Australian Government

The Treasury

SENATE STANDING COMMITTEE ON ECONOMICS

TREASURY SUBMISSION

NATIONAL CONSUMER CREDIT PROTECTION BILL 2009 AND RELATED BILLS

AUGUST 2009

OVERVIEW 3
PART A: DEVELOPMENT OF THE CREDIT REFORM PACKAGE 4
The Case for Regulatory Reform 4
Current Regulatory Framework *4*
Objectives of regulatory reform *4*
Options for regulatory reform *5*
Council of Australian Government (COAG) Reform Agenda 7
Two stage reform process *7*
Consultation Process *10*
Legal Framework to support the credit reform 10
Referral of Power *10*
Application of the new framework to existing contracts *12*
PART B: KEY ELEMENTS OF THE COAG CREDIT REFORM PACKAGE 13
A. Comprehensive Licensing Regime 13
Scope of the Definition of 'Engaging in Credit Activities' *13*
Licensing Obligations *15*
B. Responsible Lending 16
International Developments *17*
Policy development *17*
C. Enforcement and Sanctions 18
Tiered enforcement framework *19*
ASIC Powers *22*
D. Dispute Resolution Framework 22
External Dispute Resolution (EDR) Schemes *23*
Court Arrangements *23*
Access to Justice *24*
E. Enhancements to the National Consumer Credit Code 25
F. Implementation Timeframes 27
Transition and ASICs Role *28*
ATTACHMENT A - OVERVIEW OF THE MARKET 29
Overall Growth in Credit 30
Current Credit Growth 30

OVERVIEW

On 25 June 2009, the Australian Government introduced the National Consumer Credit Protection Reform Package (Credit Package) into Parliament to give effect to Phase One of the Council of Australian Governments (COAG) reforms to consumer credit.

The Credit Package includes the *National Consumer Credit Protection Bill 2009* (Credit Bill), part of which also replicates the current State and Territory based Uniform Consumer Credit Code (UCCC) as the National Credit Code (Code); the *National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009* (Transitional Bill); the *National Consumer Credit Protection (Fees) Bill 2009* (Fees Bill); and components of the *Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009* (Modernisation Bill) in relation to margin loans.

Treasury considers that the Credit Package strikes an appropriate balance between ensuring credit market integrity, including consumer protections, and supporting an efficient and dynamic financial system. The reforms address a broad range of policy considerations and operate within a Commonwealth constitutional and policy framework.

The reforms seek to maintain confidence in the credit market, putting in place a regulatory framework able to respond quickly to changing market dynamics. The main objectives of the reforms are to:

- create one national market for consumer credit;
- enhance consumer protections; and
- maintain confidence in the credit market, promoting systemic stability.

The aim of Phase One is to construct a robust regulatory framework for a national credit market with enhanced consumer protections. Phase Two of the reforms will build on this work to address more targeted issues, including those identified by COAG, such as considering the extension of the national credit protection laws to small business lending and other investment loans; product specific regulation, for example, in relation to reverse mortgages and credit cards; and further rules to stem specific unfavourable lending practices including unsolicited credit limit extension offers, deceptive advertising practices and other fringe lending issues.

The transfer of responsibility for consumer credit regulation to the Commonwealth should allow, over time, for the streamlining of relevant requirements across the broader financial services sector.

Part A of the submission provides the background to the development of the reforms and Part B provides additional information on key themes that have developed in the responses to the Senate Inquiry.

PART A: DEVELOPMENT OF THE CREDIT REFORM PACKAGE

The Case for Regulatory Reform

Current Regulatory Framework

The Australian Government has limited influence over the regulation of consumer credit through the consumer protection powers given to the Australian Securities and Investments Commission in the *Australian Securities and Investments Commission Act 2001* (ASIC Act). The scope of this power is limited to requiring credit providers to comply with certain provisions mirroring the consumer protection sections of the *Trade Practices Act 1974* (TPA). Importantly, credit providers and many of those providing advice on credit products remain outside ASIC's ambit.

Credit providers are regulated by the States and Territories primarily by the Uniform Consumer Credit Code (UCCC). Responsibility for enforcing the UCCC lies with various State and Territory Fair Trading Authorities or Consumer Affair Bodies. The focus of the UCCC is on pre-contractual disclosure requirements aimed at informing the consumer of the full costs of credit. It also prohibits 'unjust' terms in credit contracts, requires the provision of 'comparison rates' in certain credit advertising, and covers such matters as default procedures and provision for hardship applications.

There are also various ancillary State and Territory credit regulations outside the UCCC, which have developed over time to address perceived gaps in consumer protections. For example, four States have introduced interest rates caps, and Western Australia (WA) has a licensing regime for credit providers and intermediaries (or finance brokers) who advise consumer borrowers on the merits of competing credit products.

However the prolonged delays in implementing necessary reforms flowing from the cumbersome nature of the inter-jurisdictional processes remains a key limitation of the current regulatory system. This lack of policy responsiveness will be addressed through a uniform and nationally consistent consumer credit framework. When effectively implemented, it is expected to significantly improve the effectiveness of protection for consumers and potentially provide cost savings to industry and consumers.

Objectives of regulatory reform

Financial services and credit products are increasingly being provided in a national market. In common with financial products and services, credit products and services have become highly sophisticated and innovative, and providers in most cases operate across State boundaries and are nationally or internationally organised. An effective credit regulatory framework must:

- be robust and coherent;
- be sufficiently comprehensive in coverage to afford appropriate consumer protection across all relevant products and services;
- prevent significant gaps from being exploited by unscrupulous credit providers and credit service providers; and

- ensure enforcement is consistent, efficient and responsive to the changing circumstances of a dynamic national market.

Options for regulatory reform

Recognising that credit markets are national and potentially global in nature, the Productivity Commission in its report on the *Review of Australia's Consumer Policy Framework* released on 8 May 2008 recommended that the current consumer credit regulatory framework should be reformed by way of a national regulatory framework with expanded powers for ASIC as the national regulator. It also acknowledged the wide-spread view that credit-related consumer protection requirements has not kept pace with market developments, or are otherwise deficient.

A 2007 inquiry into home lending practices and procedures by the House of Representatives Standing Committee on Economics, Finance and Public Administration also recommended that the Commonwealth take over the regulation of credit, recognising the importance of consistently regulating non-bank lenders and the mortgage broker sector.

The Ministerial Council of Consumer Affairs, which has current oversight of consumer credit has progressed a number of consumer credit projects, particularly in relation to:

- fringe lending, including recommending particular regulations to target the practices of pay day lenders and other fringe lenders;[1]
- credit cards, including canvassing responsible lending obligations, such as a capacity to repay test;[2] and
- licensing mortgage brokers and regulating mortgage broking conduct.

In March 2007 MCCA, under the auspices of the New South Wales Office of Fair Trading, released the *Exposure Draft Finance Broking Bill 2007* (Finance Brokers Bill) for public comment. The Finance Brokers Bill outlined a scheme for the national regulation of finance and mortgage brokers that would impose entry requirements, mandatory external dispute resolution scheme membership and enhanced consumer protection provisions.

The Finance Brokers Bill was intended to address inappropriate and unscrupulous lending practices in the mortgage broking industry documented in the research paper by the Consumer Credit Legal Centre for ASIC in 2003. The report recommended a national licensing regime and conduct standards for the mortgage broking industry. The Bill was developed by a working group chaired by New South Wales and was initially informed by a round table conference of regulators, industry and consumer

---

[1] MCCA took submissions on its 2003 *Discussion Paper, Fringe Credit Providers*. Thirty-eight responses were received. Following consideration of submissions, the proposals were substantially reworked and included in a *Decision-Making Regulatory Impact and Financial Public Benefit Test* dated March 2006.

[2] In October 2008, the MCCA released a consultation *Regulatory Impact Statement on Responsible Lending Practices in Relation to Consumer Credit Cards*. The Paper canvassed options to assist consumer choice of card products and protect consumers from lending practices which provide continuing credit at levels which cannot be repaid without substantial hardship.

representatives from July 2003. The development of these proposals was informed by extensive stakeholder consultation on the reforms.

Financial Services and Credit Regulation Green Paper

Against this background, the Government's proposals for reforming the regulation of consumer credit and advice were canvassed in the *Financial Services and Credit Reform Green Paper Improving, Simplifying and Standardising Financial Services and Credit Regulation* (the Green Paper) released in June 2008. Submissions received in response to the Green Paper signalled overwhelming support from industry and consumer interest groups for the Commonwealth to assume regulatory responsibility for all consumer credit and for ASIC to be the national regulator.

In developing the new regulatory framework, a key consideration was the transfer of regulatory responsibility for consumer credit to the Commonwealth with minimal disruption to business and consumer protection. One approach canvassed in the Green Paper was to extend Chapter 7 of the *Corporations Act 2001* (Corporations Act) to cover the regulation of consumer credit.

The preferred alternative was to transfer the existing State and Territory regulatory regimes into the Commonwealth jurisdiction to the extent possible.

Drawing firstly on over 150 submissions to the Government's Green Paper; and secondly on the Productivity Commission's recommendations and input from inquiry participants, there was overwhelming support for a national consumer credit framework to include the following overarching characteristics:

- Coverage of all consumer credit products and all intermediaries providing credit related services, not just those advising on mortgage products. There is currently virtually no regulation of credit services, other than WA. Any attempt to limit the coverage of the new regime to certain credit products and services would inevitably give rise to 'boundary line' problems. The scope of the regime should encompass all aspects of consumer credit to ensure that the provision of advice and broking services is comprehensively regulated. There was unanimous support across the sector (from Authorised Deposit-taking Institutions (ADIs) and other lenders, brokers and consumer advocacy groups) for such a proposal.

- Retention of the UCCC concepts as a primary set of regulatory requirements within the consumer credit regulatory regime. This would incorporate, where appropriate, changes to the UCCC that have been agreed to by the MCCA at the time the UCCC became Commonwealth law. State government proposals to improve the UCCC include changes to better address fringe lending issues and vendor financing as well as reforming mandatory comparison rate requirements.

- A national regulatory framework should also include enhancements to address gaps in the areas of conduct obligations and disclosure requirements:

  - General conduct provisions should apply across the industry to cover all credit providers and credit-related service providers. These conduct requirements should ensure that there is a national standard for the provision of credit and credit services, with specific conduct

provisions to be introduced where relevant, in areas that merit more robust or specific consumer protection, for example in relation to credit cards or payday lending.

- The disclosure regime under the UCCC should be strengthened to raise consumer awareness of specific credit product risks (such as reverse mortgages or payday lending). In addition to current disclosure requirements, product and advice related disclosure should also apply. Improvements to ensure that disclosure documents provided to consumers are short, simple and easy to understand are also desirable.

- Regulatory enforcement should be expanded to allow the national regulator to intervene quickly through the use of administrative action such as banning or suspension of licences. Criminal and civil penalties would form part of the enforcement regime where appropriate.

- A national licensing system for credit providers and finance brokers, administered and enforced, by ASIC which would give consumers guaranteed access to an approved external dispute resolution (EDR) Schemes. Access to an effective dispute resolution mechanism, which currently only exists in a limited number of State and Territory ancillary regimes, should form an integral part of consumer protection arrangements in the credit arena.

Council of Australian Government (COAG) Reform Agenda

Two stage reform process

On 2 October 2008, COAG endorsed a two phased approach, beginning with the transfer of existing key credit regulation, the UCCC under Phase One.

This followed from its earlier decision in March and July 2008 that the Government would assume responsibility for the regulation of mortgages, mortgage broking, margin lending and all remaining areas of consumer credit, such as pay-day lending.

Under Phase One, the Australian Government agreed to:

- enact the existing State legislation, the UCCC, into Commonwealth legislation;
- establish a national licensing regime to require providers of consumer credit and credit-related services to obtain a licence from ASIC;
- extend the powers of ASIC to be the sole regulator of the new national credit framework with enhanced enforcement powers;
- require licensees to observe a number of general conduct requirements, including responsible lending practices;
- require mandatory membership of an external dispute resolution (EDR) body by all providers of consumer credit and credit-related services;
- extend the scope of credit products covered by the UCCC to regulate the provision of consumer credit over residential investment properties; and

- regulate margin lending (See Treasury submission to the *Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009*).

While the reform timetable was set by COAG, a decision was taken for the reform to proceed by stages and to focus efforts in the initial stage to address the systemic and regulatory gaps which States have long sought to address – that is licensing and broker legislation. Phase One therefore sought to construct a robust national regulatory platform around an enhanced UCCC with an expanded scope, and augment this through a licensing regime administered by a single regulator. At the same time, it sought to bolster consumer protection through introducing industry-wide responsible lending standards.

This would provide the basis in Phase Two to build on the next stage of the Government's reform agenda – this would encompass consideration of regulation of small business and investment lending, and areas identified as potentially requiring specific regulation, such as reverse mortgages, payday lending and consideration of remaining MCCA projects.

(i) Seamless National Credit Market

The consumer credit reforms seek to achieve consistency, certainty and a level playing field across industry through replacing eight sets of State and Territory regulations by a single, uniform and nationally consistent regime that applies equally to all credit consumers, credit providers and credit service providers.

Industry wide regulation safeguards against unregulated participants having an unfair advantage;[3] and minimises the risk of regulatory arbitrage, with providers shopping for the regulatory or industry code that best suits their market strategy.

The Productivity Commission in considering the national regulation for credit providers highlighted the potential risk of 'regulatory arbitrage' if the licensing requirements were significantly different between credit providers and brokers, and financial product providers and credit-related service providers.

Consistent with COAG's agenda for a seamless economy, uniform national regulation will deliver in the longer term efficiencies for business through reduced duplication and compliance burdens. In particular, it will replace multiple state laws and remove the need for cross-jurisdictional businesses to deal with different State and Territory regulatory bodies on the same issue.

(ii) Lifting Industry Standards and Targeting Predatory Lending

The national regime also seeks to put in place a robust regulatory framework as a first step to improve industry standards and address poor lending practices including predatory lending.

Over the past ten years, there has been a concern about poor credit practices in both the lending and credit-broking markets. For example, in 2003, the Consumer Credit Legal Centre undertook *A Report to ASIC on the Finance and Mortgage Broker Industry*.[4] It found that there were significant issues in the

---

[3] For example, brokers who subscribe to industry standards of behaviour, such as codes of conduct, compete against those who have lower costs because they do not comply.

[4] http://www.cclcnsw.org.au/images/documents/finance_mortgagebrokers_report.pdf

general practices of the broker industry and recommended that there be a nationally consistent licensing regime for brokers to promote professional standards and encourage responsible lending conduct. These systemic issues included:

- the minimal or no entry requirements for participants in the industry, resulting in some consumers receiving poor information about the nature and rights of the services, and the consequent obligations on providers;
- the commission structure of remuneration for mortgage brokers, through commission payments which gave rise to conflicts of interested that were not being disclosed to the customer;
- the customer's potential reliance on a broker recommendation, where the broker did not have a reasonable basis for that recommendation, due to the failure of the broker to properly consider the consumer's individual needs, objectives and financial circumstances; and
- a lack of accountability of brokers for poor advice due to the inability of consumers to access alternative dispute resolution (ADR) forums.

The report also noted that there were also a number of fringe players in the broker industry who systematically adopted unfair practices and pursued their own financial interests over those of their clients.

In relation to lenders, concerns have centred on the practice of predatory lending. In 2008 ASIC analysed the practice of 'equity stripping', where fringe brokers and lenders refinanced vulnerable borrowers in financial stress into loans they cannot afford, in order to earn substantial fees or to obtain the home.[5] It found that there were demonstrated problems in consumer decision making in response to financial stress, which was exacerbated by poor or self-interested conduct by brokers and lenders. MCCA has also investigated poor credit practices in the 'fringe lending' market (those who do not operate in the mainstream credit market).

To improve industry standards and address undesirable lending practices, the proposed national regulatory regime offers a comprehensive regulatory framework to achieve the policy objectives – through imposing responsible lending and conduct practices, more robust arrangements to deal with borrower hardship through EDR membership requirements and importantly a licensing regime that will be enforced by ASIC.

The national credit regime combined with the unfair contract terms provisions currently being developed as part of the COAG reform on Australian consumer law provides, for the first time, the effective tools to enable many of the harms that have been prevalent in the fringe lending sector to be effectively tackled. Where residual fringe lending issues remain, consideration will be given to consider additional regulatory tools in Phase Two to target these concerns, where there are net benefits.

[5] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_119_Protecting_wealth_in_family_home.pdf/$file/REP_119_Protecting_wealth_in_family_home.pdf.

Consultation Process

The Credit Package was developed after an extensive public consultation process which commenced with the public submissions to the Green Paper released in May 2008. The consultation that followed reflects long standing consideration of credit issues by the states and territories.

Public information sessions on the proposed consumer credit reforms were held in Melbourne, Sydney, Brisbane, Perth, Hobart, Adelaide and Canberra in late 2008.

Following the COAG decision, two key consultation bodies were set up to progress the COAG consumer credit reform agenda.

- The Financial Services and Credit Reform Implementation Taskforce (FSCRIT) comprising officials from the Commonwealth Treasury, ASIC and the States and Territories.
- An Industry and Consumer Consultative Group, comprising representatives from the key peak industry associations across the finance industry, consumer advocates, dispute resolution and legal fields.

On 27 April 2009 Senator the Hon Nick Sherry, the former Minister for Superannuation and Corporate Law, released for public exposure the draft National Consumer Credit Protection Reform legislation and associated commentary. This was subject to public consultation until 23 May 2009. Treasury received over 90 submissions to the reforms, including from industry, consumer groups and individuals. In response to the submissions, the Australian Government made a number of changes to the proposed law to reflect key issues in the law. These included changes to address regulatory burden and to improve consumer access to remedies.

Legal Framework to support the credit reform

Referral of Power

The State governments are key stakeholders in the COAG credit reform agenda, which is underlined by a co-operative effort between the states and territories and the Australian Government. The Government's legislative powers in the absence of a referral of powers from the States are not sufficient to enact a comprehensive regulatory framework for consumer credit to operate nationally. As such, a specific referral of powers from the States for consumer credit is required.[6]

In view of the absence of sufficient legislative power to regulate the provision of credit, the only source of legislative power is to have the States refer such power to the Commonwealth. This will be supported by agreement on the arrangements involved in 'switching-off' state responsibilities for credit regulation and 'switching-on' national credit laws with the commencement of the national credit regime.

[6] Paragraph 51(xxxvii) of the Constitution gives the Commonwealth Parliament power to make laws with respect to: matters referred to the Parliament of the Commonwealth by the Parliament or Parliaments of any State or States, but so that the law shall extend only to States by whose Parliaments the matter is referred, or which afterwards adopt the law.

States and Territories have indicated commitment to the COAG credit reform agenda and to focus their policy efforts to supporting the reform's agenda. To that end, they have agreed to refrain from legislating in the area of consumer credit after the transfer of state powers to the Government.

Background

Legislation of the States referring legislative power to the Commonwealth follows a relatively standard pattern that has been settled over the years. The legislation can either confer general authority to legislate with respect to a general matter described in the referral legislation (subject matter referral) or confer specific authority to legislate in the terms set out in the referral legislation (text-based referral).

Since the 1980's there have been numerous referrals, both text-based and subject-matter, which have led to the successful enactment of Commonwealth laws. There is a clear policy trend adopted by States in the last decade to move away from subject matter referrals in favour of text-based referrals.

The Commonwealth and State governments have agreed to pursue a text-based referral which involves a referral of the powers as enacted in the substantive law; that is, it requires jurisdictions to first agree and settle the text of the draft bills which comprise the national credit reform package before enactment of the States' reference legislation.

Reference Legislation

The proposed Referral Bill, which is currently being negotiated between the Commonwealth and the States, contains the following features:

- provision for the referral to be terminated by (or to terminate on a specified day unless extended by) an instrument issued by the Governor of the State (or by subsequent State legislation); and
- limits on how that legislation may be amended by the Commonwealth in the future; and the intergovernmental agreement sets out consultation requirements in relation to any amendments.

Displacement Provisions

This relationship between the Commonwealth and the States and Territories is usually outlined in a model set of provisions, which is contained in the substantive Act, called the "inconsistency" or "displacement" provisions. The leading model is the Corporations Act, enacted following the referral of State constitutional power in respect of the incorporation and regulation of corporations. This model has been refined in minor respects in subsequent referral in other areas.

A brief summary of the displacement provisions (sections 23 to 26) in the Credit Bill is as follows:

- A provision provides that Commonwealth credit legislation is not intended to exclude or limit the concurrent operation of any law of a State or Territory.[7] The concurrent operation provision provides that in all circumstances where a Commonwealth law and a State law can operate concurrently, they are intended to do so.

---

[7] This provision is in terms similar to those of several other Commonwealth legislative provisions, including section 75 of the *Trade Practices Act 1974*, section 250B of the *Water Act 2007* and section 5E of the Corporations Act.

- A provision of a State or Territory law may declare a matter to be an excluded matter, in relation to either the whole of the Commonwealth credit legislation or a specified provision of the legislation. As a result, the Commonwealth credit legislation (or the provision specified) will not apply in that State or Territory in relation to the declared matter. A Commonwealth regulation may provide that the provision does not apply to the declaration. The effect of this regulation is that the Commonwealth has paramountcy in determining whether a State or Territory provision limits or qualifies the operation of the Credit Bill.
- A provision provides that regulations can be made modifying the operation of the Credit Bill so that it does not apply to a matter dealt with by a State or Territory law, or is not inconsistent with the operation of a State or Territory law specified in the regulations.

Intergovernmental Agreement

Supporting the enactment of the Credit Package is an intergovernmental agreement (IGA). This IGA provides a political compact amongst the Commonwealth, State and Territory governments dealing with various arrangements underpinning the operation of the Credit Package.

The IGA will contain safeguards and consultative arrangements to be followed by signatories including:

- mandatory consultation mechanism about any legislative changes to the scheme; and
- resolution procedures in relation to potential inconsistency between relevant State and Commonwealth laws.

Application of the new framework to existing contracts

Certain provisions in the Credit Bill and National Credit Code (Code) may not apply to existing credit contracts. The Commonwealth's ability to apply certain provisions, such as increased thresholds for hardship variations and stays of enforcement (subsections 72(5) and 94(4) of the Code) to existing credit contracts is restricted due to the acquisition of property issue under the impact of section 51(xxxi) of the Constitution.

Section 51(xxxi) of the Constitution provides that the Commonwealth may make laws with respect to acquisition of property on just terms from any State or person for any purpose in respect of which the Commonwealth has the power to make laws.

There is a significant risk that the application of new requirements to existing contracts, could infringe section 51(xxxi) of the Constitution.

For example, in relation to hardship variations, the risk of acquisition of property rights is avoided if the proposed increase of the monetary limit (to $500,000) only applies to contracts made after commencement of the Code. Otherwise a court could make hardship orders under section 72(5) of the Code that would limit a credit provider's rights under a contract, where that contract would not have been open to such orders under the UCCC.

PART B: KEY ELEMENTS OF THE COAG CREDIT REFORM PACKAGE

The introduction of the Credit reform package delivers on the first phase in a two-phase reform action plan to transfer credit regulation to the Australian Government. Against the key themes that have emerged from public submissions to the Senate Committee on the credit reform package, the following information on the core elements of the COAG credit package is provided to assist the Committee.

A. Comprehensive Licensing Regime

The Credit Bill provides for a stand-alone national licensing scheme for consumer credit that is to be distinguished from the regulation of financial services under the Corporations Act. This is because credit involves consumers receiving money that they must repay, rather than the purchase of a financial product, that generally includes the expectation of a benefit or return from the payment in the future. Different risks therefore arise for both consumers and industry players.

Whether or not credit should simply be included as a financial product within the Corporations Act, and the existing system for holders of an Australian financial services licence (AFSL) was considered. It was acknowledged that having credit come under the AFSL would mean that existing legal concepts and standards of conduct would apply. However, the different characteristics of credit products would mean that there would be a consequent need to modify elements of the Corporations Act, diluting this effect and potentially increasing confusion for industry and consumers, where products under the same licence were treated differently.

Therefore, a decision was made that it would be preferable to regulate credit through a separate licence that:

- applied some regulatory mechanisms and existing legal concepts from the Corporations Act, where appropriate;
- but otherwise took a different approach to the Corporations Act to reflect the differences between credit and financial products (for example, the requirements in relation to financial records in Part 2-5 of the Credit Bill are much less onerous, reflecting the fact that in credit transactions the consumer receives money from the licence holder, rather than paying an amount).

Scope of the Definition of 'Engaging in Credit Activities'

Broad definitions were adopted in creating the definition of 'engaging in credit activities' so as to both limit the opportunities for regulatory avoidance, and to ensure that the legal framework is sufficiently flexible to meet dynamic market conditions.

Division 3 of Chapter 1 of the Credit Bill contemplates two broad categories of persons encompassed within the definitions of persons who are engaged in a credit activity:

- The first category primarily covers lenders and providers of consumer leases, but also encompasses activities in relation to mortgages and guarantees where they are taken to secure or guarantee obligations under a credit contract or lease.

- The second category is defined as persons who provide credit services, and primarily covers finance brokers and other intermediaries where they have a role in relation to securing credit for a consumer.

Persons who act as legal assignees are also specifically defined as persons engaging in credit activities. The definition only applies to legal assignees not equitable assignees, in order to exclude the application of the Credit Bill to securitisers.

The decision to use broad definitions was influences by the history of credit regulation in Australia, which is marked by a significant avoidance industry that seeks to use legal structures to fall outside the scope of any regulatory regime. Stakeholder consultations confirmed that this is still perceived to be a current issue. It was for this reason that:

- The definitions in items 1, 3, 4 and 5 in the table in Section 6 of the Credit Bill extend to persons who perform obligations or exercise rights in relation to a credit contract or lease, or a proposed credit contract or lease.

- The definition of ***credit assistance*** in Section 8 of the Credit Bill covers persons who either 'suggest' or 'assist' in relation to particular contracts, rather than restricting it to persons who 'recommend' particular contracts. It is considered that the scope of this definition is appropriately limited and certain, in that it only applies to persons who suggest or assist in relation to a particular contract. To put this another way, persons can readily determine whether or not they are regulated because the obligations only apply where they act in relation to a particular or identified credit contract and not more generally. The definition applies if a person either 'suggests' or 'assists' in relation to the contract, minimising the risk of avoidance on the basis of subtle distinctions between suggesting and assisting (if only 'suggesting' was a regulated activity).

- The definition of ***acts as an intermediary*** in Section 9 of the Credit Bill applies to any person who acts as an intermediary between a credit provider and a consumer, whether directly or indirectly.

It is acknowledged this approach has resulted in the activity covering some activities (primarily incidental or administrative in character) where licensing requirements are not appropriate. This has been addressed through appropriate exemptions in the draft regulations to the Credit laws (released for public exposure on 14 August 2009). The inclusion of broad regulation making powers in the Credit laws ensures that there is capacity to address future needs relatively quickly. This has the advantage of providing greater policy responsiveness to changing market circumstances than a narrower and more prescriptive definition (of when a person engaged in credit activities), with its associate limitations and avoidance risks. It is noted that there has been a regular need to provide exemptions for industry in analogous circumstances in relation to exemptions from the Australian financial services licence regime established by the Corporations Act.

To ensure that there is appropriate consideration of the regulatory framework to apply to Point-of-Sale (POS) retailers, for example car dealerships or retail outlets, POS retailers will be exempt in the interim period while the regulatory oversight for their engagement in credit activities is considered more closely.

Licensing Obligations

The primary obligations on licensees in subsection 47(1) of the Credit Bill are similar to those that apply for holders of an AFSL in Section 912A of the Corporations Act. However, there are two important differences.

Firstly, a new provision has been introduced in subsection 47(2) which allows that the level of compliance on certain key obligations such as training, competency and systems compliance – can vary according to the nature, scale and complexity of the credit activities engaged in by the licensee. This provision was introduced in response to stakeholder concerns, to make it clear that smaller enterprises with simple operations could comply with the law by adopting a very basic approach. For example, if a lender only offered a limited range of products then the requirements in relation to training representatives, or ensuring they are competent in respect of those products, will be more straightforward.

Secondly, the requirement in relation to conflicts of interest in paragraph 47(1)(b) is expressed differently and requires licensees to ensure their clients are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or by its representatives. This obligation only applies to conflicts of interest that arise by operation of law, and it is therefore expected that its predominant application will be to brokers and intermediaries rather than credit providers or lessors. Concerns that it would require lenders, for example, to resolve conflicts of interest between clients and shareholders in favour of their customers are unfounded; this is made explicit in the Explanatory Memorandum to the Credit Bill at paragraph 2.115.

The main context in which this obligation will apply is in respect of the finance broker-consumer relationship. It was noted that finance brokers in Western Australia were under similar obligations pursuant to Regulation 4 of the *Finance Brokers Control (Code of Conduct) Regulations 2007*, including to *"not take improper advantage of the trust of any party in order to obtain a benefit for the finance broker or a third party"*. It was therefore considered appropriate to introduce a requirement on licensees that made explicit the desired outcome resulting from the management of conflicts of interest.

Thirdly, licensees are subject to new requirements, to have adequate arrangements and systems to ensure compliance with its obligations under this section, and a written plan which documents those arrangements and systems. This obligation makes explicit that it is not a question of the licensee intending to comply, but that this must be supported operationally, through appropriate commitment of resources and implementation of policies. The requirement to have a written plan will assist licensees to clarify the scope of their obligations, and to ensure they are complying with the other general conduct obligations.

B. Responsible Lending

The responsible lending obligations seek to introduce industry-wide lending standards across all credit products and services. The responsible lending obligations are designed to reduce undesirable lending practices without introducing distortions to the credit market, by setting standards of conduct for licensees when entering into a credit contract with consumers.

The main factor in developing responsible lending conduct requirements have been to:

- establish consistent lending and conduct requirements to create a level playing field across industry and to promote 'good' quality or sustainable credit in the market; and
- to address unfavourable credit practices, such as predatory lending, and other types of poor credit practices that are detrimental to consumers.

The responsible lending obligations also reflect current industry practices as set by industry Codes of Conduct, such as the Banking Code of Practice, and industry organisations. The obligations establish requirements to ensure that:

- consumers do not obtain loans that are *unsuitable* for them, that is a consumer cannot be entered into or offered a loan that does not meet their requirements or that they do not have the capacity to repay. The *unsuitability* test strikes a balance between ensuring sufficient consumer protection and promoting the flow of sustainable credit in the market. The law generally applies consistently across the market to avoid creating incentives or opportunities for regulatory arbitrage, but is scalable according to the type of product or service; and

- consumers understand the product that they are seeking to purchase and to disclose any potential conflicts of interest (disclosure requirements). Information transparency or disclosure is central to promoting a more efficient marketplace. Disclosure requirements offer important consumer protection and increase consumer confidence in the fairness and integrity of the market.

The responsible lending obligations essentially define roles and levels of accountability, which creates a level playing field for all lenders and intermediaries in the consumer credit market. Further, this will build consumer trust in lenders regardless of whether they are prudentially regulated or not, thus improving the competitive position of non-ADI lenders. Greater competition in the consumer credit market will enhance outcomes for all consumers.

The obligations will contribute to a robust financial system by ensuring that there is suitable information and clarity over the allocation of credit contracts in the consumer credit markets. This will allow for the promotion of sustainable credit and the reduction of risk on outstanding credit. Moreover, introducing a nationally consistent set of conduct obligations will reduce the potential of irresponsible lending, which could undermine the overall stability of the financial system. It is noted that there are already strong disincentives to lend irresponsibly for lenders subject to prudential regulation.

The responsible lending obligations also require industry participants – brokers, lenders, aggregators and mortgage managers to provide certain information about their products and services. This disclosure is intended to enable consumers to assess and compare the quality of the service or product being offered, thereby improving transparency and leading to better outcomes for consumers.

International Developments

The application of responsible lending requirements in Australia credit lending has tracked international trends.

Prompted by the fall-out from the global financial crisis and sub-prime mortgages, other countries have also moved to develop responsible lending conduct obligations. The approach to the design of these conduct obligations have varied and been shaped by country specific circumstances.

The United Kingdom has released a July 2009 White Paper on consumer affairs, *A Better Deal for Consumers: Delivering Real Help Now and Change for the Future.* The White Paper deals with consumer credit reform in the context of financial and consumer markets. Consumer credit reform proposals include a review of credit cards, new obligations for lenders and review of high cost credit markets.

To protect consumers, the United States (US) introduced the *Credit Card Accountability, Responsibility, and Disclosure (CARD) Act of 2009*, in May 2009. This Act aims to ensure that consumers will have reliable protections and will reduce the practice of hidden fees and unfair interest rate hikes in the credit card industry. Additionally, the US Government is considering establishing a regulatory body – the 'Consumer Financial Protection Agency' – similar to that of the role played by ASIC.

The European Union (EU) has focused on similar responsible lending issues but faces additional task of harmonising responsible lending practices across Europe. The most recent consultation, the *Public Consultation on Responsible Lending and Borrowing in the EU* June 2009, discusses other areas identified as requiring further regulations, such as introduction of the more prescriptive 'suitability' test for responsible lending conduct.

Collectively these examples demonstrate that countries are focusing on responsible lending issues that have already been considered in the scope of Australia's credit reforms and as such, Australia's responsible lending obligations are consistent with policy developments overseas. In contrast to international developments, Australia's responsible lending obligations are not overly prescriptive and seek to provide a balanced policy approach in ensuring appropriate protections are achieved. There has been a conscious effort not to introduced policies that would restrict the provision of credit (such as the additional age restrictions in the United States) or distort the market.

Policy development

The reform approach had to balance the need to uniformly regulate consumer credit efficiently and to support consumers' needs, against realistic regulatory compliance standards for industry. Additionally, policy development had to be considered in the context of a wide range of credit products on the market, such as small loans and use of credit facilities (such as credit cards and pay day loans).

Advice Regime

In balancing regulatory costs with consumer protection, an 'advice model' as exists for financial services under the Corporations Act, through the Financial Services Reform (FSR) was not considered appropriate in the credit context.

There were concerns that if the 'advice' regime were applied to the consumer credit market, it would not allow licensees to provide scalable and straightforward advice to consumers due to its more rigid distinctions between 'general' and 'personal' advice. In practice, entering a credit contract can involve multiple stages of assistance at different times. An advice regime would not have provided for this level of flexibility in a credit context and would have imposed a level of unnecessary compliance for industry, without any net benefits to consumers.

The Unsuitability Test

The responsible lending obligations ensure that licensees make an assessment to ensure that any credit contract is not *unsuitable* for the consumer's requirements. This ensures that licensees do not provide or suggest unsuitable credit to a consumer which targets the social and economic cost of a consumer being provided a loan they cannot afford without undue hardship, or did not suit their requirements.

Determining unsuitability is distinct from requiring licensees to determine whether a product is suitable or 'appropriate' for a consumer (similar to the advice model in FSR). This was considered unnecessary in a credit context as it was recognised that lenders already have an incentive to ensure that the product they provide can be repaid. Implementing a responsible lending regime based on suitability would have been overly prescriptive for industry and consumers.

Importantly, the unsuitability test is supported by the requirement that the licensee must assess whether the consumer has the capacity to repay the financial obligations.

For Australian home owners who are refinancing in the face of financial difficulty, the law now also includes a presumption that the refinancing will be unsuitable for the consumer if the consumer would have to sell their primary residence to meet the financial obligations of the new finance arrangements.

In the event that a consumer's existing credit contract is unsuitable, credit assistants will now be obliged to inform consumers of their ability to seek respite from their credit provider. Taken as a whole, the responsible lending obligations ensure a robust information framework in applied place when assessing credit.

The obligations also enhance the protection for consumers by reducing the possibility of poor lending practices and providing transparent dispute resolution systems for consumers.

C. Enforcement and Sanctions

As part of the implementation of a national consumer credit regulation framework, it was agreed that ASIC should have enhanced enforcement powers for credit matters.[8] These enhanced powers have been partly achieved by extending the range of penalties and sanctions available to ASIC, which will build in greater flexibility in ASIC's ability to respond to contraventions.

---

[8] http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf

Tiered enforcement framework

The overall enforcement structure includes a tiered approach to sanctions in the Credit Bill, which reflect considerations of the *Review of Sanctions in Corporate Law* (Treasury, 2007), the *Commonwealth Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers* (Attorney-General's Department, 2007) and the *Review of Australia's Consumer Policy Framework* (Productivity Commission, 2008). It also seeks to maintain consistency with the Corporations Act and other Commonwealth consumer protection law, where there are offences in respect of similar conduct.

The tiered approach to the sanctions regime includes:

- criminal offences, including strict liability offences;
- civil penalties;
- infringement notices; and
- administrative sanctions to be exercised by ASIC as the consumer credit regulator, including banning orders against individuals, and the power to cancel or suspend an Australian credit licence (ACL).

The Productivity Commission has noted that in the context of broader consumer law regulation, a layered approach to enforcement creates a "more efficient, cost-effective deterrence and redress through regulatory action better tailored to the nature of particular breaches"[9].

It is recognised that most credit providers and credit service providers are ordinarily inclined to comply with the law. However, the tiered approach gives ASIC flexibility to target the penalty to the nature and type of contravention. It recognises that when regulating a broad range of credit providers and credit services under principled based legislation, different types of sanctions may be appropriate.

For example, an infringement notice may not be a significant deterrent for a large financial institution, but it is likely to be an effective deterrent for a small broker. Alternatively, it recognises that imprisonment may not be appropriate for an administrative oversight, but would be useful against a person involved in a contravention where a business has deliberately not complied with the law (for example, predatory lending practices and equity stripping).

There is general concern raised by industry that this tiered approach will increase compliance costs – in particular, the concern is that the risk of breaching the law will create a conservative lending culture, reducing credit in the market.

As a general rule, enforcement and sanctions powers do not create any additional obligations on business or create compliance costs unless a breach of the law has occurred or is suspected. Civil penalties and other penalties for breaking the law do not increase compliance costs for business; businesses are expected to comply with the law and a business that complies with the law will not face possible penalties.

The enforcement powers are aimed at preventing consumer detriment by deterring breaches of the consumer credit law and ensuring that appropriate and proportionate action can be taken by ASIC if a

---

[9] *Review of Australian Consumer Policy Framework*, Productivity Commission 2008, p 61.

contravention occurs. These powers will allow consumers to be confident that ASIC is fully equipped to deal with breaches of the consumer credit law.

Criminal sanctions

Criminal sanctions will apply to breaches of the Credit Bill where:

- the objectives of the offence suggest that such an outcome would be warranted; or
- where the offence is analogous to similar provisions in the Corporations Act, to ensure consistency of application of 'like' offences, preventing inconsistency in regulation.

Where the credit licensing regime is similar to the existing financial services licensing regime in the Corporations Act, creating offences in respect of the same type of conduct, the offences and penalties in the Credit Bill have generally been made consistent with those in the Corporations Act.

Most of the criminal offences are analogous to or the same as existing licensing and other requirements in the Corporations Act. To that extent, any discrepancies in criminal sanctions and offences between the two would create regulatory inconsistency and is undesirable.

Some breaches that are procedural in nature (record-keeping, lodgement of documents or disclosing information) have criminal sanctions, including indictable offences, attached. This is necessary because:

- criminal sanctions play an important role in deterring inappropriate corporate behaviour and ensuring that ASIC can prevent or minimise losses to investors, consumers and the Government;
- a failure of a licensee to comply with provisions, such as maintaining records, audit, and lodgement of documents can seriously jeopardise ASIC's ability to investigate questionable behaviour and mitigate any losses or potential losses; and
- the disclosure of information in documents to consumers is a significant policy component of financial services regulation to address the particular economic 'harm' of information asymmetry in the market.

Generally the activities that attract the strongest criminal sanctions are those that address what is considered to be the most serious 'moral' culpability in relation to the credit contract; acting unlicensed and entering, or suggesting or assisting a person to enter, an 'unsuitable' credit contract.

In particular, concern was raised about the criminal penalty attached to the offences of entering or suggesting a consumer enter into an unsuitable loan (the responsible lending conduct test). These offence provisions seek to deter the most serious 'moral', economic and social harm in relation to consumer credit, that is putting someone into or suggesting someone enter into an unsuitable credit contract.

The penalty levels were set to operate as a strong and effective deterrent against its commission, which is comparable in principle and effect to the criminal penalty to the Corporations Act offence for not providing suitable advice for financial products (5 year jail term and 200 penalty units). This advice regime has been successfully operating in the financial services sphere for a number of years. However, unlike other financial products, the economic risk attached to providing credit predominantly rests, not with the consumer, but on the lender. The lender does not have the same incentive to place someone into an unsuitable loan where the funds at risk are their own. Nevertheless, a jail term is considered

important for most egregious breaches of the responsible lending obligations in order to target unscrupulous credit lending practices, such as predatory lending and equity stripping.

As such, the criminal penalty for unsuitability was reduced to a maximum 2 year jail term and 100 penalty units.

Civil penalties

The Credit Package provide for civil penalty sanctions to apply where the misconduct affects or potentially affects the integrity of the credit market; and where there may be an absence of malicious or reckless intention. Civil sanctions have a lower burden of proof than criminal sanctions and are an alternative source of imposing legal obligations and deterring conduct. Their availability contributes to a more cost-effective, timely and proportionate enforcement approach.

It is also recognised that civil penalties play a useful role for regulating corporate wrongdoing as the amount of the penalty is a disincentive for corporate misbehaviour.

The maximum civil penalty for all relevant offences is 2,000 penalty units. This equates to $1,100,000 for corporations and $220,000 for individuals. This is consistent with the reforms to the Australian Consumer Law in the *Trade Practices Act 1974* as recommended by the Productivity Commission.[10]

Infringement notices

The use of infringement notices under general consumer law is supported by the Productivity Commission as a cost-effective way of dealing with minor breaches of the law. The issuing of infringement notices is at the discretion of ASIC.

The legislation and regulations allow for infringement notices to be issued to persons alleged to have committed certain strict liability or civil offences. This allows ASIC to deal with suspected minor offenders without the need to summons a person to appear in court.

Consumer remedies

Consumers will also have a range of remedies available to them where they experience loss or damage from the misconduct of a credit provider or credit service provider.

Consumers will also have remedies available to them even where the credit provider or credit service provider is acting unlicensed. The consumer can, among other things, prevent an unlicensed provider from obtaining profit or gain from them for their credit activity.

Consumer remedies are an important element of the enforcement regime as it enables consumers to take direct action against a provider who breaches the law and causes them loss or damage. These actions can provide sufficient deterrent against breaches of the law. Private actions are considered an important way of influencing and curbing market behaviour.

---

[10] *Review of Australian Consumer Policy Framework*, Productivity Commission 2008, p 45.

Consumer remedies also enable consumers to obtain redress from unlawful behaviour or misconduct, such as predatory lending or equity stripping, and the opportunity to receive just and equitable outcomes, particularly where they have experienced loss and damage from the unlawful conduct.

Class Actions

The ability of ASIC to obtain a civil declaration (section 166) operates as a de-facto class order arrangement. ASIC may, for example, obtain a declaration that specified conduct constitutes a breach of the legislation, and individual consumers can then rely on this court order to then apply for compensation according to their individual circumstances and the amount of their loss (which may vary). This is important where the persons who may be affected by a breach is not readily ascertainable, or too wide for ASIC to determine. ASIC may also take an action on behalf of a consumer following their written approval.

ASIC Powers

Chapter 6 of the Credit Bill replicates a number of provisions from the ASIC Act to prevent any constitutional uncertainty in relying on two separate referrals to establish a law (i.e. by amending the ASIC Act to include credit matters). This is because the ASIC Act already relies on a referral of powers through the Corporations Agreement. Using the credit referral to extend the operation of the ASIC Act to enforce the credit laws potentially carries some constitutional uncertainty. It also recognises that some of the terminology in the ASIC Act does not translate easily or in the same way in the credit context.

The ASIC Act continues to apply in relation to the Credit Bill in regard to ASIC's operation and other general and incidental powers.

D. Dispute Resolution Framework

As part of the transfer of consumer credit from the States to the Commonwealth, the Commonwealth cannot confer federal jurisdiction upon State and Territory tribunals which are not courts within the meaning of Chapter III of the Constitution. In addition, the relevant State and Territory Fair Trading and Consumer Affairs bodies will no longer provide official dispute resolution services in relation to consumer credit.

During public consultation, State and Territory representatives and consumer advocate representatives have expressed concern about:

- potential gaps between federal court jurisdiction, as opposed to State courts and tribunals, and
- the relative accessibility of the federal courts compared to the relevant State courts and tribunals.

The law establishes a three-tiered dispute resolution process to address these concerns.

- Firstly, consumers will have access to the credit service providers' internal dispute resolution (IDR) process.

- Secondly, if they are not satisfied with IDR, consumers may access the credit service providers' EDR Scheme. To obtain a licence to provide credit or credit services, the credit service provider will be required to have membership of an ASIC approved EDR scheme.
- Thirdly, consumers will retain access to the courts to seek redress. Neither internal nor external disputes resolution processes will remove a consumer's right to seek redress directly from a court. An ancillary arrangement establishes an 'opt-in' small claims procedure for certain matters.

External Dispute Resolution (EDR) Schemes

EDR Schemes provide an easy, accessible no-cost option for dispute resolution for consumers. EDR Schemes are designed to be independent and informal alternative to going to court.

The benefits of EDR Schemes can be seen in their operation under the Corporations Act for financial products and services. They are an independent mechanism for resolving complaints in situations where a consumer or investor has a complaint about a financial services product or service that the financial services provider is not able to resolve.

Court Arrangements

To address the issue of potential gaps in federal and state jurisdictions, the court framework establishes that civil jurisdiction is conferred upon all Federal and State Courts (except Family Courts), subject to their general jurisdictional limits, and criminal jurisdiction is conferred upon all State Courts, subject to their general jurisdictional limits.

This is consistent across Commonwealth jurisdiction. Under the *Judiciary Act 1903* the Commonwealth generally confers jurisdiction to State courts where the Federal Court also has jurisdiction. In addition, the Federal Court and the Federal Magistrate's Court generally do not hear indictable criminal offences (where a jury is required). This also occurs under the Corporations Act.

It would be open to the consumer or ASIC to go to the court it considers most appropriate to them in their circumstances. This could be a Federal Court or a State Court. Which court a consumer could seek redress will be limited by the general jurisdictional limits of the court, and may be determined by the value of the amount in dispute.

In determining the court jurisdiction, consumer access needed to be balanced against the development of expertise in credit matters. It was recognised that States who utilised Tribunal's in credit matters had developed specific expertise in dealing with credit matters. There had been some call to limit court jurisdiction to the Federal Courts to ensure a similar expertise was developed. However, it was important to ensure that consumers, particularly in regional areas, have court access. This broad accessibility also recognised that some State courts already had credit jurisdiction and such expertise should be retained. Generally, specific judicial expertise on credit matters is expected to develop over time.

'Opt-in' Small Claims Procedure

Measures introduced to address the concerns about accessibility include an 'opt-in' streamlined court procedure to be adopted for small claims matters and hardship variations under the Credit Bill. This enables a more expedient proceeding for small claims matters and replicates some of the advantages of State Tribunals that can no longer be utilised in the National regime. This includes acting without regard to legal forms and technicalities and a presumption against legal representation. There will also be a presumption against adverse cost orders for hardship applications under the Code, to prevent such cost orders from being a disincentive to seek a hardship application.

The procedure was originally capped at $20,000 to be consistent with a similar mechanism that existed in the *Fair Work Act 2009*. Following the exposure draft Credit Bill, it was raised that the matters available to be heard through the small claims procedure was too limited to be useful and should be extended to include other orders available under the Code. In addition, concern was raised that the $20,000 threshold to access the small claims procedure was too low and should be increased.

To reflect these concerns, the small claims procedure was extended to other orders available under the Code, and the threshold increased from $20,000 to $40,000. This amount is within the current jurisdictional limits in Magistrates and Local Courts. In determining the $40,000 threshold, the issue of accessibility was balanced against the potential abrogation of judicial power that is directing the court as to how it must operate. It was recognised that while this procedure was useful for small claims matters, to extend it further may be perceived as limiting the judicial power of the court. This is because the small claims procedure does not require to have regard to legal forms and technicalities.

Legal Proceedings

There were some concerns raised about the current ability of creditors to commence proceedings for breach of contract in a jurisdiction unrelated to the debtor (for example, commencing proceedings in Western Australia when the debtor resides in New South Wales), making it difficult for a debtor to participate in the proceedings. This would be exacerbated by removing the natural jurisdiction limits of the UCCC by creating a national regime.

To address this, the draft National Consumer Credit Protection Regulations 2009 (Credit Regulations) propose to prescribe the jurisdiction in which legal proceeding relating to a contract governed by the Code can be commenced. The Credit Regulations will provide that legal proceedings must be commenced in the State or Territory where the debtor resides, or if that is not known, the place the debtor resided when the credit contract was made. This would apply unless it is in the interests of justice to hear the matter elsewhere under the general transfer of proceedings provisions, or where the jurisdiction is agreed between the parties in a non-standard contract.

Access to Justice

Consumer groups have raised a number of access to justice issues that are related to the operation of consumer credit in federal jurisdiction. Some of these issues have been addressed in the current legislation. Any remaining issues will have the capacity to be considered in Phase Two of the reforms.

Phase Two will be further informed by the strategic framework for access to justice being developed by the Access to Justice Taskforce in the Attorney-General's Department and the outcomes of the National Alternative Dispute Resolution Advisory Council's Reference on encouraging greater use of alternative dispute resolution in civil proceedings.

E. Enhancements to the National Consumer Credit Code

The National Credit Code (NCC) largely replicates the State and Territory based UCCC, which has been the primary basis of consumer credit regulation in Australia since 1996.

The objective of the UCCC was to ensure strong consumer protection through 'truth in lending', while recognising that competition and product innovation must be enhanced and encouraged by the development of non-prescriptive, flexible laws.

In enacting the NCC, a range of important consumer focused improvements and protections were made. These include Commonwealth initiated enhancements and the implementation of well progressed State projects. These amendments are discussed in detail below.

A key policy decision, based on the Productivity Commission Report and Green Paper, was taken early on to construct the new law around the existing UCCC. A complete overhaul of a systems-intensive regime would have been costly and disruptive to industry and consumers, and could not be justified, as indicated by both industry and consumer groups. This approach also had the advantage of building on the existing systems experience and expertise.

Increasing thresholds for access to hardship variations and stays of enforcements and introducing a requirement to respond

In transferring the consumer credit regime to the Commonwealth, the Government has increased the threshold under which a debtor can request a change to certain terms of their credit contract on the grounds of hardship to $500,000 (or higher as specified in the regulations). The increase in threshold enables more consumers to apply for changes to the terms of their credit contract when in financial hardship, for example, because of illness or unemployment. This increased threshold also applies to requests for stays of enforcement.

In addition, from 1 July 2010, credit providers will have to respond to such requests within 21 days. The commencement of this enhancement has been postponed from 1 January 2010 to give credit providers the time they need to make the changes necessary to operate in this new regulatory environment.

The UCCC thresholds were set at 110 per cent of the average loan size for new dwellings in New South Wales (for example, $345,290 for 7 July to 10 August 2009). This figure changes monthly, and has varied between $295,790 and $368,390 since 2004, making it difficult for providers and consumers to know if a loan qualifies.

There are constitutional limitations in extending the increased threshold to pre-existing contracts. While this may constrain the application of enhancements to existing contracts, it should be noted that credit

providers can still voluntarily negotiate with consumers to make changes to a credit contract (even in the absence of any legal obligation on credit providers to consider such requests).

For example, signatories to the Code of Banking Practice[11] are committed to trying to help customers overcome financial difficulties with any credit facility (not just where the provider is obliged under the law).

Further, on 5 April 2009, the Treasurer announced that the four major banks had agreed to assist borrowers, regardless of the size of their loan, who are experiencing financial difficulty as a result of the global recession. This agreement has now been extended to all retail banks, building societies and credit unions. Options for assistance include:

- in relation to mortgages, postponement for up to 12 months of the dates on which payments are due under the contract (with interest to be capitalised into the loan);
- an extension of the period of the contract and a reduction in the amount of each payment due under the contract;
- interest-only breaks on loan repayments; and
- fee waivers.

Extension of the Code to credit for residential investment property

The Code has been extended to apply to credit provided to individuals and strata corporations to purchase, renovate, improve or refinance residential property for investment purposes. Under the current State regime these investment credit contracts are not subject to regulatory oversight and protection.

This is an important enhancement as investment in residential real property has traditionally been regarded as low risk investment with investors often using the equity in their own homes to borrow against. Such investment is often long term and involves large sums of debt. Past increases in property prices and average household incomes have promoted consumer confidence which has led to increased borrowing to fund investment. However, recent downturns in property and financial markets have left some investors with reduced levels of equity and liquidity.

Residential property is defined to include:

- land that contains or will contain a dwelling;
- certain Crown leases or licences where the land contains or will contain a dwelling;
- interests in a share company which owns the land (that contains or will contain a dwelling) where the individual has a right to occupy the dwelling;

---

[11] Insert reference to the P/R for code of banking practice

- aged care homes or dwellings in a retirement village; or
- an equity of redemption in land that contains or will contain a dwelling.

The protection of the Code extends to properties that must be wholly or predominately used (or intended to be used at some future time) as residential property.

Amendments progressed by the States

Prior to the COAG agreement, the MCCA had consulted on, and agreed to, making a range of amendments to the UCCC in relation to fringe lending, default notices and mandatory comparison rates. The main changes which were incorporated by the Commonwealth include:

- amendments to prevent the use of certain fee structures, purported pawnbroking mechanisms and inappropriate business purpose declarations to avoid the application of the Code;
- amendments to prohibit the taking of security over essential household goods or certain property used by the mortgagor in earning income by personal exertion (known as blackmail securities);
- the simplification of the operation and application of comparison rates;
- amendments to the default notice requirements which must be followed before a credit provider can enforce a credit contract or a mortgage against a defaulting debtor or mortgagor;
- introducing the requirement for credit providers to give consumers information when a direct debit is dishonoured; and
- giving mortgagors additional rights against a credit provider who is seeking to recover enforcement expenses when they are in breach of requirements that must be met before a credit contract or mortgage can be enforced.

In response to stakeholder concerns and to ease the transition for industry, the commencement of some of these enhancements has been deferred from 1 January 2010 to 1 July 2010 to allow industry sufficient time to effect the necessary changes to their systems and documentation.

F. Implementation Timeframes

Based on stakeholder submissions to the public consultation on the exposure draft of the Credit Bill, adjustments have been made to the implementation timeframes. The Credit Bill and the related bills were introduced in Parliament on 25 June 2009, with the anticipated implementation timetable to start on 1 January 2010.

Taking account of the views of states and territories and industry the timeframes have been adjusted to enable a staggered start for the responsible lending requirements to apply to certain industry sectors with remaining responsible lending obligations (such as disclosure obligations) expected to be in place by 1 January 2011. This would allow industry more time to transition to the new regulatory framework –

industry was primarily concerned that the timetable did not provide enough time to adjust their IT and business systems to meet the responsible lending obligations.

In addition to ensure that business had time to make the necessary compliance changes to their systems, adjustments have also been made to defer the commencement of a number of enhancements to the National Credit Code, which will commence on 1 Jul 2010.

Transition and ASICs Role

To ease the transition for industry and allow the national credit regime to be implemented in a sensible and practical fashion, ASIC will play a pivotal role in undertaking intensive stakeholder consultation to explain and clarify the regulatory requirements to industry stakeholders. ASIC will work co-operatively with industry to develop guidance material to assist industry's shift to the new regulatory environment.

ASIC has commenced issuing consultation papers inviting feedback from stakeholders in relation to its proposed guidance on complying with the licensing obligations.

ATTACHMENT A - OVERVIEW OF THE MARKET

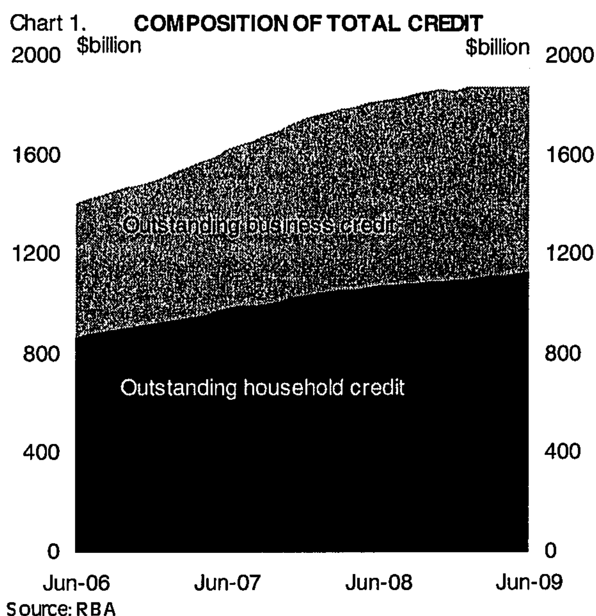
The provision of credit is a significant industry in Australia which has increased substantially over the last 20 years.

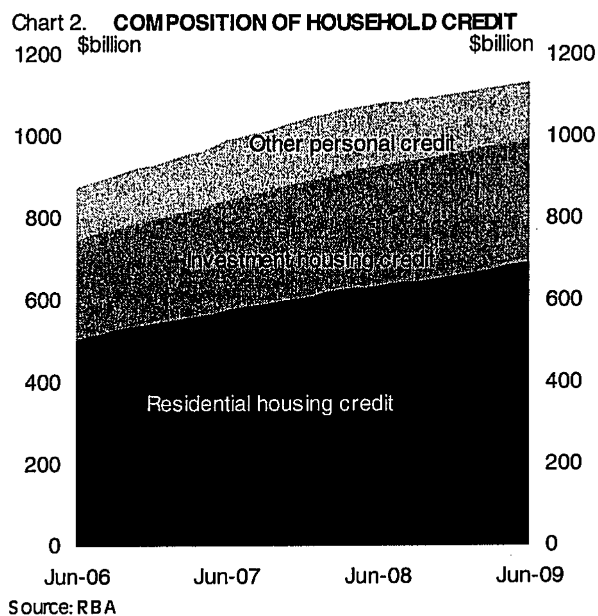
At the end of June 2009, the value of total outstanding credit in the Australian economy was $1.9 trillion, up 3.4 per cent (or around $61 billion) from twelve months ago. Over 90 per cent of this increase (or about $56 billion) is attributable to growth in total household credit. However, the Global Financial Crisis has recently slowed economic growth in Australia, impacting on the pace of credit growth.

The nominal value of consumer loans (household credit) has grown at around thirteen per cent each year since June 1988. As of June 2009, total consumer credit on issue, including securitisations, was $1.1 trillion; housing related credit on issue stood at $997.6 billion and other personal credit $136.2 billion.

Household credit accounts for around 61 per cent of total outstanding credit in the Australian economy and include owner occupied (residential) housing credit, investment housing credit and other personal credit (Chart 1).

The largest sector of consumer credit is residential mortgages (both owner-occupied and investment housing), estimated to account for around 88 per cent of all consumer loans. Other personal credit, such as credit cards and personal loans accounts for around 12 per cent of all consumer loans.





Overall Growth in Credit

The overall growth in credit over the past 20 years reflects a combination of factors:

- credit has become cheaper and more accessible for consumers;
- average household incomes have been growing, hence increasing consumers' borrowing capacity; and
- importantly, financial market deregulation has facilitated a dramatic increase in the number of credit providers and competition. This has in turn, put downward pressure on the cost of credit and encouraged innovation in loan products, leading to a rapidly expanding range of credit products and services. New products include, for example, low-doc loans, which involve less stringent credit worthiness checks, reverse or equity release mortgages.

Many of these new forms of credit have been provided by non-traditional market participants such as small lenders, non-deposit taking institutions and solicitors or vendors (offering home financing).

A significant feature of the de-regulated market has been the growth in and reliance on brokers.

While most of these developments have provided significant benefits for consumers, concerns have emerged that poor lending practices together with the failure of the current regulatory framework to keep pace with rapid changes in the financial markets have left credit-related consumer protection exposed.

In particular, poor lending practices have contributed to a growing number of borrowers experiencing financial stress.[12]

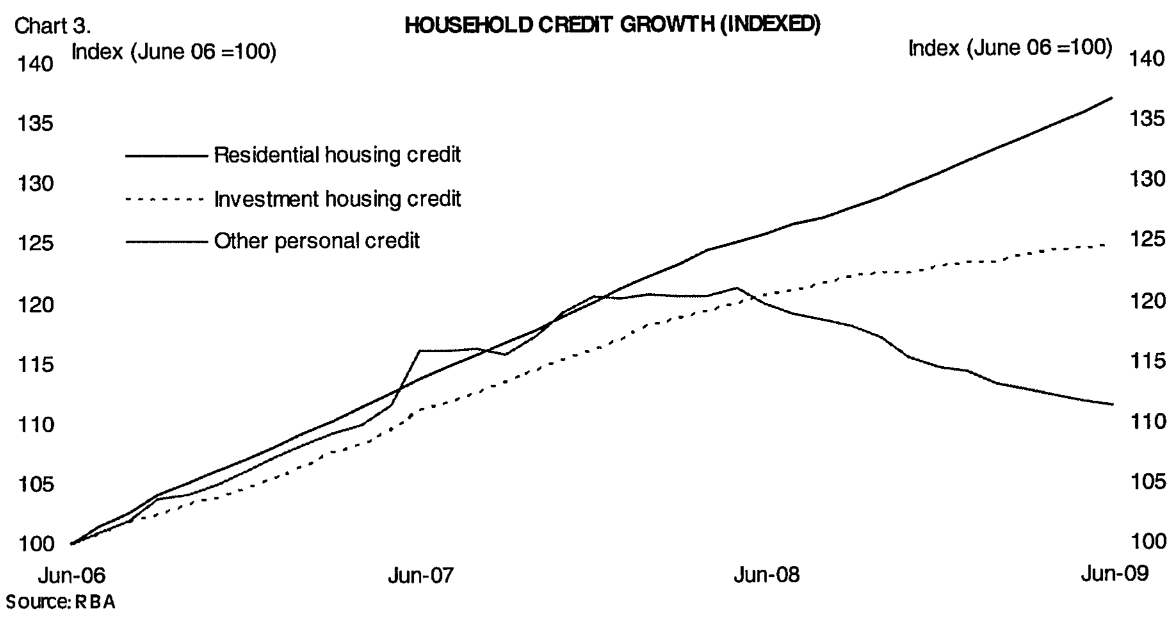
Current Credit Growth

The recent sharp downturn in economic activity has impacted the pace of credit growth. Both business and household credit has slowed in recent months, reflecting a combination of demand and supply factors.

While household credit has continued to expand over recent months, it has done so at a markedly slower pace. This mostly reflects a fall in other personal credit (Chart 3). As recently noted by the Reserve Bank of Australia, households are taking a more cautious approach to borrowing in the current economic climate and have reduced their demand for new borrowing.

---

[12] *Review of Australian Consumer Policy Framework*, Productivity Commission 2008, p 443.



At the same time, there has been some tightening on the terms and conditions on which credit is available. Specifically, there has been some tightening of lending standards around mortgage lending. This reflects the increased risks associated with lending to marginal borrowers (such as those who are unable to save for significant deposit) during a time of weaker economic growth and rising unemployment. This can be seen as a prudent response by lenders to current market economic conditions, which reflects social and regulatory expectations to lend responsibly.

However, there is some concern that the economic downturn may result in an increased reliance by consumers on fringe lenders, exposing more vulnerable consumers to predatory lending practices.