

Australian Securities and Investments Commission

Submission to the Inquiry into the Australian Securities and Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill 2008

1. ASIC's consumer protection role

Background

- 1.1. The Australian Securities and Investments Commission (ASIC) enforces and regulates company and financial services laws to protect consumers, investors and creditors.
- 1.2. ASIC administers various pieces of legislation, regulations, instruments and codes that impose consumer protection requirements on the financial services industry. The two principal pieces of consumer protection regulation that we administer and enforce are the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) and the *Corporations Act 2001* (Cth).
- 1.3. The ASIC Act contains provisions that are modelled on the consumer protection and unconscionable conduct provisions in the *Trade Practices Act 1974* (Cth). These provisions apply to the provision of financial products and services, including credit facilities and services relating to credit.
- 1.4. The *Corporations Act 2001* provides licensing, disclosure and quality of advice requirements that apply to most consumer financial products and services including securities, managed investments, superannuation, insurance products, bank accounts and financial advice.
- 1.5. Providers of these regulated financial services must generally hold an Australian financial services (AFS) licence or be a representative of an AFS licence holder, and comply with the conditions of the licence. One important condition is that licensees must be a member of an ASIC-approved external dispute resolution scheme.
- 1.6. However, these Corporations Act requirements do not apply to credit products or services (such as advice relating to credit products).

Regulation of fees

- 1.7. The principal regulatory measure in relation to fees for financial services, both at state and federal level, is the mandating of disclosure. Currently, ASIC's jurisdiction to ensure the proper disclosure of fees by banks, credit unions and other Authorised Deposit-taking Institutions (ADIs) varies depending on the class of financial product or service. Many financial products (for example, insurance and superannuation) are regulated by the Corporations Act and require a product disclosure

statement (PDS). A PDS must set out, amongst other things, the information a consumer would reasonably require to make a decision about whether to acquire a financial product (specifically including the cost of a product).

- 1.8. However, some financial products otherwise regulated under the Corporations Act, including basic deposit products such as everyday transaction accounts, have been exempted from this PDS requirement.¹ In addition credit products, such as credit cards, are not regulated by the Corporations Act and so do not require a PDS. Specific disclosure requirements for credit products exist at state level under the Uniform Consumer Credit Code² (UCCC), discussed below.
- 1.9. Accordingly, the financial products and services the subject of the current public debate on default fees (that is, basic deposit products and credit cards) do not require a PDS. For such products, ASIC's jurisdiction is limited to its ASIC Act role of ensuring that product providers do not engage in misleading, deceptive or unconscionable conduct, either by act or omission.
- 1.10. Properly disclosed fees are not otherwise circumscribed by any legislation administered by ASIC, and ASIC does not have the jurisdiction to prohibit or prevent the charging, or regulate the amount of, any default fees.
- 1.11. The common law doctrine of penalties, which renders some contractual provisions in relation to damages for breach of contract unenforceable, affects the rights and obligations of the parties to a contract. Such rights can only be enforced by individual consumers seeking relief under the common law and are not enforceable by ASIC.

2. The Uniform Consumer Credit Code

- 2.1. The UCCC applies to credit that is provided to individuals for personal, domestic or household purposes. Lending to bodies corporate or for investment or small business purposes is not regulated by the UCCC.³
- 2.2. The UCCC regulates the relationship between a borrower and lender and does not generally apply to intermediaries, including mortgage and finance brokers. The UCCC mandates the content of contractual and pre-contractual disclosure and provides relief mechanisms for consumers.
- 2.3. Section 15G of the UCCC requires that a credit contract document must contain, if ascertainable, (a) the credit fees and charges that are or might be payable under the contract and when they will be payable, (b) their amount or method of calculation, and (c) the total amount payable. If

¹ Corporations Regulations 2001 - Reg 7.9.07FA

² <http://www.legislation.qld.gov.au/LEGISLTN/CURRENT/C/ConsumCredCode.pdf>

³ UCCC, section 6 (1) (b).

appropriate, the contract must also contain a statement that fees may be changed, and how the debtor must be informed of this.

- 2.4. There is limited scope within the UCCC to challenge the quantum of fees and charges under a credit contract. An establishment or early termination fee is subject to challenge by the debtor or guarantor on the grounds that it is unconscionable under section 72 of the UCCC.
- 2.5. For establishment fees, section 72(3) provides that:

In determining whether an establishment fee or charge is unconscionable, the Court is to have regard to whether the amount of the fee or charge is equal to the credit provider's reasonable costs of determining an application for credit and the initial administrative costs of providing the credit or is equal to the credit provider's average reasonable costs of those things in respect of that class of contract.

- 2.6. For early termination fees, section 72(4) provides that:

A fee or charge payable on early termination of the contract or a prepayment of an amount under the credit contract is unconscionable if and only if it appears to the Court that it exceeds a reasonable estimate of the credit provider's loss arising from the early termination or prepayment, including the credit provider's average reasonable administrative costs in respect of such a termination or prepayment.

- 2.7. The phrase "credit provider's loss" is otherwise undefined in the UCCC, and it therefore remains somewhat unclear what the scope of such loss might be.
- 2.8. There is no definition of 'unconscionable' in the UCCC. There has only been one case where these provisions have been judicially considered - *Director of Consumer Affairs Victoria v City Finance Loans and Cash Solutions*, (2005, VCAT). In that case Mr Justice Morris said that in determining unconscionability a tribunal would likely have regard to common law notions of unconscionability, in particular the circumstances of each party. He stated that unconscionability focuses on whether one party has taken advantage of the other and has exploited the comparative advantage.⁴ Morris J held that there is no implied obligation to refrain from charging an unconscionable establishment fee, rather that a lender is at risk if it charges an unconscionable establishment fee.⁵
- 2.9. ASIC is unaware of other cases where entry or exit fees have been challenged on the grounds of unconscionability under the UCCC. The absence of cases might be, in part, attributable to the fact that state

⁴ *Director of Consumer Affairs v City Finance Loans (Credit)* [2005] VCAT 1989 (30 September 2005), at paragraph 31.

⁵ *Director of Consumer Affairs v City Finance Loans (Credit)* [2005] VCAT 1989 (30 September 2005).

government consumer agencies do not⁶ have standing to make applications relating to section 72 (or Division 3 of the UCCC in general), however recent law reform proposals would change this (see Section 4 of this submission). The cost and uncertainty of litigation relative to the sums involved might mitigate against individual consumers taking action.

- 2.10. Although there is a regulation-making power to prohibit certain fees in section 29 of the UCCC, it has not been used.

3. Australian developments

ABA announcements

- 3.1. Following growing public debate and after discussions with ASIC, the Australian Bankers' Association (ABA) announced in May 2007 that it would provide the public with more information on bank default fees (called "exception fees" by the ABA).
- 3.2. In July 2007, ABA member banks published new information on prevailing default fees, including the circumstances in which such fees arise and how consumers can avoid them. At the end of July 2007 the ABA published⁷ a fact sheet summarising the position on default fees charged by its member banks on concession accounts (accounts available to consumers with a Commonwealth concession card) and containing links to material on each of its member bank websites. The ABA indicated that individual banks would also review their terms and conditions on relevant products by the end of July 2007. In November 2007,⁸ the ABA published an updated fact sheet with comparative tables on default fees for regular transaction accounts, for transaction accounts for eligible low-income earners and concession cardholders and for credit card accounts.
- 3.3. The ABA continues to update its comparative tables (on its website) with the latest fee information. There has been significant downward movement in the maximum level of default fees charged by ABA members particularly in relation to credit cards. The ABA's comparative tables provide a useful tool for consumers looking to find the accounts with the lowest default charges, accepting nevertheless that most consumers are unlikely to choose their account on this basis. There is also potential for the downward movement in default fees to continue.⁹

⁶ Except until very recently in Victoria, where since 18 March 2008, the Director of Consumer Affairs in Victoria has been able to make applications under section 72 of the UCCC, with the passing of the *Consumer Credit (Victoria) and Other Acts Amendment Bill 2007*.

⁷ <http://bankers.asn.au/default.aspx?ArticleID=1102>

⁸ <http://bankers.asn.au/default.aspx?ArticleID=1127>

⁹ For example, National Australia Bank press release of 4 September 2007 – "Next year NAB will move further away from exception fees and put in place a model for all personal transaction accounts that gives customers greater choice to pay for the services they want," Mr Fahour said.

ABACUS announcement

- 3.4. The industry association for credit unions and building societies, ABACUS Australian Mutuals (ABACUS), announced in May 2007 that it would be meeting with representatives from consumer groups (including CHOICE and the Consumer Action Law Centre) to discuss the consumer groups' proposal for an industry-wide review of default fees. ABACUS also noted that default fees charged by its members are on average lower than the comparable fees charged by the ABA's members.
- 3.5. On 1 November 2007, ABACUS released, for consultation, a proposed Code of Practice for Credit Unions and Mutual Building Societies.¹⁰ Relevant to default fees (referred to in the draft as 'Exception Fees') the draft Code includes the following commitment
- (4.5) We will make sure any exception fees we charge (including credit card late payment fees, account overdrawn or dishonour fees, direct debit dishonour fees, cheque dishonour fees, and ATM failed transaction fees) are:*
- *Reasonable, having regard to our costs*
 - *Clearly disclosed, and*
 - *Fairly applied.*
- 3.6. The ABA Code of Banking Practice is also currently the subject of independent review. It seems likely that consumer groups will propose the inclusion of a similar "in principle" limitation on default fees in the Banking Code of Practice in the context of the review.

Individual ADI announcements

- 3.7. A number of banks have dropped the fees charged on concession accounts to between \$0 (such as the National Australia Bank) and \$10 (including ANZ, Westpac, St George and BankSA). Others have stated explicitly that the fees may be waived by a branch manager on a case-by-case basis.
- 3.8. One bank (National Australia Bank) has introduced an account with no default fees.
- 3.9. ANZ has also announced¹¹ new default fee policies, including a simplification of its fee structure, providing customers with additional methods of avoiding default fees (including 'switching off' the ability to overdraw a transaction account), and a 'fairness' policy (including not charging a customer for the first default fee they incur and not charging more than one credit card overlimit fee in any one monthly statement cycle).

¹⁰ http://www.abacus.org.au/media_centre/releases/2007/docs/abacus_draft_code_oct07.pdf

¹¹ Media release of 28 August 2007.

- 3.10. ASIC notes that a number of banks are yet to introduce concessional default fees, and also that some low income consumers will not hold the concession cards necessary to take advantage of the accounts offering concessional fees.

Mortgage fees

- 3.11. In February and March 2008, at the request of the Federal Treasurer, The Hon Wayne Swan MP, ASIC conducted an industry review of entry and exit fees that apply to home mortgage accounts. This review examined the level of exit and entry fees on home loans, how they work in practice, how they compare to the UK and USA, and how they are currently regulated.
- 3.12. ASIC found that exit fees on home mortgages fall into two categories:
- Discharge fees: charged irrespective of when the mortgage is terminated, generally related to administrative costs and well under \$1000); and
 - Early termination fees (also called deferred establishment fees): usually only charged if the mortgage is terminated in the first three to five years, and may be thousands of dollars.
- 3.13. ASIC found that as the prevalence and level of early termination fees has grown, some do not appear to be related to the underlying costs they are purporting to recover. This is potentially so for those early termination fees that are a fixed percentage of the total amount financed, or a multiple of the monthly repayment amount.
- 3.14. These methods of calculation can lead to significantly higher early termination fees. ASIC's review of fees identified a variable rate loan product that charges a \$5,685 early termination fee on a \$250,000 variable rate loan (representing 2.27% of the total loan amount), and a basic rate loan product that charges a \$7,580 early termination fee, also on a \$250,000 loan (representing 3.03% of the total loan amount).
- 3.15. Data provided to ASIC also suggested that early termination fees are high in Australia when compared with the UK and USA.

4. Other law reform proposals in Australia

Uniform Consumer Credit Code

- 4.1. In August 2007, the Ministerial Council on Consumer Affairs (MCCA) released the Fringe Lending Consultation Package, calling for submissions on proposed amendments to the UCCC. The submissions are currently being considered. The amendments, among other things, seek to:

- Modify section 72 of the UCCC to enable all fees and charges (and the combination of interest, fees and charges) to be reviewable and to permit a court, when considering an application under section 72, to take into account the objective reasonableness of costs incurred in establishing or terminating a loan of that type. The proposal would change the terminology used in section 72 from 'unconscionable' to 'unreasonable'. This shift was considered necessary following the decision in *Director of Consumer Affairs Victoria v City Finance Loans and Cash Solutions* (see above); and
- Insert a new section 72A to allow applications challenging fees under Division 3 by a Government Consumer Agency. This would give an appropriate agency the standing to represent the public interest, or individual debtors or groups of debtors.

Unfair Contract Terms

- 4.2. Consumer Affairs Victoria, with the support of the Victorian Government, intends to extend the Unfair Contracts Terms regime (Part 2B of the *Fair Trading Act* (Vic)) to consumer credit contracts, with a target commencement date of 1 January 2009.¹²

Productivity Commission

- 4.3. The Productivity Commission's Draft Report, 'Review of Australia's Consumer Policy Framework', released in December 2007, recommends that responsibility for finance brokers and other credit providers should be transferred to the Australian government, with regulatory requirements encompassed within ASIC's financial services regime.
- 4.4. The draft report also recommends the introduction of a 'tightly constrained unfair contract terms provision' into the proposed national generic consumer law. Under the recommendation the application of the unfair contract terms provision would be limited to standard form contracts and would explicitly exclude terms dealing with non-contingent or upfront contract prices. As default charges are in all cases contingent charges they would appear to fall within the scope of the provision recommended by the Productivity Commission.
- 4.5. The Productivity Commission is due to hand down its final report by May 2008.

Council of Australian Governments

- 4.6. The Council of Australian Governments (COAG) met on 26 March 2008. COAG's Communiqué advises¹³ that COAG has agreed in principle to the Commonwealth assuming responsibility for regulating:

¹² [http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Credit_and_Debt/\\$file/credit_misc_unfair_terms_consultation_paper.pdf](http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Publications_Credit_and_Debt/$file/credit_misc_unfair_terms_consultation_paper.pdf)

¹³ <http://www.coag.gov.au/meetings/260308/index.htm>

- a. Mortgage credit and advice, including persons and corporations engaged in mortgage broking activities, for the purpose of protecting consumers. The Business Regulation and Competition Working Group (BRCWG), in consultation with the Ministerial Council on Consumer Affairs, will develop details by October 2008. States will retain interim responsibility to regulate mortgage credit and advice and mortgage broker activities until the Commonwealth completes its assumption of responsibility.
 - b. Margin lending, including persons and corporations engaged in margin lending. The BRCWG, in consultation with the Ministerial Council on Consumer Affairs, will develop details by October 2008.
 - c. Lending by non-deposit taking institutions. BRCWG, in consultation with the Ministerial Council on Consumer Affairs, will develop details by October 2008.
- 4.7. COAG has also asked that the BRCWG identify any other areas of financial services activities that best sit within the Commonwealth's regulatory responsibility.

5. Overseas developments

- 5.1. The United Kingdom Office of Fair Trading (UK OFT) has a broad role in relation to the regulation of bank fees under its jurisdiction to conduct market studies and to ensure compliance with the Unfair Terms in Consumer Contracts Regulations (UK) 1999 (UTCCRs). The UTCCRs prohibit unfair contract terms generally, rather than specifically prohibiting penalty fees.
- 5.2. In April 2006, the UK OFT announced that its enforcement policy would be to assume that any default fee on credit card accounts above £12 (approximately A\$27) was likely to be unfair, in breach of the UTCCRs. In response, it appears that institutions in the UK have limited their credit card default fees to no more than £12.
- 5.3. The UK OFT had foreshadowed that similar principles could apply in relation to default charges on other ADI accounts. In March 2007, under the headline "OFT announces 'quick fix' on bank charges will disadvantage consumers", it announced an in-depth market study of retail bank pricing to sit alongside a formal investigation into the fairness of bank current account charges. Whilst when it was announced the study was to be completed by the end of 2007, it remains outstanding.
- 5.4. In addition to the in-depth study, the UK OFT announced in July 2007 that it would commence a test case in the UK High Court (equivalent to Australia's Federal Court) for a declaration on the application of the UTCCRs in respect of unauthorised overdraft charges. It stated that this action was in response to tens of thousands of complaints received by

the County Courts and the Financial Ombudsman Service. The main financial institutions cooperated with the OFT to get the test case before the Courts, and in the meantime the Financial Ombudsman Service agreed to suspend handling individual consumer claims. The OFT considers that a quick determination of this point of principle will assist in securing a clear and orderly resolution of the claims concerning the fairness of these charges. Hearings for the test case concluded on 8 February 2008, and the OFT advises that it expects the judgement to be handed down by end July 2008.¹⁴

- 5.5. During this period, individual UK banks have also made announcements in relation to default fees. For example, in September 2006, HSBC plc announced a “Fair Fees” policy for its UK account holders. This policy has introduced lower overall default fees, a sliding scale for the fees, and various grace periods and thresholds.¹⁵

Mortgages

- 5.6. In the UK, the Financial Services Authority (FSA) regulates mortgage lending. The FSA has done recent work on fees, in particular fees paid on termination of mortgage loans. Both discharge fees (called Mortgage Exit Administration Fees (MEAFs)) and early termination fees (which must only be called ‘early repayment charges’ (ERCs) by lenders) must be linked to underlying costs and must also be fair.
- 5.7. In early 2007, the FSA completed a thematic project about mortgage ERCs.¹⁶ This was undertaken in response to consumer complaints under the UTCCRs. The FSA reviewed over 60 mortgage contracts containing ERC terms. The FSA said that it considered an ERC term
- *may be unfair where it requires a consumer to pay a disproportionately high sum for leaving a mortgage contract early; and*
 - *will be in breach of the Regulations where it is not expressed in clear and plain English.*
- 5.8. The FSA said that it “did not find widespread unfair terms”.¹⁷

¹⁴ http://www.offt.gov.uk/advice_and_resources/resource_base/market-studies/personal/personal-test-case/.

¹⁵ While HSBC plc’s default fees are now around the lowest among major UK banks, HSBC plc still charges a £25 default fee in certain circumstances. It remains for the UK OFT to determine the threshold at which it will commence enforcement proceedings against default fees on bank accounts, having set the threshold for credit card default fees at £12.

¹⁶ http://www.fsa.gov.uk/pages/About/What/thematic/retail_risks/thematic_project/index.shtml.

¹⁷ http://www.moneymadeclear.fsa.gov.uk/news/product/unfair_contracts/unfair_early_repayment_charges.html

6. Australian Securities and Investment Commission (Fair Bank and Credit Card Fees) Amendment Bill 2008

- 6.1. The purpose of this submission is to provide the Committee with a factual background on the prevailing legislative position, ASIC's role, developments overseas and the recent steps taken by key stakeholders in Australia including existing relevant law reform proposals.
- 6.2. ASIC has no specific comments to make in relation to the measures proposed in the Bill. The introduction of such measures is a matter for Government, its central policy agencies and ultimately the Parliament.
- 6.3. ASIC continues to monitor the disclosure of default fees and the policy changes being announced by ADIs. We will be working with the industry to ensure that the disclosure of default fees, the circumstances in which they arise, and the manner in which they can be avoided, are disclosed as clearly as possible to consumers.

Australian Securities and Investments Commission
18 April 2008