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LAWYERS

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The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir

Inquiry into the National Consumer Credit Protection Bill 2009 and related bills

We appreciate the opportunity to make a submission in relation to the National Consumer Credit Protection Bill 2009 (**Credit Bill**) and the other bills forming part of the Government's credit reform package.

We note that while we act for a number of Australian financial institutions and have taken that experience into account in relation to the matters raised in this submission, the views expressed are ours alone.

Many issues raised in submissions made in relation to the Exposure Draft have been addressed in the version of the Credit Bill tabled in the House of Representatives and we applaud the Government's responsiveness in this regard.

Some fundamental issues relating to the nature of the regulatory regime proposed remain however. In particular, we are not convinced that there is sufficient justification to establish a separate licensing regime under a separate statute. Given the nature of the proposed credit licensing regime, there does not seem any reason not to regulate credit through the Australian financial services licence (**AFSL**) regime in Chapter 7 of the *Corporations Act 2001* (**FSR**).

There are some other issues which we and others have raised previously which also have not been addressed in the Credit Bill introduced into the House of Representatives on 25 June 2009. Further details of these issues are set out below, but in summary they are:

- the consultation period for the Credit Bill has been very short and we are concerned that this may have compromised the ability of interested parties to consider all of the ramifications of the Government's proposals;

- the time to comply with the new obligations remains tight, particularly for the responsible lending obligations;

- streamlining should be available for APRA regulated bodies and AFSL holders;

- States and Territories should not be able to impose inconsistent obligations on credit providers or advisers;

- there should be licensing and credit guide exemptions where relying on others to engage in the activity or provide a credit guide;

- the general obligations of licensees under the Credit Bill differ from the obligations imposed upon AFSL holders for no apparent reason; and

- the civil penalty and infringement notice regime proposed in the Credit Bill is significantly more onerous than equivalent licensing regimes and could lead to higher costs and a reduction in product innovation to the detriment of consumers.

Structure of the licensing regime

1. It is our understanding that the original reason for establishing a separate licensing regime under a separate Act was to enable the adoption of a licensing regime which is simpler than the AFSL regime under Chapter 7 of the Corporations Act. In fact, however, the Credit Bill mirrors almost entirely the Australian financial services licensing regime. With certain exceptions (discussed below), the following are essentially the same in the two regimes:

    - the general organisational obligations of licensees;
    - ASIC's powers in relation to granting, suspending and cancelling licences and the considerations it is required to take into account;
    - the regime for appointing external representatives (ie representatives other than employees and directors) and the liability regime for representatives; and
    - the trust account obligations of licensees.

2. The question arises therefore what advantage arises from having separate legislation. Whatever its flaws, the AFSL regime is now well known and understood. We are concerned that the proposal for a separate regime has made it harder to identify the differences between the regimes and also meant that the Government has not explained why many of those differences are appropriate. This concern is of course only relevant where the licensing regimes are so similar. If the Government had proposed a very different licensing regime, the rationale for a separate statute would be clear.

3. While we acknowledge that the new proposed responsible lending obligations are to some extent quite different from some of the equivalent FSR provisions, the Government has had no difficulty in adjusting the FSR regime to accommodate those differences when it comes to margin lending.

Margin lending

4. There is no doubt that margin lending is closely linked to the business of recommending and dealing in investment products and securities. Consequently, it is sensible for margin loans to be regulated as financial products under Chapter 7 of the Corporations Act as proposed in the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 (**Modernisation Bill**).

5. However, the consequence of separating margin lending from consumer credit is that certain investment loans will be regulated under the Corporations Act and require an AFSL, while others (ie loans to acquire residential property for investment purposes) will be regulated under the Credit Bill and require an Australian credit licence. The Government proposes to address other investment loans in phase two of its credit reform program. We understand that these will include loans secured by residential property mortgages to acquire investment products and securities. As these loans will relate to investment products and securities, the regulation of margin lending under the Modernisation Bill would suggest that they should be regulated under the Corporations Act. On the other hand, given they are secured by residential property, the Credit Bill would suggest that they should be regulated under that legislation. Neither result is entirely satisfactory.

6. Many financial planning firms engage in both mortgage broking and investment advisory activities, including advising on margin loans. The Government's decision to split consumer credit from margin lending means that these firms will be required to hold two licences and will need to comply with two very similar but not quite the same sets of obligations. We submit that this is not a recipe for promoting efficiency or reducing costs and compliance risk. We note that it also means there will not be one single regime for the regulation of credit in Australia, even at the Federal level.

Differences between margin lending and consumer credit obligations

7. The inclusion of responsible lending obligations in the Corporations Act for margin lending highlights some of the differences between the regulatory regimes proposed. An adviser recommending a margin loan will need to have a reasonable basis for their advice, which includes making certain inquiries under section 945A.[1] However, when recommending consumer credit, the same adviser will need to conduct reasonable inquiries under a different test in clause 117 of the Credit Bill. The effect of the two requirements may be similar. In both cases, reasonable inquiries need to be made and in both cases they need to relate to the customer's objectives, financial situation and requirements or needs. However these tests are worded differently and there is obviously therefore a risk that they will be interpreted and applied differently both by the courts, ASIC and industry. Furthermore, additional requirements apply under the Credit Bill as advisers are required to take reasonable steps to verify the customer's financial situation which is not required under FSR and also to make inquiries or take steps prescribed by the regulations.

8. The adviser must also provide a financial services guide in relation to the margin lending recommendation and a separate credit guide in relation to the consumer credit recommendation. Again, these inconsistencies are likely to lead to confusion or over-compliance and additional paperwork for both advisers and consumers.

Regulatory risks

9. The original purpose of the FSR regime was to limit regulatory arbitrage by regulating all financial services and products under a single regime. The FSR regime has nevertheless been sophisticated enough to include adjustments, exemptions and modifications for particular financial products and no doubt similar modifications could be made in respect

[1] In this submission, section references are references to sections of the Corporations Act and clause references are references to clauses of the Credit Bill, unless otherwise stated.

of credit products. The different regulation of different kinds of credit products seems to give rise to the potential for regulatory arbitrage.

10. We submit that if the Government continues to insist that the credit licensing regime should be based upon the FSR licensing regime then credit licensing should be included within Chapter 7 of the Corporations Act. We note that in the regulatory impact statement, the Government discusses three alternatives, licensing based on Chapter 7, expanding Chapter 7 to include credit or the status quo (Part 3.3 of Chapter 9 of the Explanatory Memorandum). The Government does not however discuss the option of developing a separate simplified licensing regime which is not based on Chapter 7.

A simpler licensing regime

11. We submit that any separate licensing regime for the provision of credit should in fact be simpler if that is the Government's intention. For example, simplicity could include:

- limiting the general obligations of licensees to the most essential matters, for example training of representatives;
- removing any restrictions or provisions relating to the appointment of representatives – licensees should be entitled to appoint representatives in an commercially appropriate manner without any need for notification to ASIC;
- removing any requirement to disclose licensing and credit representative numbers – the ASIC website provides an easy mechanism for identifying whether a licence or authorisation is held without any need to search by number;
- removing any requirement to report breaches or to report on compliance to ASIC;
- removing the prohibition on dealing with unlicensed persons – it should be up to each person to determine their own licensing requirements (we have discussed this further below).

12. In other words, we submit that any separate licensing regime should be honed down to focus on the most critical requirements which will mean that licensees are able to focus their attention and limited resources on key areas of risk to the community, rather than the minutiae of detailed and prescriptive compliance requirements. Such an approach would be consistent with the Government's 'commitment to better quality regulation [by] ensuring that any proposed new regulations are thoroughly scrutinised so that they are introduced only where necessary and at minimum cost to business and consumers.'[2]

Other concerns

13. We have concerns regarding the following matters, some of which relate to inconsistencies between the requirements applying to AFSL holders and those proposed in the Credit Bill.

[2] Ministerial Statement on Best Practice Regulation Requirements, Hon. Lindsay Tanner, Minister for Finance and Deregulation, House of Representatives Official Hansard, No. 4, 2008, page 1889.

Consultation period

14. The consultation period for the Credit Bill has been very short. The Exposure Draft was only released on 27 April 2009, with short four week period of public consultation. The Bill itself was only tabled in the House of Representatives less than four weeks ago. Consequently, the community has had less than two months to consider and raise issues in relation to the most significant reform of the credit industry since the introduction of the Uniform Consumer Credit Code.

15. We are concerned that the short consultation period has compromised the ability of interested parties to consider all of the ramifications of the Government's proposals. We also question why there needs to be such a rush to introduce the legislation. In Australia, there seems to be little evidence of any regulatory failure that is so acute to justify shortened consultation and transition (see below) periods. If anything, the current economic circumstances would suggest that everything should be done to avoid taking any steps that could impede the provision of credit. There is no doubt that the introduction of the Credit Bill will create considerable uncertainty in the credit industry which will increase costs and cause lenders and brokers to be more risk averse when considering credit applications.

Transition period

16. The Government's proposal to extend the transition regime for the responsible lending obligations by 12 months to 1 January 2011 and to provide additional flexibility for transitional periods to be amended by regulation is welcome. However, we note that the timeline for compliance with the new regime remains short.

17. Businesses engaged in credit activities need to register within a very short two month period and will then only have 18 months to submit a licence application. This is shorter than the two year transition period for licensing under Chapter 7 of the Corporations Act.

18. The licensing process involves not only the submission of an application, but also requires implementation of new procedures and processes relating to the licensee obligations. Both elements require businesses to invest significant time and resources, particularly for those that do not currently hold an AFSL. The shorter the time, the higher the expense and the greater the risk that temporary measures will be implemented initially which will need to be upgraded over time. This results in both compliance risk and additional expense.

19. The responsible lending obligations have an even shorter transition period of only 12 months. These new obligations will require significant investment by licensees to develop and implement appropriate systems to ensure that representatives are able to comply with these obligations. Once the procedures are developed, licensees will need to train representatives in relation to the obligations and new procedures. Training to an appropriate standard can take significant time. FSR had a two year transition period for implementation of similar obligations. However, the transition period for the introduction of the training requirements for retail advice in Regulatory Guide 146 was significantly longer as it was introduced on an optional basis in the years leading up to the commencement of the FSR regime and only became mandatory during that period.

20. We also support the submission made by the Australian Banking Association in relation to the Exposure Draft that there needs to be flexibility for licence applicants to select the date on which the licensing obligations commence up until the end of the transition period.

This flexibility was provided as part of the FSR transition and was essential to enable applicants to delink the licence application from compliance with new obligations. Otherwise, there is a significant risk that applications will be submitted late which in turn affects ASIC's ability to assess applications in a timely fashion.

Streamlining

21. We note that the Government proposes streamlining for certain classes of licensed finance brokers in Western Australia and also for authorised deposit taking institutions (**ADIs**). No other streamlining is proposed although there is a power to provide for streamlining for other businesses in the regulations. We submit that streamlining should be provided for APRA regulated institutions (as they are already subject to rigorous oversight by APRA) and for holders of Australian financial services licences (as they are required to have processes and procedures to comply with most of the obligations that apply under the proposed Credit Bill).

Potential overlap between Commonwealth and State laws

22. One of the primary goals of the credit reform process is to establish a single, standard, national law for the regulation of consumer credit. However, the attainment of this objective is not guaranteed by the Credit Bill. States and Territories can legislate additional requirements or exclude the operation of the Credit Bill in relation to specified matters: clauses 23 and 24. We submit that there should be a clear exclusion of State or Territory legislative power in relation to credit activities, subject only to the power of a State to terminate its referral of power to the Commonwealth.

Reliance on others

23. The Credit Bill does not provide any exemptions where a person delegates a function to a licensee. This is likely to add to the cost of compliance as it will mean that businesses that do not have direct contact with consumers will still require a licence and will need to engage in due diligence to ensure that other licensees are performing their obligations under the Bill.

24. This issue arises in relation to the licensing obligation. There is no ability to appoint a licensee to undertake activities on behalf of another business. FSR provides a number of licensing exemptions in these circumstances. Firstly, product manufacturers (in this context lenders) do not require a licence where a licensee has arranged for the provision of a financial service by the product issuer and does not require a licence to engage in other activities once the financial product has been issued. These exemptions arise under section 911A(2)(b), (ba), (c) and Corporation Regulations 7.6.01(1)(n) and (q). Furthermore, where a person delegates a function to a licensee under the FSR regime, the licensee is treated as the party responsible for the provision of that service rather than the principal meaning that the principal itself does not need to hold a licence: section 911B(3). We submit that similar exemptions should be included in the Credit Bill.

25. The issue also arises in relation to the obligation to provide a credit guide. Each licensee and each credit representative that engages in a credit activity is separately required to provide their own credit guide to the consumer. This means that some consumers will receive multiple credit guides from multiple parties which is not only likely to result in additional cost and a waste of paper, but also to ensure that none are read.

26. Under FSR, a licensee is not required to give a financial services guide (**FSG**) where an authorised representative provides the financial service themselves. The authorised representative in that case is required to provide an FSG which is required to not only cover the authorised representative but also address matters that would otherwise need to be included in the licensee's FSG: section 942C. The Credit Bill appears to require that both the credit representative and their licensee will have to separately provide credit guides. Furthermore, there is no clear indication that credit guides for multiple parties can be combined into one document. We submit that the Credit Bill should be amended to address these issues.

27. The FSR regime also recognises that where a financial service provider does not have direct contact with the customer the provider should be able to rely on another licensed or authorised provider to provide the FSG for them: Corporations Regulation 7.7.02(7). A similar exemption applies to product disclosure statements (**PDSs**) where an issuer has a reasonable belief that their PDS has been provided previously, which includes by another party: section 1012D(1). Given the similarity of the position of credit providers and financial product issuers, we submit that an exemption similar to the one found in section 1012D(1) should be included in the Credit Bill.

Securitisation trustees

28. We note that the Government has made significant changes in the Credit Bill which will have a very positive impact for securitisation trustees. However, securitisation trustees will still be required to provide a credit guide and undertake unsuitability assessments even though they do not have any direct contact with the customer. We submit that the Credit Bill should include an exemption for complying with a responsible lending obligation where a licensee has delegated the performance of that obligation to another licensee.

29. Another concern for securitisation trustees is the limited effect of clause 47(2) which permits the licensee's circumstances to be taken into account when assessing their compliance with some of the general conduct obligations of licensees. While we would have expected this to be the case for all of the general conduct obligations and would take the view that this is the case for the equivalent AFSL obligations, the inclusion of clause 47(2) now suggests that a licensee cannot have regard to their circumstances when determining what is required to comply with the other obligations. An example is the obligation to be competent. While it seems reasonable that all licensees should be competent, some will be undertaking different activities so the nature and level of competence should reflect the particular business of the licensee. This is particularly true for securitisation trustees which have a very limited role in the lending process. We submit that clause 47(2) should apply to all licensee obligations.

Credit guide exemptions

30. The Credit Bill does not recognise any circumstances in which a credit guide might need to be provided later or not provided at all and we are concerned that the credit guide provisions do not provide any clear power to make exemptions from the requirements.

31. We note that the Government has now included general exemption and modification powers in the Credit Bill in relation to the responsible lending obligations. However, we are concerned that without an express power to make exemptions in relation to credit guides ASIC may be reluctant to exercise that power. In our experience, it is important for Parliament to specifically indicate whenever a regulator is intended to have a

particular power to make exemptions to enable the regulator to feel they have sufficient flexibility to do so. We therefore submit that express exemption powers be included in relation to the obligation to give credit guides.

32. An example of circumstances where exemptions would be appropriate include where a person providing credit assistance or a credit provider is dealing with a customer over the telephone. In equivalent circumstances, under FSR, the licensee or authorised representative is permitted to provide the financial services guide later: section 941D(2).

Different obligations for licensees

33. There are a number of significant differences between the obligations imposed upon AFSL holders and those imposed upon credit licensees under the Credit Bill.

34. One significant difference is that credit licensees are required to have adequate arrangements to **ensure** that clients are **not disadvantaged** by any conflict of interest that may arise in relation to credit activities engaged by the licensee: clause 47(1)(b). This contrasts (without any explanation for the difference being provided in the Explanatory Memorandum) with the obligation under FSR for licensees to have in place adequate arrangements for the management of conflicts of interest: section 912A(1)(aa). These appear to be quite different obligations. The obligation to ensure that clients are not disadvantaged imposes a significantly higher standard than simply an obligation to have arrangements in place to manage conflicts of interest. We submit that there is no reason to have different conflict obligations applying to the different classes of licensees and submit that the formulation under FSR is also appropriate for credit licensees.

35. The Credit Bill also proposes a statutory requirement to have adequate arrangements and systems to **ensure** compliance with its obligations and a written plan which documents those arrangements and systems: clause 47(1)(k). The FSR regime does not impose any statutory obligation to have a compliance plan. ASIC's standard licence conditions do impose an obligation on licensees to establish and maintain compliance measures that ensure, **as far as is reasonably practicable**, that the licensee complies with financial services laws: ASIC Pro Forma 209, condition 4. Again, these are quite different obligations and the Credit Bill is significantly more onerous. The obligation to have systems that ensure compliance imposes an unreasonable standard of compliance upon licensees. By their very nature, compliance procedures and systems are designed to assist businesses to comply, to have measures to address non-compliance and to improve compliance systems based on the experience of investigating instances of non-compliance. The test proposed under the Credit Bill seems to require the highest possible standard of compliance systems: compliance systems that cannot fail. This test is too onerous and we submit that the formulation that ASIC uses in its standard licence conditions under FSR is more appropriate.

36. The Credit Bill also imposes an obligation on licensees to ensure they only deal with licensees in relation to activities that require a licence: clause 31. While it may sound reasonable to require licensees to consider the licensing status of those they are dealing with, it is in fact a potentially very onerous obligation and not one found under FSR. What it effectively means is that each licensee must consider the licensing status of every other person that they deal with. It will no longer be sufficient for a licensee to simply raise the issue as to whether or not a person they are dealing with is appropriately licensed for their conduct. They will be required to form a view which will require potentially extensive due diligence on the activities engaged in by an unlicensed business. This will be an impediment to commerce and seems to result in an inappropriate requirement for

licensees to act as enforcement agents. We submit that it should be up to each individual business to determine their own licensing status and requirements and to be liable for that decision. It is not appropriate to extend that liability to others.

Civil penalties and infringement notices

37. We note that the Government believes that imposing criminal sanctions for breaches of the licensing regime can result in an overly cautious approach by businesses to compliance, which can stifle innovative approaches which would otherwise be desirable to encourage while lower level breaches persist because of the difficulty of prosecution: Explanatory Memorandum, paras 9.34 – 9.35. While we acknowledge these concerns, we believe there is a real risk that the lower standard of proof and the ability of ASIC to impose infringement notices without going to court will do significantly more to create a risk adverse culture amongst regulated businesses. We are concerned that a lower standard of proof will mean that ASIC will be more inclined to prosecute breaches. The infringement notice power certainly seems likely to lead to more aggressive enforcement by ASIC.

38. We do not believe that aggressive enforcement is normally the best recipe to encourage businesses to weigh appropriately the risk of non compliance against conducting their business in a cost effective and efficient manner to reduce their costs and to manage their risks in a way that is ultimately to the benefit of consumers. We submit that the Committee should give serious consideration to the appropriateness of civil penalty regimes and in particular infringement notice powers and the potential consequences that these sorts of powers and penalties could have in a commercial environment.

We would be very happy to respond to any enquiries the Committee may have in relation to our submission.

Yours faithfully
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