

Via email: consumercredit@treasury.gov.au

Consumer Credit
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Sir,

National Consumer Credit Protection Bill 2009

I refer to a submission dated 20 May 2009, lodged by members of the Financial Services Committee of the Business Law Section of the Law Council of Australia in their capacity as individuals rather than as representatives of the Committee. For ease of reference, I attach a copy of the submission.

I am writing to confirm that the submission has now been endorsed by the Financial Services Committee and the Business Law Section. However, owing to time constraints imposed for the lodgement of submissions, it has not been possible to have the submission considered by the Directors of the Law Council of Australia.

Yours faithfully,



Bill Grant
Secretary-General

25 May 2009

Enc.

LCA FSC SUBMISSION TO TREASURY REGARDING THE CONSUMER CREDIT PROTECTION BILL 2009

This submission is made by members of the Financial Services Committee of the Business Law Section of the Law Council of Australia (**LCA FSC**) in their capacity as individuals rather than as representatives of the LCA FSC, pending the approval of the submission by the Law Council of Australia Business Law Section Executive. We are grateful for the opportunity to comment upon the Exposure Draft of the National Consumer Protection Bill 2009 and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009, and the regulations to those draft Bills (**Reform Package**). We note that Treasury included a representative of the LCA FSC in Treasury's Industry Advisory Group (**Advisory Group**), and are grateful for the opportunities that the inclusion provided for commenting upon issues relating to the Reform Package as it was developed over the past seven months. In the interests of brevity, this submission does not address issues previously raised by the LCA FSC's representative on Treasury's Advisory Group, or issues that have been addressed by Treasury in the meeting of the Advisory Group immediately following the release of the Reform Package.

1. **General Comments on the reform package**

Red tape reduction and uniform regulation

The authors support the principle of the national and uniform regulation of consumer credit in Australia, announced by Minister Sherry in October 2008, and the stated intent of the Minister to "*reduce red tape*" for the industry by introducing "*uniform national laws*" on consumer credit. That said, the authors have grave reservations about whether either of these objectives announced by the Minister (uniform regulation and red tape reduction), can be satisfied if the Reform Package is enacted as is.

The National Consumer Protection Bill 2009 (**the Bill**) and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009, permit any State or Territory at any time to exclude the application of the Reform Package in whole or part, or to introduce conflicting laws which are to prevail over the Commonwealth legislation. In practice, this loophole has the real potential to undermine the objective of uniform national regulation, whilst increasing 'red tape' for credit providers and other industry participants, if states continue to pass legislation governing consumer credit.

In addition, we note that the term "*credit legislation*" in the National Consumer Protection Bill 2009, is defined to include the Reform Package, the ASIC Act and any other Commonwealth, State or Territory legislation in so far as it regulates consumer credit, meaning that a breach of *credit legislation* will occur if a licensee or registrant breaches a state *Fair Trading Act*. This will result in states with more onerous Fair Trading Act provisions in regard to consumer credit (such as the ACT or Victoria), effectively regulating for the nation [as national licensees will generally (for the purposes of simplicity) comply with the highest regulatory bar set by any of the states on a nationwide basis].

As we understand it, the reason for including references to State and Territory laws in the definition of "*credit legislation*" was to ensure that credit providers who had breached the state Consumer Credit Codes and regulations, could be refused a licence by ASIC. If that is the mischief that Treasury seeks to address, we suggest redrafting the definition of credit legislation in the National Consumer Protection Bill 2009 to read as follows:

Credit legislation means:

- (A) This Act; and
- (B) The Consumer Credit Transitional Act; and
- (C) The ASIC Act; and

- (D) The Consumer Credit Code and Consumer Credit Regulations of each of the Australian States and Territories.

Concerns in regard to the proposed legislative timeframe

The National Credit Code (**NCC**) will come into force on 1 November this year, with registrants required to comply with the 'conduct obligations' in the Reform Package from day one of registration. We are concerned that it will not be possible for the majority of registrants to comply with the requirements of the Reform Package, given the significant changes for organisations that the reforms will require organisation to make to their –

- IT systems,
- compliance and risk management procedures and monitoring programmes,
- document retention and management practices,
- staff training, and
- sales/promotions and disclosure practices.

In larger organisations, implementing such changes can take between six months and a year. Accordingly, we are concerned that Treasury's timetable is unreasonable from a commercial perspective. We suggest that registrants be provided with some transitional relief during the registration period (until 31 December 2009) in regard to their compliance with the amended and new forms to the NCC, and further relief in regard to their compliance with their conduct obligations under the Reform Package. In the absence of such relief it is likely that credit industry participants will not register themselves as credit providers or credit service providers under the National Consumer Protection Bill 2009 until the latest possible date, namely New Year's Eve 2009.

We suggest further, that licensees be permitted to nominate the date on which they wish to be licensed, as initially occurred under the FSR regime, given that many applicants are unlikely to be ready to apply for their licences by the latest date for making such applications (30 June 2010).

Concerns in regard to complexity

The Reform Package will undoubtedly be the biggest regulatory change to hit the financial services sector in a generation, and will regulate a wide range of industry participants such as retailers and introducers, who have not previously been subject to such regulation. The complexities involved with regulating a diverse group of industry participants, and a wide range of credit products and services, should not be underestimated. We are concerned that the proposed time frame for the implementation of the regulatory package will:

- Make it impossible for many industry participants to comply with the requirements of the Reform Package 'in time'.
- Result in unintended and unanticipated legislative consequences due to a lack of "scenario testing" of the legislation using examples provided by different industry participants, and examples relating to different products and classes of consumers.

Where rushing the Reform Package results in such unintended legislative consequences, the cost to industry, and consequently the cost to consumers and the economy, including likely increases in unemployment, is likely to be considerable. For example, if the Reform Package has the unintended consequence of making the offer of certain product classes by remote means (such as online or via phone) too risky for credit providers, the access to and availability of credit for the public will contract, and will cause disproportionate disadvantage in rural and remote areas that are currently poorly serviced by financial institutions.

In our view the Reform Package should be rigorously “scenario tested” by Treasury in full consultation with industry so as to minimise such unintended consequences, rather than as appears likely, passing the Reform Package and then fixing any unintended results via the issue of a series of class orders, regulatory guides, and legislative reform/simplification projects.

In addition to conducting scenario testing, we suggest that the Productivity Commission should be engaged to assess and quantify the likely impact of the legislation upon the availability of credit in the economy, employment (particularly in the retail sector if the impact of the Reform Package is to make store credit obsolete or reduce its availability and hence reduce sales revenue), and upon particular sectors of the economy (in terms of the cost of complying with the Reform Package) such as the retail sector, financial sector, and securitisation industry.

Finally, we are concerned that FSR concepts have been applied to the consumer credit industry and credit providers in particular, despite the fact that for FSR regulated products the bulk of financial risks are borne by the consumer (as it is the consumer’s money at issue), whereas for credit, the bulk of the financial risks are borne by the credit provider (as it is the credit provider’s lending at issue).

We note that the onerous disclosure obligations under the Reform Package are at odds with the disclosure simplification work for FSR regulated products being conducted by Treasury and ASIC in consultation with the Financial Services Working Group, and are concerned that these onerous disclosure obligations are based upon a belief that the mischief in the credit industry (particularly in relation to predatory lending and fringe players in the industry) can be solved by an onerous disclosure regime. We note that the disclosure by a rogue predatory lender (on the assumption that the lender is granted a licence) of unreasonably high fees, brokerage charges, and commission payments in its credit guide and credit disclosures under the Reform Package, is unlikely to prevent desperate people who have been turned away by mainstream lenders from entering credit contracts (to their disadvantage) with the predatory lender.

That is, except to the extent that predatory lenders are denied a licence, the Regulatory Package may not reduce the extent of predatory lending in Australia or the hardship caused to consumers by predatory lenders. Rather it may increase such practices in the absence of increased monitoring and enforcement by ASIC, as mainstream lenders become more risk averse (following the impost of the Regulatory Package) in assessing whether to lend to certain classes of customers (such as self-employed people, and young people).

Lawyers and the Reform Package

We are grateful that Treasury has seen fit to provide an exemption for lawyers in the regulations to the Regulatory Package, which allows lawyers to continue to provide consumers with independent legal advice in regard to financial contracts and products such as guarantees. We also endorse the proposed low cost jurisdiction for small matters to be provided by the Federal Court under the Reform Package, as this will provide consumers with more ready access to dispute resolution for small claims. We are however concerned that the jurisdiction for larger disputes remains with the State courts, as this will likely result in inconsistent rulings on similar matters between States. We suggest that the jurisdiction for all matters should be the proposed special consumer division of the Federal Court.

We note that there are a number of technical errors, inconsistencies and oversights in the Reform Package that have been brought to the attention of Treasury separately by the LCA FSC representative on the Advisory Group and these are not reproduced in this submission. These oversights range from typographical errors and omissions in definitions that have unintended consequences, to inconsistent use of terminology between the Bills and regulations (for example the use of “credit representative” in the Bill and “credit agent” in the regulations), and the failure of the Bill to refer to a licensee’s obligations to comply

with the NCC. We suggest that before finalising the regulatory package that all cross references within it need to be thoroughly checked, as there are presently a number of errors with these.

2. Amendments to the NCC

We endorse and applaud Treasury's decision to make the numbering of the NCC consistent with the numbering of the UCCC, and to leave the terms of the UCCC largely unchanged. We do however have some concerns with the amendments to the NCC.

NCC s79A(3) & NCC Reg 36 - Notice after a direct debit default occurs

It is not clear from the drafting of s79A whether -

- (i) Notice must be given only when it is the first time that a DDR loan payment has failed on a given loan account - meaning that only one of these notices will ever be provided per loan contract, should a DDR payment fail; or
- (ii) Notice must be given whenever it is the first time that a DDR loan payment has failed under any DDR authority on a given loan account - meaning that if a customer changes originating accounts [i.e. the deposit/other account that the customer uses to make loan payments] and gives a new direct debit instruction re the new originating account, a notice will also have to be given the first time a loan payment fails under the new DDR instruction. That is, it is possible that multiple notices under s79A will be provided to a customer in regard to a particular loan contract

This issue needs to be clarified.

In addition, it is not always possible from a systems perspective to differentiate an electronic payment made by DDR from a manual electronic payment. Adjusting systems to differentiate these payments, as well as capture the first failure will be costly for the industry, and that cost will most likely be passed on to consumers in the form of a fee for making payments by DDR. We suggest that NCC s79A(3) should be deleted from the draft Bill, as the underlying issue that it is attempting to address would best be tackled by amending the EFT Code¹ or the Corporations Act 2001, and requiring the provider of the originating account (i.e. the account that the payment come from) to provide notice of the payment failure to the account holder.

In the event that the provision is not deleted, the 'turn around' time of 10 days for providing notice should be extended as it is also unreasonable from a commercial perspective. We suggest amending "10 days" to "10 business days". In addition, we suggest that Form 8 to the NCC needs to be amended so that it does not state that the consumer must cancel their DDR in writing, as a number of institutions allow customers to give verbal DDR instructions and cancellations. We suggest amending the wording of the form so that it states that a customer may be required to cancel their DDR in writing.

21 day time frames for responding to requests for hardship variations and postponement of enforcement

The draft NCC does not make it clear if credit providers can require debtors to make hardship variation requests, or requests for postponement of enforcement to a specific division/officer within the credit provider (such as a hardship variations officer or collections officer for example), so as to ensure that such requests are captured and properly dealt with within 21 days of the request being made. If imposing such requirements upon requests is not permitted, credit providers in many cases will not be able to comply with the requirements in the NCC regarding postponement and hardship variation requests, given

¹ If it is amended to cover DDR payments as part of mooted initiatives to address "mistaken payments" issues (as DDR payments are technically not payments initiated by an instruction of the customer through electronic equipment).

the number of ways in which a customer can make contact with a credit provider [verbally or in writing; or to a credit representative of the credit provider, a collections officer, or an employee who does not work in the consumer credit sphere]. We suggest that Treasury clarify this issue in the NCC.

Investment properties

The wording of section 6 of the UCCC has been amended in the NCC to extend the application of the NCC to the purchase or improvement of residential investment properties, but not the refinance of a residential investment property loan. We assume that this is not intentional and suggest that Treasury amend the wording of section 6 to cover refinancing. We note that Division 3 of Part 2 of the NCC in regard to the calculation of interest on the unpaid daily balance of a loan, when applied to residential investment property loans where interest is to be paid in advance, will in practice be problematic. We suggest that Treasury consult further with credit providers with a view to resolving this issue and amending Division 3 of Part 2 the NCC as appropriate.

We also have concerns about the unintended effect of the extension of the NCC to cover residential investment property loans if credit providers are forced to ignore underlying asset value and potential future rental income (rather than rental income streams as at the point of advice or application) in assessing a consumer's capacity to repay a proposed residential investment property loan.

We note that some borrowers may not have "the capacity to repay" a residential investment property loan, if they are self-employed and make their living by buying 'run down' residential investment properties, renovating them, and selling them on at a profit within a short period of time. At present, such borrowers can be advanced funds on the basis of the underlying asset value of the residential investment property and the borrower's successful real estate sale record to date. We question why it is seen as necessary for section 6 (in regard to residential investment property lending) to extend to cover individuals who are professional developers/renovators and make their living by developing or renovating and reselling residential investment properties.

Other borrowers seek to make a loss on their residential investment properties for negative gearing purposes, and under the new "capacity to repay" test, may no longer be offered loans. If such borrowers are to be excluded from the residential investment property loan market, there will be flow on implications for the rental market, and rental housing affordability.

Regulation of existing investment property loans

Under the present drafting of the Bill and the NCC it is unclear whether existing residential investment property loans will continue to unregulated if they are amended to increase the amount of credit or to make another substantial variation to the terms of the credit contract, or whether these loans will only be regulated to the extent of the amendment to the credit contract. Section 37 of the UCCC makes it clear that, provided a variation is made in accordance with the UCCC or the original contract, the variation will not be treated as creating a new credit contract for the purposes of the UCCC. This allows credit providers to document even material changes to regulated credit contracts using relatively simple letters of variation. In the absence of section 37, credit providers will need carefully to assess each variation of a regulated contract to determine whether a court would hold that, in substance, there is at general law a new credit contract. If they determined that it would, and at that time the predominant purpose was a regulated purpose, then the arrangement as varied would need to be re-documented using a new, compliant, credit contract.

Once the NCC commences, investment purposes will be regulated purposes. We submit that the transitional provisions to the Bill should include an equivalent of section 37 of the UCCC dealing with loans which, prior to commencement of the NCC, were not regulated by the UCCC but which, if they had been entered into after the commencement of the NCC, would have been regulated by the NCC. That provision should say that, provided a

variation on a loan made before commencement of the NCC which was not regulated by the UCCC is made in accordance with the original contract, the variation will not be treated as creating a new credit contract for the purposes of the NCC. This will mean that investment property loans entered into prior to commencement of the NCC will continue to be unregulated and will not need to be completely re-documented if an essential term of the contract is changed after NCC commencement. This outcome is consistent with the outcome under section 37 of the UCCC for existing regulated loans.

The offshore application of the NCC

We note that amendments made to the NCC will result in the NCC potentially applying offshore. The UCCC currently operates to protect debtors who are ordinarily resident in an Australian state or territory at the time they enter into their credit contract. Under the NCC, that test will be removed, and the NCC will apply to credit provided in the course of a business carried on in Australia (whether the business is the business of providing credit or the provision of credit is part of or incidental to any other business carried on in Australia).

If a credit provider carries on business both within and outside Australia, it is not clear whether the NCC will apply to that part of the business conducted outside Australia. This result will cause problems for all the major Australian banks, as they carry out some activities offshore through a branch rather than a subsidiary. While there may be an argument that the business carried on by a branch offshore (for example in Singapore) is not the "same business" as the business carried on by the bank in Australia, where the activities in both places are conducted by the same legal entity, and there is some similarity in product, there is a risk that a court would find it was the same business.

We submit that the NCC be amended to make it clear that where a credit provider carries on business both within and outside Australia, that it is only the business carried on within Australia that is caught by the NCC: That is, in our view, the activities of offshore branches should expressly be excluded from the NCC

3. The licensing regime

With what parts of the 'credit legislation' must a registrant comply?

We understand that it is Treasury's intention that registrants be required to comply with the general conduct obligations and responsible lending obligations set out in the Reform Package from the date of registration. However, many of the references to conduct obligations in the Reform Package and Regulations refer to the conduct of the "licensee", and there is no provision which requires the references to a licensee to be read as if they were references to a registered person. In the absence of being aware of Treasury's intent, this issue needs clarification in both the Reform Package and the explanatory memoranda. In addition, as mentioned in Section 1 above, Treasury should be aware that the retail industry (and many credit providers) will generally not be in a position to comply with the general conduct obligations within 6-12 months given the IT system and compliance infrastructure that will need to be built and funded in order to comply with the Reform Package. We suggest allowing licensees (and, if relevant, registrants) more time to comply with these obligations, and suggest that Treasury contemplate a 2 year transition period for compliance with the Reform Package's conduct obligations.

Dealing with unlicensed providers

The Reform Package deems that any licensee that deals with an unlicensed party (broker etc) would be deemed to be committing an offence. We suggest that the regulations to the Bill be amended to address how licensees will be notified of the banning or disqualification of a person - such as an automated ASIC notification to all licensees of banning orders against other licensees, as the manual checking of ASIC's register is not feasible or practical on a regular basis for all licensees. We suggest further that licensees be given a waiver of liability if notification (of the disqualification or banning) has not been provided to

licensees by ASIC, and that the waiver should extend for three business days after notification of a banning order (so that licensees have time to act upon the notice).

Securitisation

If debt purchasers under securitisation arrangements are required to provide debtors with a credit guide (and thus notice of the securitisation) when exercising the rights of a credit provider, this is likely to alter debtor behaviour and thus the price at which debt can be sold. The consequences of the legislation for the securitisation industry should be considered more carefully, given that the industry is struggling as a result of the GFC.

Credit activities

We are concerned about the extremely broad wording of definition 7 ("credit assistance") of the Bill, as a broker acting as an intermediary between a consumer and a bank may arguably be the customer's agent within the meaning of definition 7. This will result in the credit provider providing credit assistance to the broker (as the consumer's agent). We suggest that this outcome is not intended by Treasury, and that definition 7 should be redrafted to address this issue. We are concerned further that the concepts assisting and suggesting, in the context of providing credit assistance, are extremely broad and may catch activities by credit providers that are not intended to be caught. This issue has separately been raised by the LCA FSC representative on the Advisory Group, by reference to a number of real life examples involving credit providers. In our view credit providers, in dealing with their own products, should be exempted from the definition of "credit assistance" in definition 7.

The requirements of the bill concerning when a credit guide must be provided to a customer need to be clarified

On the current wording of the Reform Package it appears that a customer needs to be supplied with a credit guide multiple times – including when they ask for product information, and when they enter into a credit contract, and irrespective of whether or not the customer has previously been provided with an identical credit guide by the licensee for another product (or in relation to a separate enquiry regarding the same product). In our view, a licensee should not have to provide a copy of a credit guide to a customer where the customer has already been supplied with a credit guide, and where the mandatory content of the guide has not changed. In addition, where a credit representative has to produce his/her own credit guide plus the licensee's guide, surely it would be enough for the licensee's guide to suffice as long as it contains a one page addendum that discloses the details of the credit representative's EDR scheme and their commission to the extent that it differs from the commission payments disclosed in the credit provider's credit guide?

We are concerned that consumers will receive multiple credit guides that will serve to confuse them rather than assist them. As noted above, we do not believe that such disclosure will solve any mischief in the market or stop predatory lenders taking advantage or desperate and vulnerable people. We expect that credit guides will become the 'credit law version' of a Financial Services Guide under the FSR regime and become a weighty document that consumers do not read, that is padded out with marketing material, or combined with other documents. On a practical note, we draw Treasury's attention to the paper shortage and printing bottle neck that occurred in the industry after the introduction of mandatory FSG and PDS disclosure requirements under the FSR regime, and suggest that the same practical issues may arise in regard to the production of credit guides given that most large institutions source their paper and printing services from common sources.

Other licensing requirements

We endorse the requirement in the Reform Package that licensees (other than ADIs) must have professional indemnity insurance (PI), but note that in practice it may be difficult for smaller licensees to obtain PI. We suggest that this problem could be overcome if the government established a common fund for PI purposes.

4. Responsible lending obligations and general conduct requirements

We note that the LCA FSC representative to the Advisory Group has raised a number of concerns in regard to the responsible lending obligations and general conduct requirements, in addition to concerns about the disclosure of commissions and conflicts of interest in the Reform Package. Those concerns have already been noted by Treasury, and are not re-stated in this submission. Our remaining concerns are summarised below

Assessments

In our view, section R260 of the National Consumer Credit Protection Bill 2009 should be substantially redrafted. We suggest that the part of section R260(3) of the Bill 2009 allowing credit providers to rely upon credit assessments for a period of thirty days be retained, and amended to allow credit providers to rely upon credit assessments for a period of more than 30 days for secured lending products (inclusive of home loans and some personal loans). In our view, the 30 day period be extended to 90 days, on the basis that most conditionally approved home loans (involving a credit assessment) will not result in a credit contract for 60 to 90 days. We suggest further, that the remainder of R260(3) be deleted as it is superfluous (as credit providers are not prohibited from relying upon data provided by third parties), and it may be relied upon by more risk indifferent credit providers to justify their reliance upon tick-list assessment data provided by brokers.

We re-iterate the LCA FSC representative to the Advisory Group's view that preliminary assessments in general are of little value to either the consumer or licensee as they can only be based upon limited information provided by the consumer, and in the case of retailers, the assessment will be conducted by persons who may not have the financial literacy or skills to conduct them (meaning that credit providers will be unlikely to rely upon such assessment data under R260(3), further justifying the deletion of that provision from the Bill).

Finally, we suggest that the two day turnaround time for providing a consumer with a copy of their credit assessment is too short to be met in practice, and suggest extending that time to ten working days.

General issues with responsible lending obligations

We endorse Treasury's decision to adopt a flexible, risk based approach to what constitutes 'reasonable inquiries' (in regard to a licensee's responsible lending obligations) and what lengths a licensee is expected to go to in verifying information provided by a consumer. In our view however, the "capacity to repay" test is a backdoor way to get licensees to assess positive credit data, and engage in a degree of positive credit reporting with one another (subject to the customer's consent) in order to verify customer data as part of the credit provider's responsible lending obligations. We suggest that Treasury consider the implications of this practice from a privacy law perspective, and the risk for licensees should the government not introduce a positive credit reporting regime at the same time as the new credit legislation is introduced. Similarly, there seems to be an expectation that licensees undertaking credit assistance will be able to access credit information or information from credit reports relating to a customer, before that customer has made an application for credit – which is not permitted under section 18N of the Privacy Act.

We suggest that licensees would do a better job at assessing capacity to repay (and meet Treasury's objectives) if they were permitted to engage in positive credit reporting. A positive credit reporting system would also result in better data verification than would be possible using the current negative reporting system coupled with Treasury's back door positive credit reporting/ responsible lending obligations.

We suggest further that Treasury consider the privacy law implications associated with all licensees (particularly retailers) collecting capacity to repay information (and thus sensitive financial records and identifying information) from individuals, inclusive of how that

information will be stored, and the real potential for identity theft and fraud should that information inadvertently fall into the wrong hands. We expect that retailers will struggle to collect and store such information consistent with the guidelines issued by the OFP and with the Privacy Act itself, particularly where such information is collected on the shop floor in a high pressure sales environment.

We suggest that the Bill be amended to make it clear that offers to make hardship variations to a debtor's contract (and accordingly increase the amount the debtor will have to repay), or allowing overdrawings on a customer's credit card (to pay for groceries and essential items for example – but having the effect of increasing a customer's credit limit) are carved out of the responsible lending obligations. In the absence of such amendments consumers may suffer detriment.

Point in time approvals and credit limit increase offers

Two practical effects of the Reform Package will be to reduce or eliminate the availability of unsolicited 'pre-approved' credit limit increase offers, and low doc loans. Whilst we endorse these reforms, we note that the demise of low doc loans coupled with the introduction of the 'capacity to repay' test, may make it harder for self-employed people to access credit (where they have not recently lodged their tax return). We note also that, long term, the reforms will not eliminate non face to face, point in time approvals, as automated decisioning matrices can be amended to provide to assessments of products that are not unsuitable for a customer, and the customer's capacity to repay.

20 May 2009