.

Mainstream sector submissions also generally supported measures designed to expressly target malpractice among the fringe market, so long as such measures did not inadvertently impact mainstream providers that were already heavily regulated. This is consistent with MCCA's strategic agenda from September 2005 on protecting clients of fringe credit providers.

Despite the effort to provide sensible, considered and constructive feedback, there was no further action or engagement by MCCA with industry on these proposals until August 2007 when the current proposals were published on the MCCA website. Further, mainstream credit providers have not received a formal invitation to make a submission on these important proposals.

¹ MCCA, "Fringe Credit Providers – Discussion Paper" (August 2003) at 44

During the intervening period, the *Fringe Credit Providers – Decision-Making Regulatory Impact Statement and Final Public Benefit Test* (March 2006) was prepared. Despite the 2006 date, to our knowledge this document was only published on the MCCA website in March 2007. This was not a consultation document. The *Decision-Making RIS* does suggest extending the application of s.72 to all fees and charges, but it does not propose a low-level “unreasonableness” test in its discussions.

Subsequently, the August 2007 Consultation Paper made the following surprising observation:

Although these amendments will apply to all credit providers, they are particularly targeted at practices which are considered unjust and exploitative.

This was in addition to the inclusion of an amendment designed to:

enable all fees and charges (and the combination of interest, fees and charges) to be reviewable under s.72 of the Code.

This history shows that the proposals now set out in the August 2007 Consultation Paper were not flagged in the August 2003 Discussion Paper. To the extent that the March 2006 (2007) *Decision-Making RIS* recommends extending the unconscionable fee provisions to cover all fees, it does not recommend turning s.72 into a mechanism for challenging any fees unless they reflect actual costs or losses.

Our last opportunity to comment on these proposals was in October 2003. The character of what was raised in 2003 is now very different to that put forward by MCCA today. The consultation process has failed to provide appropriate opportunity for industry to properly engage on these proposals as they are currently formulated.

The lack of proper process in the way the Draft Bill, which fundamentally changes the Code, has been prepared and released, must be recognised. We believe that the broad price regulation that would result from these measures requires a full regulatory impact statement and cost benefit analysis as well as further and more detailed consultation with all stakeholders. If that rigorous process determines changes should proceed, there will also need to be adequate time given to implement them. These proposals also add to debate that is surfacing around the effectiveness and adequacy of the current State/Territory-based credit regulation framework.

Why apply Fringe Lending proposals to mainstream lenders?

We query MCCA’s apparent intention, reflected in the proposed replacement of Code s.72 (Clause 11 of the Draft Bill) of stopping credit providers from earning income on all fees and charges. In our view, the current drafting of Clause 11 suggests this outcome. Earning income on fees is a well-established and general commercial practice. It is not clear why MCCA believes earning income on interest is acceptable but not on fees, particularly as the two sources are inter-related.

We seek further explanation from MCCA as to its reasoning and the justification in terms of identifiable market failure and consumer detriment requiring such drastic legislative

intervention. This has certainly not been part of the debate on fringe lending until this point. Even if a policy case could be substantiated for limiting default and similar fees to the recovery of costs or losses, this does not easily translate to other fees such as annual fees or fees for exceeding set transactions.

We are concerned that the Code s.72 proposals will have a negative impact on product competition. Among other dynamic factors in a competitive market, fees play an important competitive role in product innovation, design and flexibility as well as in relation to pricing. The proposals also ignore the role fees play in giving consumers incentives to use lower cost channels or to minimise their transactions and be rewarded by lower cost credit if they do. This would be a disincentive on the market from making such offers and borrowers could lose the benefit of discounted rates.

We believe these proposals risk introducing commercial and prudential uncertainty for mainstream lenders. While they might mitigate some unacceptable or egregious behaviour among some fringe lenders, the restrictions they will impose should have no place in the mainstream market in the absence of market failure.

Proposed amendments not supported

We oppose the proposals set out in the consultation package for the following reasons:

- (a) *These amendments represent substantive scope creep.* The deliberate extension of the fringe lending proposals to cover all code-regulated credit providers is an unwelcome, impractical and excessive addition.
- (b) *These amendments disregard feedback already provided.* Little regard appears to have been given to feedback we provided to the *Fringe Credit Providers – Discussion Paper* in 2003. The wider sets of proposals now advanced have been released despite there being no engagement of stakeholders for four years.
- (c) *These amendments are flawed.* MCCA proposes a series of flawed amendment proposals that have the real potential to drastically impact mainstream credit providers by imposing additional regulatory burden and de jure control on fees.
- (d) *These amendments create a blunt price control mechanism.* Our members, who comprise the mainstream lending market, support the principle of opening and reviewing egregious transactions, interest or other charges. But we are concerned these proposals apply a blunt instrument that directly affects the activities of our members even though they have never been the intended targets of predatory or fringe lending reforms. The effect of these proposals is to turn Code s.72, in particular, for example, from a tool to respond to extreme or overreaching conduct into a price control provision of indeterminate scope.
- (e) *These amendments have not been subject to adequate industry consultation.* This is a significant disappointment and is particularly worrying given we believe these proposals represent the single biggest change to the Code since its inception.

Conclusion

Clearly our members do not accept the fundamental proposals in the Draft Bill, which is that mainstream lenders should be covered by fringe lending reforms and that income cannot be earned on fees, or that flexibility cannot be apportioned between interest and fees to meet market competition and to foster future product innovation.

These fundamental issues have not been the subject of consultation; they warrant separate and detailed discussion and impact assessment. These are the most significant changes to the Code since its creation. They go far beyond addressing poor lending by fringe lenders, who are only a very small feature of Australia's consumer credit landscape.

A further process of consultation is required to include a rigorous assessment of the evidence of market failure justifying these proposals, a cost benefit analysis and a thorough canvassing of alternative policy approaches that properly target areas of identifiable consumer detriment.

We note that MCCA has recently commissioned research by an independent consultant on the design of pre-contractual disclosure regulation. We endorse this evidence-based approach and recommend that MCCA commission robust research into its fringe credit proposals. Research should focus on identifying the true nature of the market failure and the likely impact of the proposed reform.

We would welcome the opportunity to participate in a meeting of officials and credit providers and their representatives to discuss and clarify the numerous technical, policy, economic and operational implications of these proposals.

In the meantime, if you require any clarification about this submission please contact Steve Edwards (02/9231 5877, steve@afc.asn.au), Josh Moyes (02/8299 9033, jmoyes@abacus.org.au) or Ian Gilbert (02/8298 0406, igilbert@bankers.asn.au).

Yours faithfully



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Member companies

Adelaide Bank, AMP Bank, Australia and New Zealand Banking Group, Arab Bank Australia, Bank of Cyprus, Bank of Queensland, Bank of Western Australia, Bendigo Bank, BNP Paribas, Citibank, Commonwealth Bank of Australia, Credit Suisse, Elders Rural Bank, HSBC Bank Australia, ING Bank Australia, Laiki Bank Australia, Macquarie Bank, Members Equity Bank, National Australia Bank, Rabobank Australia, St George Bank, Suncorp, The Toronto-Dominion Bank, United Overseas Bank, Westpac Banking Corporation

ABS Building Society, Greater Building Society, Heritage Building Society, Hume Building Society, Lifeplan Australia Building Society, Mackay Permanent Building Society, Maitland Mutual Building Society, Newcastle Permanent Building Society, The Rock Building Society, Wide Bay Australia

Alliance One Credit Union, AMP Employees' & Agents' Credit Union, Austral Credit Union, Australian Central Credit Union, Australian Country Credit Union, Australian Defence Credit Union, AWA Credit Union, B & E, Bananacoast Community Credit Union, Bankstown City Credit Union, Berrima District Credit Union, Big Sky Credit Union, Blue Mountains & Riverlands Community Credit Union, Cairns Penny Savings & Loans, Calare Credit Union, CAPE Credit Union, Capital Credit Union, Capricornia Credit Union, Central Murray Credit Union, Central West Credit Union, Circle Credit Co-Operative, Coastline Credit Union, Collie Miners Credit Union, Community Alliance Credit Union, Community CPS Australia, Community First Credit Union, Companion Credit Union, Comtax Credit Union, Connect Credit Union of Tasmania, Country First Credit Union, Credit Union Australia, Credit Union Incitec Pivot, Croatian Community Credit Union, CSR and Rinker Employees Credit Union, Defence Force Credit Union, Discovery Credit Union, Dnister Ukrainian Credit Co-operative, ELCOM Credit Union, Electricity Credit Union, ENCOMPASS Credit Union, Ericsson Employees Credit Co-Operative, Esso Employees' Credit Union, Eurobodalla Credit Union, Family First Credit Union, Fire Brigades Employees' Credit Union, Fire Service Credit Union, Firefighters & Affiliates Credit Co-Operative, First Option Credit Union, First Pacific Credit Union, Fitzroy & Carlton Community Credit Co-Op, Ford Co-Operative Credit Society, Gateway Credit Union, Geelong & District Credit Co-Operative, GMH (Employees) Q.W.L. Credit Co-Operative, Goldfields Credit Union, Gosford City Credit Union, Goulburn Murray Credit Union Co-Operative, H.M.C. Staff Credit Union, Heritage Isle Credit Union, Hibernian Credit Union, Holiday Coast Credit Union, Horizon Credit Union, Hoverla-Ukrainian Credit Co-Operative, Hunter Mutual, Hunter United Employees' Credit Union, IMB, Industries Mutual Credit Union, Intech Credit Union, islandstate Credit Union, Karpaty Ukrainian Credit Union, La Trobe Country Credit Co-Operative, La Trobe University Credit Union Co-Operative, Laboratories Credit Union, Latvian Australian Credit Co-Operative Society, Lysaght Credit Union, Macarthur Credit Union, Macaulay Community Credit Co-Operative, Macquarie Credit Union, Maleny and District Community Credit Union, Manly Warringah Credit Union, Maritime Workers of Australia Credit Union, Maroondah Credit Union, mecu, Melbourne University Credit Union, Memberfirst Credit Union, Muslim Community Co-Operative (Australia), New England Credit Union, Newcom Colliery Employees Credit Union, Northern Inland Credit Union, Nova Credit Union, NSW Teachers Credit Union, Old Gold Credit Union Co-Operative, Orana Credit Union, Orange Credit Union, Phoenix (NSW) Credit Union, Plenty Community Credit Union, Police Association Credit Co-Operative, Police & Nurses Credit Society, Police Credit Union, Polish Community Credit Union, Power Credit Union, Powerstate Credit Union, Pulse Credit Union, Qantas Staff Credit Union, Queensland Community Credit Union, Queensland Country Credit Union, Queensland Police Credit Union, Queensland Professional Credit Union, Queensland Teachers' Credit Union, Queenslanders Credit Union, R.T.A. Staff Credit Union, Railways Credit Union, RegionalOne Credit Union, Resources Credit Union, Satisfac Direct Credit Union, Savings and Loans Credit Union (S.A.), Security Credit Union, Select Credit Union, Service One Credit Union, SGE Credit Union, Shell Employees' Credit Union, South West Slopes Credit Union, Southern Cross Credit Union, South-West Credit Union Co-Operative, StateWest Financial Services, St Marys Swan Hill Co-Operative Credit Society, Sutherland Credit Union, Sutherland Shire Council Employees' Credit Union, Sydney Credit Union, Tartan Credit Union, Territory Insurance Office, The Broken Hill Community Credit Union, The Gympie Credit Union, The Police Department Employees' Credit Union, The Summerland Credit Union, The TAFE and Community Credit Union, The University Credit Society, Traditional Credit Union, Transcomm Credit Co-Operative, Uni Credit Union, United Credit Union, Victoria Teachers Credit Union, Wagga Mutual Credit Union, Warwick Credit Union, WAW Credit Union Co-Operative, Westax Credit Society, Woolworths Employees Credit Co-Op, Wyong Council Credit Union

AllCommercial Finance, Alleasing, Australian Finance Direct, Australian Integrated Finance, Australian Motor Finance, Automotive Financial Services, Bidgee Finance, BMW Australia Finance, Capital Finance Australia, Caterpillar Finance Australia, CBFC, Centrepoint Alliance, CIT Group, DaimlerChrysler Financial Services, De Lage Landen, Elderslie Finance Corporation, Esanda Finance Corporation, Ford Credit Australia, GE Commercial, GE Money, General Motors Acceptance, Hanover Group, HP Financial Services, Indigenous Business Australia, Integrated Asset Management, International Acceptance, John Deere Credit, Key Equipment Finance, Komatsu Corporate Finance, Leasewise Australia, Liberty Financial, Lombard Finance, MotorOne Group, Millbrook Finance, PACCAR Financial, Profinance, RABO Equipment Finance, RAC Finance, RACV Finance, Retail Ease, Ricoh Finance, Sharp Finance, SME Commercial Finance, Suttons Motors Finance, Toyota Financial Services, UFSG, Volkswagen Financial Services, Volvo Finance, Westlawn Finance, Yamaha Finance

SCHEDULE

Detailed comments on Draft Bill

Introduction

We provide the following commentary on the Draft Bill to, as appropriate –

- Identify flaws in specific policy and/or drafting
- Indicate our clear position on provisions
- Provide drafting suggestions should the Bill proceed
- Recognise those provisions which we would regard as consistent with the stated policy objectives targeted at market failures by fringe credit providers.

Where we have expressed opposition to a provision of the Draft Bill, the fact we also make comment and provide suggestions should not in any way be taken as our support the provision or its underlying policy.

Long Title & Clause 1 – Short Title

The long title to the Draft Bill states it is “An Act to amend the Consumer Credit (Queensland) Act 1994 to make changes to the Consumer Credit Code.”

This title is too generic to be of any assistance in interpreting the Draft Bill or the affect it is to have, if enacted, on the Consumer Credit Code (Code). Also, it does not reflect the stated policy objective of the last 4 years of addressing issues relating to fringe credit providers.

Our reason for providing this comment is to assist courts and lawyers in interpreting the Code should it be amended by the Draft Bill. Addressing our concern would provide courts and lawyers with specific guidance in applying clause 7 of Schedule 2 to the Code which requires that “the interpretation that will best achieve the purpose or object of this Code is to be preferred to any other interpretation”. Reflecting the fringe credit provider policy objectives of the Code explicitly in the Draft Bill’s title is to be preferred to relying on implication.

The policy papers to date on fringe credit have expressed in broad terms a delineation of between the fringe and mainstream. However, a more specific definition has been elusive. Below we make a recommendation to define mainstream credit providers, so that all others would be regarded as fringe credit providers and accordingly subject to the Draft Bill.

We **recommend** –

- the long title to the Draft Bill be expanded to make explicit reference to addressing concerns about fringe credit providers;
- the short title in clause 1 be more descriptive of the legislative policy, e.g. Consumer Credit (Fringe Credit) Amendment Bill 2007; and
- mainstream credit providers be defined as –
 - companies who are regulated by the Australian Prudential Regulation Authority (APRA) as authorised deposit-taking institutions; and
 - companies who are ‘registered entities’ with APRA under the Financial Sector (Collection of Data) Act and
 - any other company or class of company prescribed by regulation.

Clause 2 – Commencement

Should the amendments as drafted proceed, sufficient lead time must be allowed for changes to documents, procedures, training and systems (including software development), taking into account other regulatory change demands on credit provider resources, e.g. the Anti Money Laundering & Counter Terrorism Financing Act. Refer also our comments on Clause 14 dealing with transitional arrangements. We **recommend** consultation with industry before any commencement date is set.

Clause 4 – Amendment of s.7 (Provision of credit to which this Code does not apply)

Policy

The proposed amendments are entirely consistent with the explicit policy objective of the Draft Bill. They seek to address abuses of exemptions currently afforded by the Code. In providing disclosure, protection and rights to consumers and in placing providers of consumer credit on a consistent regulatory base, the proposed amendments are not opposed.

Drafting

We have no comment to offer on the drafting.

Clause 5 – Amendment of s.11 (Presumptions relating to application of Code)

Policy

There have been abuses of business purpose declarations by fringe credit providers that concern us. While appreciating those abuses, in practice the business purpose declaration can and does work efficiently for commercial and investments finance providers and their customers. We are concerned at the proposed removal of the current Code provisions implementing the declaration. The March 2006 Decision-Making Regulatory Impact Statement on Fringe Credit Providers makes it clear its intended target of the reform is the fringe, not commercial and investment finance providers who are outside the scope of the Code.

We are of the view the current business purpose declaration provisions are adequate for their intended purpose. The amendments proposed are not necessary as the measures contained in the Code to deal with abuses involving the inappropriate taking of declarations is shown to be working. Case law confirms courts will not allow a credit provider to rely on a declaration in circumstances where it can be shown the provider (or a finance broker) knew or should have known it was false. Recent cases of note are *Permanent Mortgages v. Cook* in 2006 and *Hamafam v Saadullah* in 2007.

In addition, those involved in inducing false declarations will breach Code s.144. The foreshadowed national regulation of finance brokers should reinforce this by placing greater responsibility on brokers in their dealings with clients.

Officials with responsibility for Code compliance and enforcement also have recourse to powers involving disciplinary action, 'negative licensing', unjust conduct, enforceable undertakings, fair trading prosecutions, etc, which can be directed at those abusing the business purpose declaration provisions.

Accordingly, we are of the view there are insufficient grounds to remove the so-called conclusive presumption for the business purpose declaration for mainstream providers. And, contrary to suggestions by the recent Victorian Credit Review, it is not unnecessary regulation that should be regarded as 'red tape' that would justify removal of the provisions.

From a disclosure perspective, the business purpose declaration puts finance applicants on notice about the potential to lose Code rights if they sign a declaration. To remove the declaration may in fact leave applicants less informed.

The business purpose declaration gives commercial and investment finance providers greater confidence they -

- can enter into contracts that the Code would not otherwise permit (e.g. commercial hire-purchase, equipment leases, margin loans); and
- competitively price their products without allowance for Code compliance regulatory costs; and
- provide finance in a way that meets the flexibility, promptness, taxation and other requirements of business and investor customers.

In recognising the concerns expressed about fringe credit providers and their abuse of business purpose declarations, we stand ready to explore with officials and other stakeholders a range of possible solutions aimed at enhancing the declaration provisions rather than taking them away completely.

However, if the amendments proceed, we have provided comments below that we believe will achieve a comparable outcome for commercial and investment financiers.

Operational & Compliance Considerations

Should the proposed amendment proceed, the removal of the business purpose declaration would involve changes to the documents, procedures and systems used by commercial and investment finance providers.

Application and/or contract documents contain the declaration. Documented operational and compliance procedures to be followed by staff, brokers and others, would need revision, supported by some re-training. Systems will also need to be changed so they do not produce/require the declaration. These are costs that will be borne by commercial and investment finance providers not regulated by the Code and their customers.

Drafting

While finance providers, whether consumer, commercial or investment, will ordinarily inquire in broad terms about the purpose for which finance is required, we are concerned about the way the proposed amendments require inquiries to be made in order to rebut the evidentiary presumption in Code s.11(1).

In particular, the amendments provide the presumption can only be rebutted if 2 specified conditions are met. As noted below, the use of the word "only" is unduly restrictive. The amendments are uncertain in their operation and are inconsistent with Code ss.6 & 7 in the following respects.

- The proposed s.11(2) fails to address the fact a loan can be unregulated for reasons apart from the loan purpose. For example, a loan can also be unregulated because

of the type of borrower (e.g. if the borrower is a company) or because of the type of loan (e.g. if the loan is exempt from the Code under s.7 or Regulations). Under the proposed s.11(2), if the loan is from a company but is not a business or investment loan, would it be presumed to be regulated?

- If a loan product is obviously unregulated (e.g. a margin loan for share trading), why should the lender be called on to prove it had checked with the debtor about the loan purpose to rebut the presumption in s.11(1).
- The process required to comply with the proposed s.11(2) is unclear. It raises a range of questions which need to be addressed for compliance certainty in the drafting, such as:
 - What level of inquiry would satisfy s.11(2)?
 - What does "identified" mean?
 - Would it be sufficient if the finance provider has some tick boxes in the loan application form to obtain the information? (E.g. what about online applications?)
 - How much detail should finance providers request?
 - Is it sufficient to specify for instance that a car loan is for the borrower's day to day business requirements or would more information be required?

The proposed s.11(2) does not provide enough flexibility for those circumstances where the borrower provides what a finance provider knows or suspects to be incorrect information. It is possible other information makes it clear the loan is for business purposes but the borrower asserts the loan is for personal use or vice versa, leaving the finance provider in a difficult compliance position.

Clause 6 – Amendment of s.15 (Matters that must be in contract document)

Policy

While we understand the policy objective, its legislative expression gives rise to significant concerns. The proposed amendments reflect s.10B of the Consumer Credit (NSW) Act and that section's unsatisfactory nature. That nature is based on the ambiguity in knowing what is required for compliance with its requirements.

Under the proposed amendments, the figures stated as the annual percentage rate and the total interest charges, which are required under Code ss.15(C) & 15(D), are to include charges and amounts that are "in the nature of interest charges (whether or not expressed to be interest charges)".

The key compliance factor for credit providers will be the correct categorisation and disclosure of the annual percentage rate, interest charges and credit fees and charges. To get that categorisation wrong will bring serious compliance consequences. If a charge which is later regarded to be a charge "in the nature of interest" is initially disclosed as a credit fee and charge, the Code's civil penalty regime will be attracted.

The concern is the concept of charges and amounts "in the nature of interest charges (whether or not expressed to be interest charges)" is uncertain and not defined. Also, it is left unclear about the relationship of this requirement with other Code provisions, such as

ss.21, 26, 27, 28 and the definitions of “annual percentage rate”, “credit fees and charges” and “retained credit fees and charges”.

As these amendments reflect NSW s.10B of its Consumer Credit Act, we are disappointed the experience with that provision has not been taken into account with the amendments. The NSW Office of Fair Trading has found it necessary to release 2 administrative Statements of Regulatory Intent and Compliance Policy on issues relevant to these amendments, giving an indication of the uncertainty around the concept. While helpful, the Statements are no substitute for precise regulation which obviates the need for a judicial interpretation to determine its meaning and application.

The NSW Commissioner for Fair Trading, in a Statement of Regulatory Intent, dated 19 April 2006, acknowledged the s.10B of the Act amendment was originally introduced in a response to the actions of short term lenders. The consequence is of increased market place compliance uncertainty for all lenders.

A need arose to issue another Statement of Regulatory Intent and Compliance Policy on 31 May 2006 to assist industry in dealing with disclosure requirements for shared equity mortgages, a new product development by mainstream lenders. In that statement, the Commissioner acknowledged the annual percentage rate and interest charges are unascertainable for shared equity mortgages. While the Commissioner has expressed the view the disclosure of the appreciation fee calculation methodology is sufficient for compliance purposes in NSW, this is not the law.

We believe these amendments require further consultation with a view to either developing alternative approaches, including non-legislative, administrative and/or targeted options, and/or resolution of the conceptual and compliance ambiguities.

Finally, if these amendments become law, NSW should repeal its s.10B to ensure at least uniformity of requirements.

Drafting

These amendments should be removed from the Bill to allow further consultation.

Clause 7 – Amendment of s.46 (Prohibited securities)

Policy

The proposed amendments are entirely consistent with the explicit policy objective of the Draft Bill. They seek to expressly address abuses by ‘fringe elements’ who take what are colloquially called ‘blackmail securities’, something that Code s.70(2)(m) was directed. The proposed amendments are not opposed.

Drafting

We have no comment to offer on the drafting.

Clause 8 – Amendment of Part 4, Div 3 Heading (Changes on grounds of hardship and unjust transactions)

No comment – a technical, consequential amendment. Refer our comments on Clause 11.

Clause 9 – Amendment of s.70 (Court may reopen unjust transactions)

Policy

Refer our comments on Clause 7. It appears, as a matter of policy, a mortgagor under a mortgage which is void under the proposed Code s.46(3) – (6) is to be given the opportunity to have a court consider whether the mortgage is unjust. We find it illogical for a court to be asked to conduct such a review of a mortgage which is void.

The Code provides other enforcement and remedial provisions for mortgages declared by the Code to be void. A credit provider who enters into a void mortgage breaches s.49. Also, a mortgagor can pursue compensation rights under s.114.

Drafting

Reconsider need for proposed amendments to Code s.70.

Clause 10 – Amendment of s.71 (Orders on reopening of transactions)

No comment – a technical, consequential amendment. Refer our comments on Clause 11.

Clause 11 – Replacement of s.72 & insertion of s.72A (Court may review unconscionable interest and other charges)

Policy

Our comments on Clause 11 will –

- examine the way in which the Clause would undermine a core policy objective of the Code concerning product flexibility
- identify the price-control implications
- identify the adverse implications for competition and credit consumers
- demonstrate departures from the RIS on which the Draft Bill is based, particularly in not continuing to apply the ‘unconscionability’ test

These amendments represent a significant change in the Code’s core policy. When introduced into the Queensland Parliament on 4 August 1994, apart from emphasising the role of disclosure under the Code, it was stated –

- the Code would regulate, “but without restricting product flexibility and consumer choice”; and
- “the policy of the legislation is to rely generally on competitive forces to provide price restraint”.

Under the current Code, there are considerable opportunities for product flexibility and consumer choice, and these opportunities have been embraced by credit providers, especially compared to previous restrictive Credit Acts.

Also, the financial services sector has experienced a substantial increase in additional dynamic competition over the last decade. That competition has manifested itself in many ways, including price competition with respect to interest, fees and charges. Indeed, the amendments give recognition to this with its guidance to a court considering “the reasonableness of a matter”, that it “may have regard to the standards of commercial practice generally”.

On the face of it, this recognition suggests there is no fundamental mischief requiring the legislative intervention evinced by the Bill. Targeted action aimed at those who are price gouging or charging fees at unconscionable levels should be considered as an alternative policy or administrative response.

We believe market forces in the mainstream have been, and continue to be, sufficient to moderate the price of credit, whether fees or interest. We do not see an intention in the present Code to tie every fee to specific costs and be measured against the ambiguous concept of “unreasonableness”. If that were to be the case, it may have implications for low cost credit and flexible consumer choices.

In addition, the amendments are a significant departure from the Decision-Making Regulatory Impact Statement (“RIS”) on which the amendments purport to be based. Regrettably, the departure is a further reflection on the unsatisfactory process that has led to the amendments.

The RIS, dated March 2006, was not the subject of consultation and was not released until March 2007. This RIS shows Ministers approved a continuation of the unconscionability test, not the introduction of a new and vague lower-threshold unreasonableness test. The RIS recommended the unconscionability test be applied to all credit fees and charges beyond the current establishment, prepayment and early termination fees.

Specifically, the relevant approved RIS recommendations state “that the existing remedies in the Code be modified to –

- enable all fees and charges and the combination of interest, fees and charges to be reviewable under s.72 of the Code. The test for determining unconscionable fees and charges should be linked to the underlying costs or loss associated with the fee or charge. The test for determining unconscionable interest will be based on s.70(2)(n) of the Code;
- enable a court to consider fees and charges reasonably imposed by other credit providers in determining unconscionable. interest and charges under s.72;
- permit a court when considering an application under s.72 to take into account the objective reasonableness of costs incurred in establishing or terminating a loan of that type;
- clarify the operation of s.72(3) generally;
- permit government consumer agencies to make applications under ss.70 and 72 of the Code.”

Our concerns are with the apparent departure by the Draft Bill from the RIS that expands the scope of reviewable fees beyond establishment, prepayment and termination fees, and removes the concept of unconscionability, which is built on well-established principles. In contrast, the concept of “unreasonableness” is ill-defined and the move to it suggests a watering-down of the tests applicable to credit fees and charges. We therefore **recommend** removing the proposed s.72(1)(f) & (g) and s.72(6) & (7), and retaining in s.72 the concept of unconscionability.

In our view, these amendments are an attempt at broad-brush price control, departing significantly from the Code’s basic policy tenets. The amendments extend well beyond dealing with problems with fringe credit providers.

There needs to be a wider assessment of potential implications for these amendments. The Code has delivered on its policy of product flexibility and enhanced consumer choice, through greater disclosure, pricing freedom and competition. There have been many benefits as a result. To our mind, the amendments, covering all fees and charges imposed by all consumer credit providers, are inconsistent with these policies.

Clause 11 also provides, through the insertion of a new section Code s.72A, for class actions to be undertaken by consumer agencies, as well as those agencies being able to take action in the public interest. We perceive a lack of appropriate balance in dealing with this aspect of the Bill. In the summary of proposed amendments in relation to clause 11 in the Consultation Package, the clause is described as “having been much awaited”. We are not clear by whom Clause 11 has been awaited. These amendments were not part of the 2003 consultation process. We note they were mentioned in the September 2005 MCCA strategic agenda, but only the context of providing additional protections to clients of fringe credit providers.

The question whether it is appropriate for consumer agencies to have power to conduct class actions is broader than the issue currently under consideration with these proposals. The central issue is that consumer agencies should not have the power to conduct class actions against mainstream credit providers based on provisions in the Draft Bill.

Operational Considerations

Should the amendments proceed, they may result in a distortion between internal fees and external costs.

This development is contrary to the basis on which the Code was amended some time ago to allow for enforcement expenses recoverable by a finance provider to include its internal costs “reasonably incurred by the use of the staff and facilities”. Until that amendment, enforcement expenses were confined to those costs incurred in using the services of third parties, or as otherwise defined in the Code. The rationale for the change was a recognition that consumer credit providers can undertake enforcement and pass on costs to consumers in a more cost efficient manner than third parties, and that should be encouraged. This was seen to benefit consumers.

In addition, should the amendments proceed, there will be significant costs incurred, and time taken, by credit providers as they undertake comprehensive reviews of their pricing models.

Drafting

References to “unreasonable” should be changed to “unconscionable” throughout the proposed s.72.

The current Code s.72(3) has been changed in the proposed new s.72(3) to remove provision for a calculation of an establishment fee to be based on the finance provider’s average reasonable costs. The drafting of the amendment suggests only actual costs are acceptable. We believe this is an unintended omission and **recommend** its reinstatement

The proposed s.72(6) is far too prescriptive in its approach. It assumes all charges have a cost rationale – many are about product design and consumer choice. A deferred establishment fee, or early termination fee, may be set to recover some on the discounted

interest margin foregone during the honeymoon rate period. In any event, the drafting should at least be amended to allow the consumer credit providers to use an estimate of the costs as a basis for the calculation of the fees.

The proposed new s.72(7)) provides that, in considering the reasonableness of fees, other than default fees, the court may have regard to “the standards of commercial practice generally”. We are unclear how evidence can be adduced to establish this. The RIS sets out a test which allows “a court to consider fees and charges reasonably imposed by other credit providers in determining unconscionable interest and charges”. This at least gives a clearer indication of what is required, rather than comparisons to “standards of commercial practice generally”.

Clause 12 – Amendment of s.100 (Key requirements)

No comment – a technical, consequential amendment. Refer however our comments on Clause 16.

Clause 13 – Amendment of s.150 (Presumptions relating to application of this Part)

Policy

Refer our comments on Clause 5.

Drafting

Refer our comments on Clause 5.

Clause 14 – Insertion of new Part 12, Div 3 (Transitional arrangements)

Policy

Well thought through commencement and transitional provisions are important factors in the implementation of change. Given the documentation, systems, etc, issues involved in a number of the amendments, we **recommend** consultation on the commencement date. Also, industry has finite resources available to it which are currently engaged in implementing significant reforms such as Basel II and the Anti-Money Laundering and Counter Terrorism Financing Act. We believe it reasonable for a 24 month lead time.

Also, in light of the documents complying with current Code requirements, we recommend the transitional provisions permit a phasing out of requirements. While many consumer credit providers produce documents through their computer systems, many others continue to rely on the printing and distribution of Code-compliant documents in pre-printed format. To require the affected contract and related documents to be recalled from use, destroyed and replaced is wasteful.

Therefore, we **recommend** a transitional approach along the following lines –

- in the event the business purpose declaration is no longer recognised by the Code, that permits the continued appearance of the declaration in documentation
- in the event a direct debit warning is required to be included in Code documents, that permits continued use of documents without the warning for a reasonable time

(e.g. 24 months), provided cancellation rights are included in other documents given to consumers to keep.

Such a flexible approach is particularly justified given the impact of changes extend beyond the justified fringe providers, to include commercial and investment finance providers and other mainstream credit providers, and the time taken so far in the development of the policy and Draft Bill.

We are also concerned that the transitional provisions do not satisfactorily deal with the potential impact of the amendments on existing contracts.

One example of this is in relation to s.72. In our view would be grossly unfair for:

- the change from unconscionable to unreasonable, and
- the change from endorsing a calculation of establishment fees based on an “estimate of average reasonable costs” to “reasonable costs”,

to apply to existing fees charged, or already payable, under existing credit contracts. Credit providers cannot be expected to reassess all of their existing fees on existing contracts, where those fees are acceptable under the current regime, and potentially be required to unilaterally vary those fees to reflect a change of law.

In relation to s.72, we do not believe that the proposed transition rules go far enough to address the above as they refer to when an application for review is made. What this means is that a credit providers existing fee structure is subject to challenge under the new s.72 provided that the customer waits until the new s.72 comes into effect. This is unworkable and the customer benefit is hard to see.

In addition, sufficient time would need be allowed for a complete reassessment of fees as they are disclosed in current credit contracts in light of the change in the grounds for, and expanded scope of, reviewing fees.

Drafting

The drafting of the transitional arrangements require greater scope and flexibility. We **recommend** including a comprehensive regulation-making power consistent with that relied upon during the implementation of the Code.

Consumer Credit Regulation 1995

Amendment – Direct debit arrangements

Policy

Direct debit arrangements work well in the interests of both credit providers and their customers. Those arrangements are an efficient and simple way for repaying credit facilities. Direct debit is cost-effective compared to other methods of payment, which involve additional processing costs. This is why many credit providers charge a fee when payments are made by non-direct debit means.

In our view, the amendments are not justified. The right to cancel, and the process for how to do it, is highlighted in the direct debit service agreement required under the bulk electronic clearing system rules, known as the BECS rules. A customer receives this Agreement at the time the credit contract is signed and before the Direct Debit Authority is

signed. The Agreement sets out cancellation details, variation arrangements and how to dispute debits.

In addition, the prescribed statement may well mislead customers about their payment obligation under the contract, particularly when payment by direct debit is a contractual obligation or alternative payment arrangements will result in additional costs to the customer.

There is also the potential for serious inconsistency to arise if there are changes to the bulk electronic clearing system rules and the Consumer Credit Regulation is not speedily amended and consequential amendments are not then promptly implemented in each State and Territory under the ministerial agreement.

If there is a compelling policy need to require all consumer credit providers, not just the fringe, to repeat direct debit cancellation rights, then, as an alternative, we would suggest consideration be given to including the statement in the Code's Form 2 Information Statement.

It should also include a warning to consumers they should contact their credit providers to make acceptable alternative repayment arrangements to avoid direct debit dishonour fees and defaulting on their payments.

Operational & Compliance Considerations

Should the proposed amendment proceed, the inclusion of a prescribed statement of cancellation rights would involve changes to documents, procedures and systems. In particular, should the proposed warning box proceed, it will require changes to credit contract documents and templates.

This will further lengthen the contract and add to the disclosures consumers are intended to read and understand. Systems will also need to be changed to incorporate the prescribed text. These would be costs unnecessarily incurred by consumer credit providers as the details about cancellation are already provided to consumers who pay by direct debit.

Drafting

The text of the warning box is too simplistic – refer our policy comments above.

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