



22nd May, 2009

Manager
Consumer Credit Unit
Corporations & Financial Services Division
The Treasury
Langton Credit
PARKS ACT 2600

Dear Sir or Madam

PROPOSED CONSUMER CREDIT LEGISLATION: NATIONAL CONSUMER CREDIT PROTECTION BILL, 2009 (NCCBP) AND RELATED DRAFT LEGISLATION

We refer to your request for submissions regarding the effect of proposed changes to the legislation regarding consumer credit that are contained in exposure drafts released on 27 April 2009. We are pleased to present this submission on the effect of the proposed legislation with respect to strata corporations as defined in section 186A of the proposed National Credit Code (these corporations are also known variously as bodies corporate, strata companies and owners corporations).

Our submission covers several areas:

1. Lannock's credentials to make this submission
2. Our view that there is no benefit to strata corporations in being subject to this legislation
3. Our view that the proposed legislation imposes undue costs for little public benefit
4. Various issues with the legislation if it is decided that strata corporations should be included

Lannock's credentials in making this submission

As founder and chief executive officer of Lannock, I hold an undergraduate degree in economics and post-graduate degrees in commerce (specialising in finance) and management. I am a Sloan Fellow of Stanford University, having obtained a Master of Science from its renowned Graduate School of Business. I was for 14 years a corporate banker with Westpac Banking Corporation where I worked in a variety of roles including credit analysis, account management and research.

I founded Lannock Strata Finance in 2004 to address the funding needs of strata corporations. As CEO of Lannock, I have presented at conferences of all state strata institutes. Lannock is a sponsor of research into strata issues through being a founding member of the Strata Research Consortium

and an industry partner of the City Futures Institute of the faculty of the Built Environment at NSW University.

Strata Corporations as consumers

Lannock believes that there is little to be gained by including strata corporations as consumers under the proposed legislation. The proposed National Credit Code repeats the approach of the Uniform Consumer Credit Code in relation to strata corporations.

It is not clear to Lannock why the existing Uniform Consumer Credit Code provides (in its effect) that “primarily residential” strata corporations should be deemed to be consumers. In the Commentary issued when the Uniform Consumer Credit Code was proposed in 1995, there was no explanation of the policy reason for treating strata corporations as consumers and Hansard does not contain any discussion of this.

It may be that the legislators thought that strata corporations might regularly obtain credit for “personal domestic or household purposes”. We submit that the maintenance of common areas of a strata development can and should be distinguished from what one might call “conventional” domestic or household purposes. In any event the governance arrangements within strata (discussed below) are a compelling reason to cease regulating strata corporations as consumers.

We note that strata corporations are the only type of corporate entity that is treated as a consumer (in other words, as if they are individuals). And yet a strata entity is always a body corporate.

The legislation that governs these bodies corporate varies from state to state, but in essence, all states have very similar requirements that mean that strata corporations have a corporate existence that gives them a character that should not be compared with that of natural persons.

In general, strata corporations are required to:

1. Undertake annual budgeting
2. Resolve to accept the annual budget in a general meeting
3. Produce annual financial statements and present them annually in a general meeting
4. Maintain records and books of account for all financial transactions
5. Have an “executive committee” which includes the nominated roles of chair, secretary and treasurer
6. Have general meetings at least annually for which due notice and an agenda are required
7. Produce and circulate minutes of committee and general meetings

Corporations may choose to engage a ‘strata managing agent’ to assist them in these matters as well as obtaining advice from accountants and lawyers and both of these professions have specialist strata service providers.

The actions of strata managing agents are governed by separate but complementary legislation.

Decisions about funding must follow the due process set out in legislation which usually requires a decision by a majority (sometimes an ordinary majority, at other times a “special” majority) in a general meeting.

As referred to above, this requires a meeting to be called, notices (including the agenda from which only limited changes may be made in the meeting) to be sent to all owners. Owners have the opportunity of attending in person or nominating a proxy.

As one would expect, decisions are usually well-debated and all owners have the opportunity not just to cast their vote, but also to speak to each motion.

With such a high degree of corporate governance, record keeping and procedure surrounding financial decisions, it is clear that there is a substantial difference between the borrowing actions of a strata corporation and those of an individual.

At a high level, the decision to borrow is made between households, not within one household, and almost invariably with professional advisers assisting. We are not aware of any instance since strata legislation was introduced in 1961 where a corporation has experienced a problem which the proposed credit legislation would have addressed.

Licensing requirements

Under existing regulation of consumer credit, there is no need to hold a licence to provide credit, except in Western Australia. There is a requirement for registration in the Australian Capital Territory and Victoria. Instead, credit providers who do not comply with their legal obligations can be banned on application by the relevant regulator. This is known as a “negative licensing regime”.

We think that a positive licensing regime introduces an inappropriate barrier to entry to the market for the provision of credit. The existing negative licensing regime appears to have operated effectively for the past 5 decades and could be continued.

If strata corporations continue to be deemed to be consumers...

Lannock’s view is that there is no social benefit in deeming strata corporations to be consumers.

However, if they are to be characterised as consumers, we have several concerns with the structure of the proposed legislation.

In the strata industry, Lannock relies to some degree on an indirect sales model. Lannock has alliances with suppliers of goods or services to strata buildings. If major work is required, a supplier proposing to supply goods and services can present financing from Lannock as one possible solution to the funding needs of the strata corporation for that work.

At present, a supplier would typically provide a short indicative outline of the likely cost of credit and the criteria applied by Lannock when considering applications for loans.

In this situation, commissions may be payable either by Lannock to the supplier or by the supplier to Lannock in connection with the transaction.

As drafted, the actions of the supplier in the example above would be a “credit activity” because the supplier would provide “credit assistance” (see DEF5, DEF6 and DEF7 of the NCCPB). They would not be exempted by draft Regulation 6.3 of the National Consumer Protection Regulations. Proposed Regulation 6.3 would allow a supplier to explain to a customer how to contact Lannock subject to disclosure of commissions it might receive. But the current role of a supplier in its dealings relating to Lannock would go further than that, and the supplier would have to obtain an Australian Credit Licence or be appointed as a credit representative of Lannock.

This would expose the supplier to having to provide a credit guide to the prospective customer, conduct a preliminary assessment of the potential unsuitability of the credit contract, become a member of an approved external dispute resolution scheme and obtain the mandated compensation arrangements (no insurance is presently available for the role of the supplier). The cost and difficulty of taking these steps and training staff of the supplier is out of proportion to the role of the supplier, and it would probably destroy this critical method of credit distribution for Lannock. This has the effect of reducing consumer choice of payment options and would probably reduce economic activity because prospective customers might otherwise not be able to fund the relevant works on the common property.

Secondly: typical actions of strata managers as “agents” for the strata corporation also appear to require a credit licence. Companies and persons act in their capacity of strata managers within the strict parameters of specific legislation which governs their activity and their relationship with their clients. Additional legislation is not required to ensure that they act responsibly with their client’s best interest in mind.

Direct effects for Lannock

Lannock Capital Pty Limited (Lannock Capital) is a credit provider and would need to have a credit licence. Loan origination is normally conducted by its parent, Lannock Strata Finance Pty Limited (LSF). LSF could be appointed as a credit representative of Lannock Capital.

As stated above, Lannock believes that this industry does not need a licensing regime to operate effectively. The experience of strata legislation over a 5 decade period is evidence that a negative licensing regime can be effective.

If strata corporations continue to be treated as consumers, Lannock’s new responsibilities would include:

- Becoming a member of an external dispute resolution scheme;
- Creating a satisfactory compensation fund for non-compliance with the NCCPB.

Taking each of these responsibilities sequentially, Lannock submits as follows:

- Lannock believes that in the case of a body corporate, such as a strata corporation, the administrative remedies already available through the various government bodies (for example,

in NSW, the Consumer Tenancies and Traders Tribunal) and legal remedies in the courts should be preferred over an external approved dispute resolution scheme.

- There should be no need to establish a compensation scheme. In any event, no professional indemnity insurance is presently available in the market place to cover the risks of non-compliance with legislation such as the NCCPB. In fact, Lannock has sought PI insurance regarding its current obligations under the existing legislation and this is not available. These are risks which are normally absorbed by a credit provider and prevailing accounting principles require appropriate provisioning for these risks when they appear.

We thank you for the opportunity to respond regarding the proposed legislation. We would be delighted to provide additional information or answer any questions the commission may have, in writing or in person.

Yours sincerely

Paul Morton
CEO
Lannock Strata Finance Pty Ltd