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Mr Greg Lake
Principal Researcher
Senate Economic Committee
Department of the Senate
Parliament House
Canberra ACT 2600

By email to: Greg.Lake@aph.gov.au

Dear Mr Lake,

Questions on Notice - National Consumer Credit Protection Bill 2009 and related Bills

Thank you for the questions on notice that provide us with the opportunity to further assist the Committee in this inquiry.

Information that we are able to provide follows in the order the questions have been asked.

Question: How extensive is the referral from the States likely to be? Will it only cover the areas covered by the bill? Or could states still implement other regulations relating to consumer credit (for example, regulating point of sale credit assistance)? Is there any chance that the referral may still leave areas within the regulation of consumer credit where inconsistencies between states could emerge?

Answer: It is understood that the referrals from the States are to be text based and not a general referral of legislative power. This means that until the terms of the Bill(s) before the Commonwealth Parliament have been finalized the States will have to wait. The experience with the uniform Consumer Credit Code was that despite the States and Territories entering into a uniformity agreement in 1993 States were able to circumvent the agreement by amending fair trading legislation. Two examples are provided, the first in the ACT where the parliament amended the Fair Trading Act to require credit providers to undertake a prescribed customer assessment process before issuing a credit card or credit

card limit increase to the customer. The second example occurred in 2009 in Victorian where the parliament amended the Fair Trading Act to extend its unfair contract terms legislation to credit contracts regulated under the uniform Consumer Credit Code.

Section 26 of the National Consumer Credit Protection Bill enables a referring State to enact a law that declares a provision of that law to displace a provision under the Commonwealth credit legislation. The ABA is concerned that the ability of a State to enact a displacement provision could lead to additional consumer credit regulation being created that applies on that State but does not apply nationally.

Question: Is there any way that the bill could be structured differently to ensure that no inconsistencies arise between the commonwealth legislation and the regulation imposed by any State?

Answer: The ABA does not have the necessary constitutional law expertise to suggest how the bill might address this. Two possible areas for limiting the power of a State to enact a law displacing provisions in the Commonwealth credit legislation could be: -

- Through general referral of power by the States giving the Commonwealth power to cover the field; or
- Removing the ability of the States to enact displacement provisions

Question: How does the ABA see the role of Finance Brokers changing as a result of this reform?

Answer: The ABA expects there will be some consolidation in the finance broking sector and possibly fewer stand-alone brokers due to higher initial operating costs and ongoing compliance cost due to increased regulation.

As a result, brokers may choose to align with a network of brokers under an aggregator arrangement or merge under a broker alliance which may group brokers under credit representative structures. There may also be an increase in alignment of brokers with particular lenders under new distribution arrangements; particularly for brokers who cannot afford to remain as sole operators for a range of lenders.

In terms of the respective roles of finance brokers and credit providers the ABA is very supportive of the clearer separation of these roles and functions in Chapter 3 of the bill, there remains a risk that consumers may not fully appreciate the different objectives in the regulation behind a credit assessment that is conducted by a finance broker and the later assessment conducted by the credit provider. Consumers should understand that a responsible lending decision by a finance broker is not necessarily determinative of a credit provider's decision whether to approve the credit application and whether further information is required by the credit provider.

These changes should be positive for consumers, as will the greater confidence and trust afforded to consumers by EDR membership and broker training.

Question: In what way do you see the role of a person who 'suggests' or 'assists' a consumer as being different from someone who 'recommends' or 'negotiates'? Why do you think the definitions need to change?

Answer: This matter was raised with the Committee before the draft regulations had been released by Treasury for consultation. The ABA is pleased that the proposed exemptions for referrers (which should include a referrer providing the consumer's contact details to the credit provider as well as the referrer providing the credit provider's contact details to the consumer) help to resolve this difficulty.

The activities of 'suggesting' or 'assisting' a consumer is much broader and captures a wider range of persons from those who 'recommend' or 'negotiate'. To make a recommendation or to negotiate is based on aligning a person's objectives and capacity with the contract recommended or negotiated. By contrast, suggesting/assisting is of a more general nature which can occur even where a particular lender or particular loan product is mentioned without consideration of the person's objectives or capacity.

To apply the full weight of regulation in the case of 'recommendation/negotiation' rather than 'suggesting/assisting' will capture 'intentional' activities to promote particular credit arrangements rather than incidentally/unintentionally capturing general referrals to a credit provider.

To explain, the use of the expressions 'suggests' or 'assists' could extend to situations where simple information is being provided to a consumer to help them decide where they might seek a credit facility. For example, a bank officer might simply help a customer with information for the customer to make a choice between the costs of an early payout of fixed versus variable interest rate loans, the term of a fixed loan, options for repayment, as opposed to substantive advice or recommendations about these choices.

The ABA does not advocate for the bill to introduce an advice regime as exists under Chapter 7 of the Corporations Act. The issue is to ensure that it is clear under the bill (and the regulations) that active assistance that would be involved with recommending to, or negotiating on behalf of, a consumer is the conduct objective.

Question: What problems do you see with the EDR (External Dispute Resolution) requirements when it comes to banks with an 'owner-operator' model or 'third party branch' structure? (Where branches are owned by an individual and operate as agents of the bank – cf page 6 of ABA submission – 1st five paras)

Answers: The problem is that each owner operator will need to be appointed as a credit representative and therefore join an EDR scheme even though the principal (the bank) is a member of the EDR scheme and responsible for the agents' (franchisee's) conduct.

The bill contemplates that credit representatives should join an EDR on the basis that if the authorising licensee no longer exists, the borrower still has recourse to the agent's (franchisee's) own EDR scheme.

In the case of the ADI model the subject of this submission, if the principal ceases to exist so too will the agent (franchisee) cease to exist.

The agent (franchisee) being part of the ADI's structure and the ADI regulated by APRA, it is very unlikely that the ADI will cease to exist. The ADI might decide to fold in the agent (franchisee) into the ADI highlighting the importance of the agent (franchisee) being included within the ADI's EDR scheme membership.

Under the next question the ABA refers to APS 231. Item (j) of clause 20 of APS 231 should be available to the ADI to stipulate that the agent (franchisee) belongs to the ADI's EDR scheme.

A wider application of this argument is that a requirement for credit representatives to also be members of an EDR along with the principal credit provider's membership of an EDR will lead to duplication and increased costs.

It also raises concern about the consistency of decision making by EDR schemes given the multiple memberships of EDR for participants in the credit chain. This also raises the question about how decisions will be reconciled for credit assistance providers and credit providers who are members of different EDR schemes where the issues in dispute may be similar, for example, for the unsuitability test considerations.

Question: You suggest an amendment to the liability provision for credit representatives so that it only applies to the actions within their authority. Why is this amendment necessary?

Answer: First, the legislation would extend the law of principal and agent to attach liability to the principal for all unauthorised acts of the agent. Actual, implied and ostensible authority of a credit representative is covered in the general law principle but the principle should not be extended to a case where the credit representative decides to embark on a frolic of its own.

An ADI credit licensee, as an APRA regulated entity, must take precautions in appointing (outsourcing of material functions) a credit representative. For example under Australian Prudential Standard APS 231 stipulates certain requirements of an outsourcing agreement by the ADI.

Clause 20 of APS 231 states:

"At a minimum, the agreement (including arrangements with related bodies corporate) must address the following matters:

a) the scope of the arrangement and services to be supplied;

b) commencement and end dates;

c) review provisions;

d) pricing and fee structure;

e) service levels and performance requirements;

f) audit and monitoring procedures;

g) business continuity management;

h) confidentiality, privacy and security of information;

i) default arrangements and termination provisions;

j) dispute resolution arrangements;

k) liability and indemnity;

l) subcontracting;

m) insurance; and

n) to the extent applicable, offshoring arrangements (including through subcontracting).

The ABA believes that in complying with APRA's prudential requirements an ADI should not be required to accept liability for actions by its credit representative that are outside of the terms of the credit representative's written authority.

Further, unless the licensee's liability is limited to the authorised activities of the credit representative the likely effect is an increase in the number of licensee's and a reduction in any incentive for a license to appoint credit representatives.

Question: You advocate extending the responsible lending criteria to include the use of technology to assess existing customers' suitability for further credit facilities. Would this allow unscrupulous lenders to satisfy the responsible lending criteria but provide, for example, an increase in a credit card limit that is beyond the capacity of a customer to manage?

Answer: Whatever methods of assessment a credit provider uses, the credit provider still must demonstrate that the processes used result in responsible lending decisions. Unscrupulous lenders that are increasing a credit card limit to an amount that is beyond the customer's capacity to manage will not meet this standard.

What the ABA was suggesting was a combination of predictive credit score models in combination with more comprehensive credit reporting, the availability of which would help avoid over commitment. These rules would not override the obligation that a customer can meet repayments without substantial hardship.

Technology assists in deriving a more predictive and reliable assessment of a person's capacity because this is based on factual information, history, credit modelling and in the future, more comprehensive credit reporting. By contrast relying on debtor representations about their financial status can in fact be unreliable in certain cases.

Banks employ sophisticated assessment systems for their existing customers that provide the bank with a wide range of information about the customer's transaction and performance with the credit card facility they have with the bank.

More comprehensive credit reporting could support these systems in providing information about the customer's performance on credit facilities that are not held with the bank.

Further when a bank makes an offer of an increased credit card limit to its customer, the following information also is available to the customer:

(1) In the offer letter, information on how much more the customer will have to pay each month, if they take up the offer so the customer is able to easily assess the increased repayments needed if they use the additional credit.

(2) Advice to customers, included in marketing material, that if their personal circumstances have recently changed, for example loss of employment, or are likely to change, for example maternity leave, they should not accept any credit card credit limit increase offer, and should immediately contact their bank.

(3) A capacity for individuals to opt for a lower credit card credit limit than the increase offered. For example, a customer could opt for a $1000 increase in preference to a $2000 limit increase offered.

(4) An industry benchmark that any ABA member bank customer could reduce their credit card credit limit:

- If the bank has a telephone facility to do this – within 24 business hours of receipt of request;
- In any other case – within 48 business hours of receipt of request.

Question: On page 9 of your submission, you give the example of a person purchasing a house on 120 day settlement terms. You suggest that the prospective period of 90 days after which a credit provider must again assess the credit facility as 'not unsuitable' may force consumers and lenders to go through all the same processes again will be inconvenient. How could this be improved?

Answer: Due to the varied circumstances which arise and influence the time period between application for credit and entry into the credit contract and the settlement of the facility The ABA considers a longer or more flexible time frame should be addressed in the legislation.

The issue is to avoid inconvenience to customers whose loans have been approved only to be required to endure a repeat of the credit assessment.

Question: How many individuals are likely to be involved in complex residential property developments? You call for an exemption for lending to individuals for

residential property development for the purpose of sale on completion. How much of a problem do you think the current regulations will create?

Answer: The ABA is not able to provide a certain figure. However, the number of these developers would be fewer relative to small individual residential property investors.

For banks, the issue is that these larger residential property developers generally involve larger credit exposures to the bank than under a consumer credit portfolio. Therefore, these facilities are managed under the bank's commercial business customer portfolio rather than under a consumer loan portfolio. There could be additional commercial-type facilities enjoyed by the customer that are not available to consumers. These arrangements entail the use of commercial IT systems processing which are not designed to comply with consumer credit regulation.

If the individual is a professional property developer / trader this may be disclosed by the existence of the customer's Australian Business Number in which case the facility should fall outside the consumer credit regime because the facility would be for a business purpose.

Further, the ABA believes there is a difference between credit facilities provided to an investor who acquires a property for the purposes of re-sale (with or without the need for repairs or renovations) to pay out the credit facility and an investor who acquires the property for the purpose of holding the property as an income producing investment that will provide the basis for servicing a longer term credit facility.

We trust this information is of assistance to the Committee and please contact me if anything we have written requires further explanation or clarification.

Yours sincerely

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Ian B Gilbert