

## **Chapter 2**

### **Background and summary of the main National Consumer Credit Protection bills**

#### **A Brief History of Australia's Consumer Credit Laws**

2.1 Although the Australian Constitution does not give the power to make consumer law to the Commonwealth, in recent years there has been a shift towards consensus consumer protection laws between the States, Territories and the Commonwealth.

2.2 Australian consumer credit regulation has a long history stretching back to the 1960s. In his Second Reading Speech for the Consumer Credit (Queensland) Bill 1994, the then Queensland Minister for Consumer Affairs, the Hon. Tom Burns, said:

The conditions pertaining to credit in the late sixties and early seventies were far different than those pertaining by the mid-eighties, let alone the 1990s. In the 1960s, the market was dominated by finance companies, and, for example, variable interest consumer loans were unknown, as were credit cards and the range of hybrid products now available.<sup>1</sup>

2.3 During the 1970s a number of inquiries in Australia (such as the Molomby Committee of 1972-73) and in the United Kingdom (such as the 1971 Crowther Report) called for reforms of consumer credit laws and, particularly, the establishment of a uniform approach to the regulation of credit. In 1973, the Standing Committee of Attorneys-General agreed to the foundation of a credit laws committee consisting of State and Commonwealth representatives and three members of the Molomby committee with a brief to develop model consumer credit legislation for introduction in all State and Territory parliaments.

2.4 In 1981, NSW and Victoria simultaneously introduced legislation which was widely criticised for the lack of uniformity in essential areas. By the late 1980s, Queensland, Western Australia and the Australian Capital Territory had also enacted consumer credit legislation.

2.5 By the end of the 1980s, a lack of consistency between the various pieces of State and Territory legislation was becoming an increasing problem. Many consumer credit laws were criticised for being drafted in a complex and convoluted manner, with extremely large penalties for technical breaches. Some laws, though intended to regulate by substance and not by form, forced credit providers into a narrow range of products and inhibited creativity and innovation. These restrictions substantially limited competition. Furthermore, the limited scope meant that not all credit providers were covered. For example, in most States, the legislation did not cover building societies or credit unions and a range of products (including housing finance).

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1 The Hon. Tom. J. Burns, *Queensland Legislative Assembly Hansard*, 4 August 1994 p. 8828.

2.6 In July 1993, representatives of each State and Territory Government signed the Australian Uniform Credit Laws Agreement 1993, which stated:

...that without fettering the powers of future Parliaments the Scheme will provide for the introduction of Initial Legislation into the Parliament of the State of Queensland and require the other States and Territories to do one of the following:

- (i) adopt that Initial Legislation; or
- (ii) enact and maintain legislation which is consistent with the Initial Legislation.<sup>2</sup>

2.7 The Queensland Legislative Assembly passed their model Consumer Credit (Queensland) Bill in 1994, which contained a Consumer Credit Code. In accordance with their agreement, this code was adopted by all the other States and Territories and became known as the Uniform Consumer Credit Code (UCCC).

2.8 Despite this uniformity in the Credit Code, different credit licensing schemes emerged in some states. As Mr John Brady of the National Financial Services Federation said:

It is harder to get a licence in WA than it is to do almost anything else. There is a six-week period between making an application and getting a licence. They have regular audits. They turn up and look at files. It is very good, and hopefully this system will be at least as good as that. To get a licence in Victoria you write a letter and the licence comes back in the mail the following day. The ACT has a similar documentary requirement to WA, but from what I can gather—and I apologise in advance to the ACT regulators if I am wrong about this—they do not look at the documents that are given to them; they just issue the licence in any event. In the ACT there is no-one, really, who is a lender just in the ACT. They are always outside the ACT as well. WA is very good; the rest are at least equivocal.<sup>3</sup>

### **The Consumer Credit Protection Reform Package**

2.9 The Consumer Credit Protection Reform Package furthers the goal of a national, uniform approach to consumer credit laws and includes a national licensing scheme to overcome some of the current inconsistencies. The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, said during his Second Reading Speech that the bills provide for:

...one single standard and uniform regime for consumer credit regulation and oversight.<sup>4</sup>

2.10 The bills are based, in part, on a referral of constitutional powers by the states. The new regime gives effect to the Council of Australian Governments' (COAG)

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2 Australian Uniform Credit Laws Agreement, 30 July 1993.

3 Mr John Brady, National Financial Services Federation, *Proof Committee Hansard*, 24 August 2009 p. 26.

4 The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009 p. 1.

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agreement on 26 March and 3 July 2008 to transfer responsibility for regulation of consumer credit, and a related cluster of additional financial services, to the Commonwealth and implements the first phase of a two-phase Implementation Plan to transfer credit regulation to the Commonwealth.<sup>5</sup>

### *Phase 1 and Phase 2*

2.11 The first phase will nationalise the consumer credit code and make certain improvements to that code (such as the introduction of responsible lending obligations, which includes assessing the suitability of a credit contract and the responsibility to verify information and make reasonable inquiries).

2.12 The second phase of the reforms will include a range of other improvements to the regulation of consumer credit and, in preparation for that phase, the Government and ASIC are undertaking further consultation to discuss issues such as the introduction of new disclosure requirements, the inclusion of other types of consumer products (such as goods rentals and leases) and the issuance of guidelines explaining how the new regulations will be treated by ASIC.

### *The Phase 1 reform package*

2.13 In addition to translating the UCCC into Commonwealth law, there are four main components to the legislative reforms in the Phase 1 package:

- an Australian Credit Licence (ACL) regime to be administered by the Australian Securities and Investments Commission (ASIC) for those engaging in credit activities;
- industry-wide responsible lending conduct requirements for licensees;
- improved sanctions and enhanced enforcement powers for the regulator (ASIC); and
- enhanced dispute resolution mechanisms, court arrangements and remedies for consumer protection.

### ***The National Consumer Credit Protection Bill 2009***

2.14 The National Consumer Credit Protection Bill 2009 is the primary bill in the package. The bill includes five important aspects: 1) a national licensing regime; 2) responsible lending obligations; 3) sanctions and remedies; 4) a critical dispute resolution mechanism; and 5) the National Credit Code.

### *The National Licensing Regime*

2.15 The bill outlines the requirement for a person engaging in credit activities (defined below) to hold an Australian Credit Licence (ACL) and the obligations imposed on such licences. The key elements of this licensing regime are that:

- it requires a person who is engaged in credit activities to, initially, be registered with ASIC, and to subsequently hold an ACL;

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5 National Consumer Credit Protection Bill 2009 *Explanatory Memorandum* p. 3.

- it imposes entry standards for registration and licensing, and enables ASIC to refuse an application where the person does not meet these standards;
- it requires registered persons and licensees to meet ongoing standards of conduct while they engage in credit activities; and
- it empowers ASIC to suspend or cancel a licence or registration, or to ban an individual from engaging in credit activities.<sup>6</sup>

2.16 The licensing process will start on 1 January 2010. Before that date, anyone engaging in credit activities will need to be registered with ASIC, and must apply for registration between 1 November 2009 and 31 December 2009. They will then have the six-month period between 1 January 2010 and 30 June 2010 to apply for an ACL. Further details of the transitional arrangements follow later in this report.

2.17 The Explanatory Memorandum explains that participants will need to hold a licence if they engage in any of the following credit activities:

- entering into credit contracts of consumer leases;
- collecting money due under a credit contract (including where the lender has ceased providing credit, and where an assignee has purchased the debts from the original credit provider);
- acting as an intermediary between the borrower and the lender (principally as finance brokers, but not exclusively so, with the definition also covering bodies such as introducers, mortgage managers and aggregators); or
- suggesting or providing assistance in respect of a specific credit product with a particular credit provider.<sup>7</sup>

2.18 It is expected that ASIC will issue guidelines on the procedures for becoming a licence holder. These guidelines may also outline the qualifications which the bill sets out for being issued a licence, which include meeting and having the financial and human resource capacity to continue to meet minimum training requirements. Additionally, licensees must meet enhanced conduct standards including the requirement to act honestly, efficiently and fairly (discussed further below).

2.19 Authorised Deposit-taking Institutions (ADIs) will automatically qualify for a licence and it is likely that, by way of regulations, Western Australian brokers who hold an 'A' or 'B' class licence will be similarly 'streamlined', because of the rigour of the licensing scheme in that State.

2.20 A person who engages in credit activities after 1 July 2011 will need to hold a licence or they commit an offence.

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6 National Consumer Credit Protection Bill 2009 *Explanatory Memorandum* p. 27.

7 National Consumer Credit Protection Bill 2009 *Explanatory Memorandum* p. 31.

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### *Responsible Lending Obligations*

2.21 Lending obligations arise when a licensee enters into a consumer credit contract, when they suggest a credit contract to a consumer or when they assist a consumer to apply for a credit contract. The key obligation is to ensure that they do not provide, suggest or assist with a credit contract that is unsuitable for the consumer. This obligation requires licensees to inquire reasonably and to verify a customer's financial circumstances so as to make an assessment that the credit contract will meet the consumer's requirements and that the consumer has the capacity to repay the contract.

2.22 Licensees must also disclose key details about themselves that will assist the consumer to understand with whom they are dealing, the costs they will incur and the dispute resolution services available to them.

2.23 Further, consumers will now be made aware of their right to request a variation in their credit contract in the event of financial hardship, rather than continue to suffer distress or seek to refinance their loan and exacerbate their debt levels.<sup>8</sup>

2.24 ASIC and consumers will be able to take action against a licensee for non-performance of the responsible lending conduct obligations. Breaches of these responsibilities can result in a range of criminal and civil sanctions.

### *Sanctions and Remedies*

2.25 The bill sets out the remedies available to consumers, including remedies in relation to unlicensed conduct, the jurisdiction and procedures of the courts, and the dispute resolution mechanisms available to consumers.

2.26 The new framework is supported by a tiered approach to the sanctions regime, which includes:

- criminal penalties for licensee misconduct, including possible imprisonment for up to two years for those who lend contrary to the responsible lending requirements;
- civil penalties for licensee misconduct, which enables ASIC to seek fines of up to \$220,000 for an individual and \$1.1 million for a corporation;
- infringement notices enabling ASIC to act quickly to penalise certain breaches of the law; and
- consumer remedies, such as compensation, which allow consumers to seek redress for their loss and damage from a licensee.<sup>9</sup>

2.27 Importantly, the transfer of the regulation of consumer credit from the states to the Commonwealth will result in a change in the bodies which provide dispute resolution services and exercise jurisdiction under the new legislation.

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8 The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009 p. 3.

9 The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009 p. 3.

2.28 The dispute resolution framework seeks to address any potential gaps between what matters can be heard by a federal court and state courts and tribunals, as well as the relative accessibility of the federal courts compared to their state equivalents.

#### *Dispute Resolution*

2.29 The bill provides for a dispute resolution framework that facilitates the transition of credit regulation powers to the Commonwealth and any new aspects of the overall regime. The framework is expected to assist consumers to obtain redress using a three-tier approach:

- firstly, consumers are able to access the licensee's internal dispute resolution process;
- secondly, if they are dissatisfied with the outcomes of the internal process, consumers may access the licensee's external dispute resolution scheme. Membership of an ASIC-approved external scheme will be compulsory for registration and licensing; and
- thirdly, consumers retain access to the courts to seek redress. Neither the internal nor the external process will remove a consumer's right to seek redress directly from a court (including a small claims procedure in certain circumstances).

2.30 This arrangement is in line with the trends to provide accessible, timely and cost effective dispute resolution processes. It also recognises that in cases of hardship or other consumer credit issues, a facilitated or negotiated outcome can be more favourable to a debtor than if it had been formally heard and determined under law.

2.31 The key policy objective of the amendments is to maintain accessibility to dispute resolution in terms of location, procedural simplicity and costs, taking into account the different jurisdictional context when transferring the regulation of credit from the states to the Commonwealth.<sup>10</sup>

#### *National Credit Code*

2.32 The National Credit Code will provide a consumer protection framework for consumer credit and related transactions and will be enacted as a Schedule to this bill. It largely replaces the UCCC and includes amendments to enable the UCCC to operate effectively in the Commonwealth context. The objective of the Code is similar to the UCCC, namely:

...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.<sup>11</sup>

2.33 The Commonwealth has specifically decided to enhance or extend the operation of the Code compared with the UCCC in the following ways:

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10 Notes from this section drawn from National Consumer Credit Protection Bill 2009 *Explanatory Memorandum*, pp. 118–125.

11 National Consumer Credit Protection Bill 2009 *Explanatory Memorandum*, p. 239.

- it covers credit for residential investment properties, providing important protections to ‘mum-and-dad’ property investors;
- it increases the monetary threshold under which consumers can request a change to certain terms of their credit contract on the grounds of financial hardship from a fluctuating figure<sup>12</sup> of around \$330,000 to a fixed figure of \$500,000. The code includes a new, flexible power to raise this threshold if necessary...
- credit providers will be prohibited from using essential household goods as security;
- credit providers will be required to give consumers information when a consumer defaults on their contract or a direct debit is dishonoured; and
- as well, the code reduces the potential for unscrupulous lenders to avoid the application of the law to consumers.<sup>13</sup>

2.34 The Code does regulate many aspects of the provision of certain types of credit, including upfront and ongoing disclosure obligations, requirements for changing credit contract terms or terminating contracts, and penalties and remedies. The Code also regulates consumer leases.

2.35 Section 5 of the National Credit Code sets out the circumstances in which the Code will apply to the provisions of credit. Generally, it regulates the provision of credit where it is provided:

- for personal domestic or household use;
- to purchase, renovate or improve a residential investment property; or
- to refinance such credit.

2.36 The definition of 'credit' otherwise expressly excludes credit provided for business or investment use.<sup>14</sup>

### ***National Consumer Credit Protection (Fees) Bill 2009***

2.37 The National Consumer Credit Protection (Fees) Bill 2009 enables the imposition of fees, as taxes, for certain activities conducted under the National Consumer Credit Protection Bill 2009 and the National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009, such as the lodgement of

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12 The amount is set as 110 per cent of the average loan size.

13 The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009, pp 7151-2.

14 National Consumer Credit Protection Bill 2009 *Explanatory Memorandum*, p. 31.

documents (including applications for an ACL), or inclusion of a document in, or inspection of, a register maintained by ASIC.<sup>15</sup>

2.38 The approach taken in this bill is generally consistent with the *Corporations (Fees) Act 2001* which deals with the imposition of fees under that act.

***National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009***

2.39 This bill supports a smooth and comprehensive transition from the current state-based regulation of consumer credit to the new national scheme. A number of key elements in the bill facilitate this transition:

- it sets out the requirement for persons currently engaging in credit activities to register with the Australian Securities and Investments Commission (ASIC) prior to becoming holders of an Australian credit licence.
- it will substitute existing rights and liabilities under the state-based Uniform Consumer Credit Code with equivalent rights and liabilities under the National Credit Code;
- it will substitute existing court proceedings in train under the Uniform Consumer Credit Code with equivalent new proceedings under the National Credit Code;
- it provides that the National Credit Code does not apply to state or territory tribunal proceedings; and
- it grants functions and powers in relation to appeal, review or enforcement proceedings.<sup>16</sup>

2.40 Both this and the National Consumer Credit Protection Bill 2009 provide for a broad regulation-making power in recognition of the need for flexibility to deal with circumstances that may arise in the future. Such a power ensures that any necessary consequential amendments can be made without the need for the enactment of another act.

2.41 As a person (who is not acting on behalf of a licensee) who engages in credit activities after 1 July 2011 without a licence will commit an offence, it is expected that by this date, there will no longer be any need for transitional arrangements.

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15 The bill is a separate bill in order to comply with the requirements of section 55 of the Constitution. That Constitutional provision provides, in part, that laws imposing taxation shall deal only with the imposition of taxation, and that any other provisions dealing with any other matter must be dealt with separately. The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009, p. 5.

16 The Hon. Chris Bowen MP, *House of Representatives Hansard*, 25 June 2009 p. 5.