Finance Industry Delegation
Australia

A SUBMISSION TO THE SENATE ECONOMICS COMMITTEE

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

from the

FINANCE INDUSTRY DELEGATION

To the:

Senate Economics Committee
Parliament House
Canberra ACT

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Is this submission confidential? **No.**

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

This proposed legislation is a major concern - providing ASIC with autocratic and uncontrolled power to intervene in the marketplace

About the Finance Industry Delegation

The Finance Industry Delegation represents some 187 non-ADI (bank) credit providers and lessors of all sizes across Australia. Delegation supporters lend in excess of 40,000 loans per month.

Introduction

We request that the members of the Committee and Secretariat note:

1. The provisions to impact on Small Amount Credit, Medium Amount Credit and All Other Credit (non-bank/ADI), associated with ASIC-provided Australian Credit Licenses, were never part of the Financial System Inquiry mandate, or the Inquiry's recommendations in its November 2014 report. The Inquiry did not consider these loans and did not invite participation in any consultation.
2. Nor did Minister Kelly O'Dwyer's "*Design and Distribution Obligations and Product Innovation Powers*" Paper, December 2016, which was her Ministerial response to the Inquiry's recommendations, consider this credit sector.
3. There was no participation invited from this credit sector when Minister O'Dwyer and Treasury conducted some preliminary consultation meetings with "stakeholders" before the Bill was released in July 2018.
4. The drafting of the provisions in the section of the Bill directed to changes to the Corporations Act, intended for very different "*financial products*", could also ensnare the Small Amount Credit, Medium Amount Credit, All Other Credit (non bank/ADI) lender, with simple credit or loan products that are already substantially regulated by the National Consumer Credit Protection Act 2009 (the Credit Act). That means many of the design and distribution provisions and the associated ASIC Stop Orders may apply to this other sector of the finance industry, in circumstances where this was never recommended by the Finance System Inquiry, nor considered by the then Minister when she adopted the Inquiry's recommendations.
5. The lack of clear definition of key terms in the Bill concerning the Product Intervention Power and amendments to the Credit Act (National Consumer Credit Protection Act), provides a substantial lack of clarity and certainty - contrary to the fundamental principles of good government.
6. Further, somewhat contradictory provisions in the Bill will allow ASIC to fail to perform its required duties, but the lender will not have any recourse and ASIC's authoritarian demands will have to be accepted - no matter how impaired the process leading up to ASIC imposing its will, with the declaration on its website of an intervention order.
7. There is no provision for the necessary appeal in any part of this Bill.
8. There is no provision for tabling in the Parliament. It is our view that the "orders" should be regulations - attracting the opportunity for parliamentary scrutiny - and not effectively isolated from any transparent review. This Bill allows ASIC to highjack the Parliament's powers.
9. There is no provision in the Commonwealth Constitution allowing a government authority to override the Parliament, as the Bill envisages.

10. With two relatively lesser exceptions - amendment and removal of an order - ASIC does not required Ministerial approval.
11. If some part of the motivation is to extend ASIC control over the exemptions to the National Credit Code in Section 6 of that Code, then amendment of the Code is required by the Parliament, not an indirect and uncertain opportunity for ASIC to effectively usurp the Parliament.
12. Fundamentally, ASIC has unfettered power under this proposed legislation, with Ministerial involvement so limited as to constitute an abrogation of Parliamentary and Ministerial power to ASIC.
13. These wide powers mean that no lawyer or compliance adviser will be able to provide professional advice concerning the design and marketing of credit products, as the Credit Act will no longer provide any certainty.
14. At no time was any legitimate ASIC capability assessment undertaken and the Finance System Inquiry did not make any enquiry as to ASIC's ability to handle its monstrous suggested new powers.

Lack of clear definitions

The specific inclusions that are of great concern to the Finance Industry Delegation for which clarity is sought, include:

(a) Lack of clarity as to whether or not already substantially regulated Small Amount Credit Contract (SACC), Medium Amount Credit Contract (MACC) and All Other Credit Contract (AOCC) credit providers (as defined in the National Consumer Credit Protection Act 2009) come under the provisions concerning "*design and distribution of financial products*".

For example, Section 994C(6), refers to "*the regulated person*". We are unclear as to whether or not an Australian Credit Licensee, under the Credit Act, could be deemed a "*regulated person*".

(b) This same sub-section refers to a "*financial product*". We are also uncertain as to whether or not the credit contract referred to in the first paragraph associated with this point could come within the definition of a "*financial product*", for the purposes of the suggested amendments to the Corporations Act.

Key content of concern in the Bill

<u>Application of proposed legislation - ASIC total discretion</u>

It is noted that the amendments will probably apply to all credit products provided while a lender is engaging in a credit activity, i.e. while being a lender [Section 301D], without any recognition of current regulatory regimes that directly and/or indirectly interface with what is proposed in the Bill.

They will also apply to short term credit "*that is currently not regulated under the Credit Act*" (Explanatory Memorandum Clause 2.24). That means those credit models not regulated under the National Credit Code - in particular the 24% interest rate cap, 5% fees cap, less than 62 days product. ASIC and a succession of Ministers have never understood that those exemptions are expressed as exemptions from the Code, not the Act as a whole.

This application of the proposed legislation is set to be in force when the credit product is being offered to "*ordinary consumers*" (Explanatory Memorandum Clause 2.20), [Section 761D and 761GA, Corporations Act]. Again, the industry sector represented by the Finance Industry Delegation has not been provided with any clarity as to what constitutes an "ordinary consumer".

Despite this breadth of application, the powers given to ASIC are extensive.

Without any of the necessary appeal process included or recognised in the new sections, ASIC will assess the risk of "*significant detriment*" to consumers. Effectively, it is entirely optional as to whether or not ASIC bothers to discuss anything with the lender first [Section 301A].

Provision of such freedom to ASIC is unsound, unjust and tyrannical.

ASIC consultation - not what it seems. In reality, not even necessary

The Explanatory Memorandum, released with the Bill by the responsible Minister at the time, at Clause 2.9 claims:

1. that "*ASIC must satisfy consultation and notification obligations before an intervention order is made*".

   However, ASIC can ignore this and the orders will still stand. This is unbelievable legislation.

2. The Explanatory Memorandum continues - "*Affected parties will be given the opportunity to make submissions to ASIC before an intervention is made...*".

   We have been unable to discover any provision in the Bill that provides for these submissions. Further, there is no recognition of effective consultation, for the legislative instrument orders, involving face to face contact between ASIC and industry sector representatives. The Finance Industry Delegation considers that this opportunity must be mandatory.

3. "*All interventions will be made public*".

As indicated in the Bill, that means they will be published on the ASIC website.

Despite the fact that ASIC has every Australian licensee's contact details, ASIC is not obliged to have any direct contact with lender stakeholders to inform them as to what, effectively, will be changes in the law.

Lenders will have to check the ASIC website every day to see the applicable law for that day.

Given ASIC's compulsorily acquired contact details and the cost effective ease of mass emailing, this burden on the lender is unnecessary.

No retrospective effect - but contract templates legally being used now, will be captured in the future

The Explanatory Memorandum states that "*ASIC may only intervene in relation to products that are made available for acquisition after the commencement of the new power*".

However, this is explained as meaning it cannot apply to an existing contract, or assignment of an existing contract - but it can apply to existing contracts of the type planned to be lent in the future (Explanatory Memorandum Clause 2.28)[Section 301C(1)].

That means existing contracts for business/credit model 'X' already in existence, cannot be challenged by ASIC using their new powers, but the same model 'X' contracts in the future can be. In other words, the fact that ASIC has not taken any action in the past, is no guarantee that lenders will be able to use the same business model in the future.

This introduces substantial uncertainty.

ASIC - opinion only required

ASIC has simply to declare "*significant detriment*" (Explanatory Memorandum clauses 2.31 to 2.36)[sections 301E and 301D], without necessarily satisfying the rules of evidence, to bring a case against a lender.

The Bill states that ASIC only has to be "*satisfied... that a person is engaging, or is likely to engage, in credit activity and... the credit product has resulted in, or will or is likely to result in, significant detriment to consumers*". There is no specification as to how ASIC would come to the decision that it was "*satisfied*".

In our opinion, this provides a highly subjective power for ASIC to act in a very autocratic manner. It also confers on ASIC the opportunity to engage in fortune telling and opens the way for the possible execution of personal vendettas.

Further, "*Significant*" is not defined, except that it has "*its ordinary meaning*".

The provision gives ASIC extremely wide discretion, providing for such to be considered by ASIC - and no-one else - to be "*sufficiently great to justify an intervention, having regard to the circumstances of the case and the object of the intervention power*", i.e. this is jargon that ASIC can exploit for any reason, when it sets out to "get" a lender.

ASIC is free to chose the "*relevant detriment*" and the factors that justify that choice.

These factors can be both objective and subjective, current and future, and are unlimited, i.e. "*actual or potential financial loss to consumers*", through to "*any other relevant factor*" can be considered.

"*Detriment*" is not defined. The Explanatory Memorandum states, "*It is intended to cover a broad range of harm or damage that may flow from a product*". The sources of that harm or damage can include "*the product's features, defective disclosure, poor design, or inappropriate distribution*". Once again, these are extremely broad and completely subjective.

All these elements contribute to major uncertainty for lenders.

Section 301D(3) allows ASIC to impose a banning order, or any conditions it deems fit.

In Section 301E, ASIC is given further highly subjective opportunities to decide if there is "*potential financial loss*", and whether or not the product being examined "*will or is likely to result in significant detriment*".

Again, we have the opportunity for ASIC to act in a tyrannical manner.

Complying with existing law is not a defence - ASIC can overrule and ignore the Parliament

That effectively means the Commonwealth Parliament is irrelevant - only ASIC counts.

The then Minister Kelly O'Dwyer stated, "*...a product may cause such detriment even if it complies with all laws*" (Clause 2.35).

That means Minister O'Dwyer released an Explanatory Memorandum that stated ASIC could ignore the law passed by the Parliament and do whatever it likes. We wonder why we need a Parliament and pay Federal politicians - except to pass laws allowing the bureaucrats to run the country.

Intervention orders - in reality, immense and unchecked/uncheckable power to ASIC

The Delegation notes the following in regard to intervention orders [Section 301C, 301B, 301H]:

1. The term can be up to 18 months, but ASIC can extend the term for a specified time - or indefinitely - "*until it is revoked*" [Section 301H(1)].
2. Intervention orders can effectively ban a product.
3. Intervention orders can impose conditions. One of those conditions being that the loan can only be offered to a particular class of persons (e.g. not to Centrelink recipients), or must be offered with a particular warning.

4. An intervention order can be directed at one lender or a class of lenders.
5. ASIC does not need Ministerial approval to invoke an order but, ironically, it does need to do so to amend the order [Section 301J] and also to revoke an order [Section 301K].

With the extraordinarily wide discretion provided to ASIC in these sections, these appear to be the only Ministerial powers in the proposed legislation.

While the Minister has to receive a report from ASIC, there is no opportunity for the lender or industry sector to make submissions concerning the proposed amendment or revocation. This continues a common theme in the Bill - exclusion of the lender from everything other than being a victim of ASIC's brutal and unjust use of power.

Consultation - not in ASIC's culture

The provision for consultation [Section 301F] is offered in circumstances where ASIC has never made it easy to arrange consultation with the finance sector and has a range of consultation committees, or forums - none of which involve participation by representatives from the industry sector of concern to the Finance Industry Delegation.

The Explanatory Memorandum claims there are "*three consultation requirements*":

1. "*With people or entities that are likely to be affected by the order*".
2. ASIC "*must identify these parties and invite them to participate in the consultation process*".
3. However this is then contradicted, with the proposition that this can be replaced by "*public consultation*" - meaning "*to make a proposed order, or a description of such an order, available on its website and to invite public comment on the proposed order*" (Clause 2.49)[Section 301F(2)].

What is "*public comment*"?

Who will know?

Will submissions be published on the website?

Or will ASIC adopt Treasury's haphazard approach of sometimes publishing, sometimes not and, if it does, not publishing all submissions, which creates an institutionalised opportunity to avoid transparency.

What happened to the invaluable and essential opportunity for face to face contact?

Unfortunately, it deteriorates even further in Clause 2.52 [Section 301F(3)] - "*This consultation process is intended to be mandatory. However, a failure to comply with the requirements does not invalidate an intervention order. This ensures that an otherwise valid intervention order is effective despite any defect in the relevant consultation process*".

This is a licence to allow ASIC to disregard conducting any consultation. There will not be any opportunity to even challenge whether or not the order is "*valid*".

In other words, there is no challenge available when there has been a major error by ASIC.

Equally worse - the only penalty an inept ASIC would face is to include any instances of these stuff-ups in its Annual Report [Section 301F(3)]. For examples as to how inclusions in Annual Reports have been whitewashed, one need only look at the EDR schemes' reports over recent years.

Even if ASIC breaches a consultation requirement under Section 17 of the Legislation Act 2003 - concerning all other government department and authorities' legislative instruments - Section 301F(4) provides that Section 17 does not apply in these circumstances. ASIC is exempt from the rules the Delegation understands

universally apply to all other Commonwealth Government Departments and Authorities.

As members of the Committee would know, legislative instruments are not available for parliamentary scrutiny and disallowance-style regulations. They are simply listed on a legislation register, so that the parliament knows they exist - but does not know their content.

In other words legislative instruments are like regulations, in that they are part of the law that applies. However, regulations are tabled in the Parliament by the relevant Minister, who must defend them if any MP or Senator challenges them.

ASIC does not have to defend its legislative instruments in the Parliament, or even to the Minister that is supposedly in charge.

Amendments to the Bill must be made that return the Parliament to its expected and constitutional role.

Intervention orders

Public notice of intervention orders - far from satisfactory

Where intervention orders and any amendments (applying to some individual lender) are not legislative instruments, ASIC must serve a copy "*on any person to whom ASIC considers the order applies*". This is particularly the case when a lender is being singled out.

However, if ASIC fails to serve the notice, Section 301L(1) provides that the order is still valid. Again, ASIC does not have to obey the law when creating a new law, and their ASIC created law is still valid. This cannot be left as it is.

This same ASIC lack of accountability and lender peril applies to amendments to intervention orders [Section 301L(4)].

Revocation of an order need only be published on the ASIC website [Section 301L(7)].

Similarly, all orders must be published on the ASIC website [Section 301L(6)], including:

1. a description of the significant detriment;
2. if the order takes effect other than the day after it is published - that other date;
3. a description of the consultation undertaken; and
4. why the order is an appropriate way of reducing the significant detriment.

Again, the Delegation is most concerned that all communication is limited to posting on the ASIC website, without any attempt to provide for ASIC contact with the individual lenders.

Further, no reasonable minimum period has been included for commencement, providing lenders with both a warning and time to prepare.

None of this information can be used to object to the order - it is a done deal and the targeted lender faces major penalties if it disobeys the order (see below).

Commencement and amendment/revocation of intervention orders unsatisfactory

Section 301G provides:

(a) If the order relates to a particular lender, or a particular lender's product - it is not a legislative instrument - and it applies from the date it is published, or date otherwise prescribed.

Again, this implies the lender has got to keep a daily eye on the ASIC website.

(b) If the order applies generally - it is a legislative instrument - and applies from the day after it is registered with the Parliamentary Secretariat or Speaker's Office, on the Federal Register of Legislation.

Again, this implies every lender has got to keep a daily eye on the Parliament's Register of Legislative Instruments [Section 31G(1)].

ASIC can amend or revoke an intervention order at any time. The amendment or change commences the next day after registration of the legislative instrument, or otherwise from the day it is published on the ASIC website.

The Finance Industry Delegation considers the extremely limited notice provides a significant detriment to credit providers, particularly as there would be a lack of opportunity to seek legal and other professional advice, to re-arrange lending processes, to amend contracts (and the necessary IT time taken), to amend advertising and to train staff on the new content. This also means, if the lender is unable to complete the implementation of the necessary changes prior to the commencement of the intervention order, ASIC would be in a position to unfairly target the lender.

ASIC may require the lender to notify other people (e.g. staff) and/or consumers, and may specify how this notification is to occur [Section 301P(3) and (4) and 301N(1)(b)].

If there is an expectation of individual contact placed on the lenders, then this should also be the expectation for ASIC.

Penalties - why are they criminal?

The Delegation notes that all offences are Criminal - from not obeying the order with your lending model, to not informing staff or the consumers as demanded - 200 penalty units at $185 per unit, plus imprisonment for 5 years - or both - and a civil penalty of $200,000 for an individual and $1 million for a company.

In addition, the lender can face a civil action from consumers if the lender breaches the Act and the consumer suffers "*loss or damage*". This liability exists, regardless of whether or not ASIC has taken any successful action.

The court can declare the contract void, make an order for the return of money including interest, and otherwise make other orders as it thinks fit, in accordance with current provisions in the NCCP Act.

In the Delegation's opinion, the totality of the possible penalty - particularly with a criminal conviction - is oppressive and unconscionable.

The Regulation Impact Statement (RIS)

The accompanying RIS is unacceptable. In the Finance Industry Delegation's opinion, the RIS comments do not match the reality.

1. The RIS states that Treasury met with "*key industry stakeholder and consumer groups*". We have been unable to discover anyone from the SACC/MACC/AOCC finance sector who was invited to do so.
2. It states that the Financial System Inquiry received over 180 submissions. We have been unable to discover any lender from the SACC/MACC/AOCC finance sector who made a submission. This is understandable - the Inquiry was not interested in small (non bank) lenders.
3. The RIS refers to the Financial System Inquiry interest in a number of products - none of them associated with SACC/MACC/AOCC loan products.
4. The RIS gave absolutely no consideration of the position of currently substantially regulated SACC/MACC/AOCC credit products.

The ASIC submission

Recently, ASIC posted a submission concerning the Bill on its website.

The ASIC submission seeks to magnify and extend its powers to basically impose any of the provisions, included in the Bill, to any entity that is regulated by any law where ASIC is the enforcer.

ASIC has already participated in developing the Bill, now they want to extend their powers under the legislation, effectively receiving two bites of the cherry. The following summary of the ASIC submission shows, as the Economics Committee would have observed, ASIC wants:

1. the design and distribution functions to also apply to credit providers under the NCCP Act, by way of all ASIC Act regulated entities being included. This will give ASIC the power to determine:
   (a) the distribution (marketing) channel employed, with substantial record keeping being envisaged;
   (b) distribution of product to accord with consumers' objectives, financial situations and needs - which ASIC attempts to separate from the NCCP Act provisions by explaining that the NCCP Act is about avoiding consumer hardship; and
   (c) that the legislation would apply to currently exempt credit products;
2. the establishment of a self managed compensation fund; and
3. that ASIC will have the power to order training.

ASIC claims that giving ASIC wide product intervention powers will help ASIC to:

(a) act more quickly and effectively to address the problems in the market;

(b) reduce the number of consumers for whom the risks of a product are "*misaligned*" with their objectives, financial situation and needs; and

(c) facilitate informed decision making by consumers.

In short, ASIC will intrude in the market place and play nanny undertake unfettered social engineering.

All is promised with a robust industry consultation process after the legislation is passed and throughout the implementation of the desired provisions. This when ASIC has a history of ineffective or non-existent consultation with the Australian Credit Licence industry sector, particularly those lending under $30,000 .

Inclusion of amendments to satisfy these requests must be considered in the light of the sham ASIC Capability Review undertaken in 2015-16, the various industry sectors' adverse assessments of ASIC performance and the revelations as to ASIC's incompetence that emerged from the Banking Royal Commission.

<u>Support for a broader approach</u>

ASIC lists the following issues as determining that there is a need for ASIC's broader powers:

(a) Products are not well designed, or provide good enough utility (e.g. value for money) to many types of consumers.

ASIC alleges this goes beyond the consumer's ability to afford the product. Credit providers would also have to assess whether or not the characteristics of the product were suitable during the enquiry stage of the assessment. There is no room for consumer assessment, ASIC will do the decision making for them.

(b) Products are only "likely" to be suitable for a limited class of consumers, but are distributed without appropriate targeting, making it "likely" that they will

ultimately be sold beyond the class of consumers for which they are "suitable". This would mean credit providers would have to consider whether or not distribution methods chosen were consistent with the most recent target market assessment.

(c) Instances where the volume and types of complaints the entities are receiving, suggest the distribution process is not working effectively to align consumers with suitable products, but no action has been taken.

ASIC will expect post-introduction product reviews by the credit provider, looking for indications of poor design - particularly arrears, defaults, rates of early payout, requests for hardship.

ASIC presents an example of a consumer applying for a SACC to pay an electricity bill.

This is identified as risking the consumer becoming dependent on high cost finance, and product design demands that the consumer be offered an alternative product by way of change in design, or offering this class of consumer different terms.

In other words, ASIC knows best and wants to control what goes to market without clearly defined laws, without necessary substantial investigation, without needing enforceable undertakings or prosecution - just whatever ASIC deems within the scope of its very wide and unchecked current, and potentially future, powers.

ASIC power preference

ASIC wants "*as much flexibility as possible*" for product intervention.

Again, such flexibility leads to major industry uncertainty and the opportunity for ASIC to undertake subjective and inexcusable social engineering.

Ministerial control and appeal mechanism

The Finance Industry Delegation is very disturbed to note that there is no proposed Ministerial control and appeal mechanism.

The Delegation considers that ASIC's attempt at social engineering eliminates consumer choice and substitutes it with ASIC choice - usurping the role of the Parliament and securing dictatorial control, without any appeal rights in an area that is largely highly subjective.

Given the above, the Finance Industry Delegation requests a very careful examination of every element in the Bill that increases ASIC's power.

No consultation for our stakeholders

The Finance Industry Delegation emphasises - to the date of releasing the Bill, there had been a total exclusion of lenders/credit providers involved with Small amount Credit Contracts, Medium Amount Credit Contracts and "All Other Credit Contracts", as regulated by the National Consumer Credit Protection Act 2009, from the consultation process. This included exclusion from three significant consultation meetings or witness opportunities such as:

1. no involvement in consultation with the Financial System Inquiry;
2. no involvement in the consultation meeting process adopted by the Minister, leading up to the Bill; and
3. no involvement in the consultation meeting process identified in the Regulatory Impact Statement.

As a result, the Bill, the Explanatory Memorandum and the Regulatory Impact Statement do not include any content that reflects any contact with Finance Industry Delegation supporters and their finance industry sector (or any other non-bank lending industry representative body), despite the representative bodies being listed

on a Treasury consultation panel, during these significant consultation meeting opportunities.

Conclusion

We trust that there is further opportunity to present the smaller non-bank/ADI lending sector's views to the Committee, as the review of the Bill proceeds.

To date, this significant sector of some 380 Australian Credit Licensees has been ruthlessly excluded.

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