National Financial Service Federation Ltd

Submission to the

Senate Economics Committee
inquiry into the National Consumer Credit Protection Bill 2009 and related bills

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INTRODUCTION –THE FEDERATION.

The National Financial Services Federation Limited is the body representing lenders which operate out of the mainstream lending market and includes the type of lenders which in the past have been called “micro” or “fringe” lenders. The Federation has amongst its members small amount short term lenders together with pawnbrokers and payday lenders. Loans range from a few thousand dollars for up to a year or so, to a few hundred dollars over a few weeks as well as loans arranged through the pawnbroking system. Amongst its members there are businesses operated by one person, to large conglomerates operating many shop fronts and those operating in a franchise arrangement throughout the country. It has members which operate from one location, within one State jurisdiction or across several States and in some cases in all States. Whilst other types of players in the industry are members, it is primarily credit providers which are represented by the Federation and these comments are directed principally at the provisions relating to credit providers.

The Federation’s aim is to promote the enhancement of customer service and build greater government and community understanding of the micro and alternate finance industry throughout Australia.

Whilst the Federation has only been in existence for a couple of years, it has worked hard to ensure that all its members operate within the confines of the law and attempts to keep its members up to date with current movements in the law so that its members can keep abreast of all developments.

INVOLVEMENT IN THE PROCESS

The Federation was invited by the former Minister, Senator Sherry, to join the industry consultative group to discuss the matters required during the transition of the legislation from the States to the Commonwealth, and the author of this submission was the person so appointed.

It has always been the position of the Federation that those currently operating in this market need to remain in the market, not only because if the not insignificant employment it creates, but because the people who use the lenders have no other alternatives, generally speaking.

There is little doubt that the lenders in this area of the market provide a valuable resource to those who for one reason or another find themselves unable to access funds elsewhere. Mainstream lenders have made a conscious decision not to service this area of the market, unless they do so from the social responsibility aspect as we find the NAB has done recently with their “Step Up” Loans. There are also the NILS schemes throughout the country, but generally the capital available and the purposes to which the loans may be put are severely limiting. The NILS schemes provide nationally only a small percentage of the

loans provided in one State by one of the Federation's members. To suggest that the NILS scheme is an adequate alternative is not facing reality, although the position is improving, all be it slowly.

Small amount lending is simply not available from the mainstream lenders. If anything, there has been a tightening of the market in recent years. The following table[1] provides some guidance:-

Institution	Minimum loan					Minimum term
	25th July 2005	3rd December 2006	1st Feb 2008	23rd June 2008	6th May 2009	
Westpac	$5,000	$4,000	$4,000	$4,000	$4,000	1 year
National	$5,000	$5,000	$5,000	$5,000	$5,000	1 year
St George	$3,000	$3,000	$3,000	$3,000	$3,000	1 year
ANZ Bank	$4,000	$5,000	$5,000	$5,000	$5,000	1 year
Commonwealth	$3,000	$5,000	$5,000	$5,000	$5,000	1 year
Suncorp	$3,000	$5,000	$5,000	$5,000	$5,000	1 year
Bank of Queensland	$3,000	$3,000	$3,000	$3,000	$3,000	1 year
Bankwest	$5,000	$5,000	$5,000	$5,000	$5,000	3 years

The average minimum loan available from these lenders has increased from $3,875 in July 2005 to $4,375 in May 2009, that is the minimum loan average has increased, not decreased over that time. Anecdotally, it is reported that the requirements for qualification for these loans has also tightened.

FEDERAL LEGISLATION

From the first mention of the transfer credit legislation form the States to the Commonwealth, the Federation has been strongly in support of that move. The support was given because:-

1. There were to be simpler compliance requirements for those working across boarders.
2. There was the promise of reduced costs of compliance – ultimately to the benefit of the consumer – by a "reduction in red tape".
3. There was a chance for the creation of an easier regime for consumers to follow from a consumer protection point of view.

The proposal was met with enthusiasm. The Government announced that "(t)his plan will significantly boost consumer protection, cut red tape for business and deliver on our commitment to modernise Australia's key financial services with the provision of single national regulation and oversight."[2]

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[1] Taken from information available on the banks' websites and accessed 6th May 2009.

[2] Brochure "National Consumer Credit Single, standard, national regulation of consumer credit for Australia" issued August 2008, available from http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf accessed 9th July 2009

It is a fact that several aspects of the regime do not achieve this aim. Whilst the Federation remains supportive of the proposal in general, there are a number of matters which the Federation would like to see amended in order that these aims may be achieved.

CUTTING OF RED TAPE.

Unfortunately, in the view of the Federation, the Bill does not cut red tape. In some respects this is unavoidable, but in other aspects it is certainly avoidable. There are other aspects of the package which positively, and it seems deliberately, add to the red tape with which businesses must deal.

Licensing

The Federation has in a number of different forums suggested that licensing of lenders should take place.[3] Whilst the detail of the licensing process is still not available, we suspect that it will look and feel like the current Chapter 7 of the Corporations Act licensing, which the Federation suspects may be significantly more than is required in relation to credit providers when one considers the difference between the risk profile of those currently licensed (banks, financial advisers, insurers) and credit providers.

The primary difference is that credit providers are the ones taking the risk because it is the credit providers who stand to lose. For those dealing with banks, financial advisers and insurers, the consumer is the party parting with money in the expectation that they will get something back – in the case of banks, their money, in the case of advisers, come reliable advice and in the case in insurance, cover.

In the case of small amount credit providers (and particularly those who are unsecured), apart from the case of actual fraud by an employee, there is very little possibility of the borrower actually losing money or suffering a loss. The worst that can happen is for the credit provider not to get the capital back.

As a result, there are several aspects of the proposed legislation which the Federation believes are not warranted for credit providers. They are:-

- The "compensation" arrangements required under (amongst others) section 48 of the National Consumer Credit Protection Bill. As the Federation understands it, there is intended to be a standard requirement that the "compensation" be by way of an insurance policy. In its preparation for the consultation meetings, the Federation tried to source insurance which would satisfy this provision. The Federation was unable to find any. The primary consideration, it seems, was that the insurers had difficulty in ascertaining

[3] For example, the submission of the Federation made to the Queensland Attorney General on the occasion of the Queensland Government legislating to bring in an interest rate cap in 2008.

what the risk being sought to cover was. If it was damage suffered by the consumer, as seems to be the case, then the general opinion was that there was no damage.

On the 15th July 2009 ASIC issued a Consultation Paper[4] discussing these arrangements. There does not seem any substantial movement from the earlier proposal.

This paper raises further issues of the financial resources question. There is no guidance on this issue other than to say that licensees will be required to self-assess what resources there will be. The Federation appreciates that the final position of ASIC has not been determined.

- The audit requirements as contained in Chapter 1, Part 2-5 of the National Consumer Credit Protection Bill are aimed, no doubt, at ensuring that those who operate in the market are financially able to do so, and are likely to be there if something goes wrong in the future. With the provision of credit, there is little that can go wrong, the main assets of a credit provider being its loans, and therefore in the hands of the consumers. To place a requirement that there need to be, under any circumstances, an audited report, at the cost of the credit provider, in unreasonable in the Federation's view when the credit provider is the entity assuming all the risk.

National Regime

Unfortunately, there are several aspects of the new national regime which do not deliver what was promised by Minister Sherry. In the communiqué issued after the July 2008 COAG meeting, the following appeared:-

> *National regulation through the Commonwealth of consumer credit will provide for a consistent regime that extinguishes the gaps and conflicts that may exist in the current regime. The new regime is anticipated to introduce licensing, conduct, advice and disclosure requirements that meet the needs of both consumers and businesses alike. A seamless national regime will assist in ensuring that consumers are better protected in their dealings with credit products and credit providers, including brokers and advisers.* (Emphasis added)[5]

There are other pronouncements from Government on the aims of the legislation. These include:-

> *These new measures will protect consumers and cut red tape for business.*[6]

[4] Consultation Paper 111 "Compensation and financial resources arrangements for credit licensees"
[5] Communiqué from the COAG Meeting held 3rd July 2008. Found at http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/index.cfm accessed 6th May 2009
[6] Press Release, Hon Nick Sherry issued 3rd October 2008, found at http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/064.htm&pageID=003&min=njs&Year=2008&DocType=0, accessed 6th May 2009.

> *Under the first phase of the plan, the Commonwealth will take responsibility for trustee companies, the existing key credit regulation, and the Uniform Consumer Credit Code (UCCC) by enacting it as federal law.*[7]
>
> *Extending the powers of the Australian Securities and Investment Commission (ASIC) to be the sole regulator of the new national credit framework with enhanced enforcement powers.*[8]
>
> *Subsequently, on 3 July 2008, COAG agreed that the Australian Government would assume responsibility for regulating all consumer credit products.*[9]

As a consequence the Federation took the view (and conducted the industry consultation on this basis) that the main aims of the legislation are:-

1. Provide a Commonwealth-based national system of consumer credit legislation;
2. Create a seamless system between States;
3. Extinguish the gaps and conflicts which exist in the current regime;
4. Introduce licensing, conduct and disclosure requirements that meet the needs of businesses and consumers alike;
5. Provide a system solely regulated by ASIC, and
6. Provide protection for consumers whilst not imposing greater burdens on industry.

The primary concern to the Federation was the disclosure very late in the process that the States which currently had an interest rate cap would continue with those caps after the commencement of the federal legislation. Therefore those lenders which operate across the nation will have at least three separate legislative regimes to contend with – the NSW/QLD/ACT arrangement, the Victorian arrangement and the balance of Australia. At present there are three interest rate regimes in Australia and it was not known until on the day the draft legislation was released that there was any indication that this would continue past the commencement of the federal legislation.

In the process of discussing issues in the consultative group, as it had been indicated that the interest rate caps would give way to a new responsible lending conduct regime, agreement was given to the new conduct requirements knowing that the interest rate issue would go away. The responsible lending conduct

[7] Press Release, Hon Nick Sherry issued 3rd October 2008, found at http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/064.htm&pageID=003&min=njs&Year=2008&DocType=0, accessed 6th May 2009.

[8] "National Consumer Credit, single, standard, national regulation of consumer credit for Australia", undated brochure, issued circa October 2008 found at http://treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.PDF accessed 6th May 2009.

[9] Summary of COAG agreement found at http://treasury.gov.au/consumercredit/content/coag_agreement.asp accessed 6th May 2009.

requirements itself were seen to add considerable cost to the lending procedures already in the Consumer Credit Code, but lenders represented by the Federation were willing to assume these in the knowledge that the interest rate issue would go away and there could be savings elsewhere. Lending in this area is not very profitable, as indicated by the mainstream banks failure to embrace it as an available product.

What we now have is the worst of both worlds. We have the additional cost of the formal responsible lending requirements and the further costs of complying with the interest rate caps. Had that been known at the time, there would have been other considerations given to the discussions. The cost of the dual system will eventually be passed on to the consumer – the credit provider is unable to assume any further costs.

The Federation believes that this is not the place to make submissions on the efficacy of the interest rate cap regime. Suffice to say that a loan of $100 for 1 week falling under the Consumer Credit Code, under the NSW/Qld interest rate cap arrangement will allow the lender to recover in total only about 80 cents. With the formal requirements of the Code (precontractual disclosure documents written contracts etc), staff time, cost of capital, cost of the application process, cost of bad debt, such caps prevent this type of lending being profitable at all.

OTHER SPECIFIC ISSUES

There are a number of specific issues in the legislation which have caused the Federation some concern:-

CREDIT GUIDES – ADDITIONAL DISCLOSURE?

In addition to the precontractual documents required by Section 15 of the Code, the Bill introduces the requirement to prepare and present Credit Guides. No doubt this is a copy of the Product Disclosure Statement regime in the Corporations Act. It is yet another piece of paper (or in reality several pieces of paper) a consumer will take away and probably not read.

There is significant evidence that additional disclosure does nothing to benefit the consumer, and in fact may have the opposite effect.[10]

[10] Consumer Affairs Victoria, Submission to Productivity Commission Inquiry into Australia's Consumer Policy Framework, June 2007 pp 128-9; Malbon, J "Predatory Lending" (2005) 33 *ABLR* 224 at p 236; Malbon J, *Taking Credit, Report for the Consumer Credit Code Post-Implementation Review*, (Tasmania, Department of Justice and Industrial Relations, September 1999), http://www.creditcode.gov.au which was the basis for Malbon J, "Shopping for Credit: Empirical Study of Consumer Decision-making" (2001) 29(1) *Australian Business Law Review* 44. The NCP Report itself is KPMG Consulting *NCP Review of the Consumer Credit Code Final Report* December 2000 http://www.creditcode.gov.au/content/downloads/final.pdf and it cites Malbon 19 times.

Research is currently being undertaken on the effectiveness of disclosure[11] and the Federation is of the view that it would be appropriate to wait until that research has been completed before requiring more disclosure to take place, particularly when there is already a disclosure regime in place.

LICENCE CONDITIONS

Section 45(6) of the National Consumer Credit Protection Bill states that ASIC must "ensure that the licence is subject to a condition that specifies the credit activities or classes of credit activities that the licensee is authorised to engage in". There is no indication in any of the documents released which comment on classes of licenses. The Federation is of the opinion that if the intention is that there will be classes of licenses, as appears from this section (and others), it is necessary to set out the classes somewhere.

CREDIT GUIDE OF CREDIT PROVIDERS

The Federation has made comments in relation to the need for further disclosure as required in the Credit Guide above. The requirement to provide a Credit Guide is contained in Division 2, Part 3-2 Chapter 3 of the National Consumer Credit Protection Bill (section 126ff).

The time for delivery of the guide is of concern to the Federation. It is understood that regulations (yet to be released) may provide for changes to the timing, but as it currently appears the Guide must be delivered after "it becomes apparent" … "that it is likely" that there will be a credit contract. The way a number of lenders have arranged their documents is that the document signed by the client is an offer submitted to the credit provider.

Therefore, it is not until the receipt of the offer that it becomes "likely" that there will be a contract. It would seem that the time section 125(1) requires the delivery is at the time the offer is made to the credit provider by the borrower, as up until that time, the matter has really progressed as simply a negotiation. The Federation believes that this is too late if the apparent aims of the section are to be achieved.

[11] Western Australian Department of Consumer and Employment Protection acting on behalf of UCCMC and MCCA, issued a tender for "Consultancy Services for the Simplification of Disclosure Regulation-Consumer Credit Code." In the tender the following appeared: "*The key message arising out of consultation was that any changes to existing disclosure should be based on consumer testing and analysis and consideration of current research in relation to consumer behaviour and patterns of comprehension.*" WA Dept of Consumer and Employment Protection , *Request for Consultancy Services for the Simplification of Disclosure Regulation-Consumer Credit Code*, February 2007, p 27

NATIONAL CREDIT CODE
(Schedule 1 of the National Consumer Credit Protection Bill)

There are a number of aspects of the Code with which the Federation has an issue:-

Section 46 – Prohibited securities.
The Federation has no issue with the majority of the new part of this section – preventing the taking of security over essential household goods – and in fact supports its aims. However, there is one aspect of the new law which does cause some concern.

Subsection 2 provides as follows:-

(2) A mortgage cannot be created over goods that are essential 19 household property unless:

(a) the mortgagee supplied the goods to the mortgagor as part of a business carried on by the mortgagee of supplying goods and the mortgagor has not, as a previous owner of the goods, sold them to the mortgagee for the purposes of the supply; or

(b) the mortgagee is a linked credit provider of the person who supplied the goods to the mortgagor.

Section 46(2), therefore, provides two exceptions to the rule preventing such security:-

1. Where the goods are actually supplied by the mortgagor, or
2. Where the finance is provided by a linked credit provider of the supplier.

It seems obvious that the reasoning for the exceptions is twofold. First, it will ensure that the retail side of a business is not adversely affected by a restriction on available finance. Secondly, it seems that the thinking is that there are times where the particular circumstances of a potential borrower are such that there should be the ability to offer security over household goods, and that circumstance seems to be in cases when the borrower does not have the possession of the goods. It follows that the reasoning is that as the potential borrower does not have the goods at the time of the purchase, the borrower is really not losing anything by providing security over goods being purchased – the borrower is in a "net-better" position, or at least not in a worse position.

However, there are instances where those arguments are not catered for. If there is no in-principle objection to providing security over goods not in the possession of the borrower at the time the loan is negotiated, why is the exemption not extended to circumstances where a borrower is taking a loan to recover goods not currently in the borrower's possession? Examples of these

situations are where the goods to be secured are subject to a repairer's or warehouseman's lien, or in the possession of a pawnbroker.

Further, and more importantly from the Federation's point of view, the ability of a independent financier to take security (and as a result, often to supply finance) is limited to cases where that credit provider is a linked credit provider of the supplier of the goods[12], that is generally where there is some commercial arrangement between the credit provider and the supplier of the goods.

If a person was buying a $10,000 plasma TV from a national retailer, ostensibly the TV would fall within the definition of "essential household items" - being the "television set" referred to in regulation 6.03(3)(e) of the *Bankruptcy Regulations 1996*. The result is that no matter what the personal circumstances of the borrower, the only way the goods can be purchased with finance requiring security is to have the supplier of the goods finance the purchase,[13] or to have the supplier's linked credit provider do so.[14]

It is not possible for the borrower to arrange their own finance, possibly on more favourable terms with another financier who may not, for example, be paying a commission to the retailer and thereby, one would assume, increasing the cost of the loan. This will create circumstances where the options of borrowers are severely limited and where independent financiers will be at a significant disadvantage. It is not third line forcing, but it does allow the borrower only one option. The Federation has concerns that it is arguable that this may, in cases where a trader has only one linked credit provider, breach section 140.[15]

There seems no logical reason why the exception should be limited to linked credit providers, if there is to be an exemption at all.

The Federation's suggestion is to extend the exemption in section 46(2)(b) to cases where the owner of the goods does not have possession of the goods at the time the loan is negotiated and to remove the linked credit provider requirement which would allow the borrower freedom to deal with any licensed credit provider. To do otherwise limits the bargaining power of the consumer and the consumer's options.

Section 87 – Notice on first Direct Debit default.

This is an entirely new provision and requires the lender to provide a special notice where the debtor defaults on a payment under a DDR scheme.

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[12] See section 127 of the National Credit Code.
[13] As foreshadowed in section 46(2)(a)
[14] As set out in section 46(2)(b)
[15] Section 140 provides "A supplier must not require a purchaser of goods or services to apply for, or obtain, credit from a particular credit provider."

DDRs are used very often in all sorts of financial arrangements – payment of utility bills, board, telephone accounts, credit card payments – in fact wherever there are regular or scheduled payments due. The Federation wonders why payments pursuant to credit contracts are given this particular treatment, which simply adds red tape in a system said to remove red tape.

The draft form required to be sent, previously distributed and which will eventually form part of the regulations, simply repeated the information contained in most DDR agreements signed by clients at the time the DDR is entered into. These agreements are in practice approved by banks operating the system. In other words, the Federation believes that this requirement adds nothing to the system already in place.

The requirement is that "(t)he credit provider must give the debtor, and any guarantor, a direct debit default notice under this section within 10 business days of the default occurring"[16]. Whilst there is no definition of what "default occurring" means, it seems reasonable that what is intended is when the requesting bank is advised by the paying bank that the funds will not be available. The other alternative is when the requesting bank advises the requester, or when the requester actually finds out.

Further, there is no definition of "give to the debtor". Does it mean "sends", or does it mean "delivers to"? One would have to operate cautiously and assume the latter.

The Federation is concerned that where there is a strict liability offence created the time limit may be a problem, and in any event may not achieve the aim.

Firstly, where the days align to the detriment of the credit provider, the credit provider may not even know of the default until several days after the offence. The Federation is aware that the time limit is expressed in working days. It is possible under certain circumstances for the credit provide not to even be aware that there has been a default until the period has half expired.

Secondly, if the purpose of the notice is to advise the debtor that there are certain actions that can be taken in relation to the DDR, in cases where the payments are taken weekly or fortnightly, delivery of the notice within 10 working days will mean that the next payment will have been requested before the notice is due to arrive.

Section 88 – Default Notice.

There are new requirements in relation to the matters required to be included in the default notice sent before any action can be taken under a credit contract.

[16] Section 87(2)

Whilst a crude comparison, the old Code had about 60 words of requirements, the new section has in the order of 260 words. The old notice could be sent in about half a page of ordinary type – it was succinct, straight to the point and easy to understand.

Under the new requirements it is estimated that the notice will take in excess of two pages. The Federation wonders how this is a reduction in red tape, what benefits there are to the consumer, and whether it is more likely that the debtor will read three pages of a typed document than half a page?

OTHER MATTERS

There are other more specific issues the Federation has with the legislation, but it may not be appropriate to deal with them in detail here.

The Federation is grateful for the opportunity to make these comments on behalf of its members and would welcome the opportunity to provide further detail if it was thought appropriate.

John Brady
17th July 2009