SUBMISSION 9

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23 May 2011

The Secretary
House of Representatives Standing
Committee on Economics
Parliament House
CANBERRA ACT 2600

Inquiry into the National Consumer Credit Protection Amendment (Credit Cards and Home Loans) Bill 2011

The Australian Bankers' Association appreciates the opportunity to provide comments to the Committee on the exposure draft *National Consumer Credit Protection Amendment (Credit Cards and Home Loans) Bill 2011* ('Bill') and to appear before the Committee on 25 May 2011.

The ABA is the peak national body representing 23 banks authorised by the Australian Prudential regulatory Authority (APRA) to carry on the business of banking in Australia.

The ABA's membership includes the four large banks, foreign banks and smaller retail banks all of which operate on a national scale.

1. Introductory remarks

Despite the consultation process leading to this inquiry, the ABA and its member banks have significant concerns with the Government's policy on credit cards and home loans key fact sheets (KFSs).

Since 1 January 2011 all credit licensees (credit providers and credit assistance providers) have been legally obliged to comply with the responsible lending obligations under Chapter 3 of the *National Consumer Credit Protection Act 2009* ('NCCP'). These obligations form part of 'phase one' of the Government's credit reform project, announced in 2008, and require that a credit product or service is not 'unsuitable' for the customer[1]. The obligations ensure that a customer's

[1] The NCCP defines situations where a contract may be 'unsuitable', including: where a consumer will be unable to meet the repayments or can only comply with substantial hardship; or, the contract does

requirements, objectives and capacity to service the credit facility are paramount. Licensees are subject to penalties for non-compliance under the NCCP.

Together the NCCP, the *National Credit Code* and ASIC's *Regulatory Guide 209* provide comprehensive coverage of credit activities, including credit card lending. These regulatory instruments confirm that the obligations apply when credit providers are suggesting, assisting with or providing a new credit contract and to credit limit increases on a particular contract.

The ABA had previously submitted that sufficient time after the implementation of the new responsible lending regime was required before additional regulation was proposed, in order to assess the effectiveness of the regime. The ABA notes that the responsible lending obligations are already having an impact on how banks and other credit providers engage with customers regarding credit card offers or extensions of credit.

In spite of the credit reform project, and proposed implementation of responsible lending obligations on 1 January 2011, the Prime Minister announced prior to the 2010 election that the Government would introduce seven credit card regulatory measures. The legislation was to be enacted by mid 2011 for commencement in mid 2012 and would apply to new credit card contracts following commencement.

The Government's *'Competitive and Sustainable Banking System'* package announced in December 2010 then accelerated the Government's election commitment to credit card reforms and made provision for the home loans KFSs, both of which are now contained in the draft Bill.

The first Exposure Draft (ED) of the Bill was released on 3 March 2011 for consultation; with only two working days provided for written submissions to be received by Treasury. The ABA respectfully submits that this two day consultation period was extremely inadequate to allow industry to undertake an in-depth analysis of the potential legal and practical implications of the draft legislation. Such an analysis is only possible once the legislation has been made available.

The ABA also wishes to highlight to the Committee our concerns that less than three full working days have been provided for submissions to be made in this inquiry.

Prior to the draft Bill being released, a number of consultation meetings were held between Treasury, banking industry representatives, consumer groups and other stakeholders aimed at ensuring that a workable balance was achieved between consumer protections, legal certainty, administrative simplicity and commercial imperatives for banks and other credit providers.

Unfortunately, the Bill contains a number of provisions which are contrary to positions which the ABA understood were established at these consultations. As a result, the Bill presents substantial business risks and operational challenges for banks and other credit providers. Additionally, the practical application of some of

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not meet the consumer's requirements or objectives.

the Bill's provisions could result in confused outcomes for consumers and consequently increase the risk of consumer complaints. Specific comments on these matters are detailed in Section 2 of the submission.

Furthermore, the ABA respectfully submits that some parts of the Bill are inconsistent with the Government's election commitments announced under the '*Fairer, Simpler Banking'* policy. Therefore, there are multiple gaps between the stated intent of the Government and the legal and practical outcomes of the Bill in its current form.

Finally, the absence of proposed regulations to accompany the Bill means that industry cannot fully assess the potential impact or the likelihood of unintended consequences of this new regime. This is of particular concern as much of the detail in the Bill is to be dealt with by the associated regulations. Only once the final package is released can industry comprehensively comment on the full impact of the reform package.

2. Specific Comments

The ABA has endeavoured to confine our submission to the major concerns related to the Bill itself.

2.1 Division 4 – Offers to increase credit limit of credit card contract

Issue 1

Provisions in relation to unsolicited credit limit increase invitations (UCLIs) are to apply to existing and new customers contrary to the Prime Minister's election commitment that UCLI provisions would only apply to new customers.

Concerns

The retrospective application of these provisions will prove costly to industry and extremely cumbersome to implement. The rationale behind extending the provisions to existing customers has not been provided by the Government. Furthermore, the rationale behind the policy shift has not been included in the Regulatory Impact Statement (RIS) despite it resulting in significant implementation and administrative costs to business.

Section 133BF(7) in referring to the "giving of consent" under s 133BF(2) and section 133BF(1)(a) suggest that for existing customers some form of positive affirmation or express consent may be necessary. As a result, UCLIs will be prohibited unless the existing customer consents i.e. opts-in to receiving CLIs.

The administrative burden of compliance and the cost of seeking and recording customer opt-ins for the receipt of otherwise prohibited written communications would be extremely high, given that there are approximately fifteen (15) million existing credit cards in circulation.

Recommendation 1

The application of the prohibitions to existing cards should be consistent with the Prime Minister's election commitment and removed from the Bill.

Recommendation 2

Alternatively, customers with existing cards should be 'deemed'[2] to have opted-in, with the option of opting-out from receiving CLIs each time they are sent a CLI. The deeming of consent by existing customers is a reasonable and practical solution to the administrative complexity and high cost that the Bill in its current form creates.

Issue 2

Broad prohibition on written communications to customers regarding credit limit increases (CLI).

Concerns

The scope of section 133BE (5) and the definition of a "credit limit increase invitation" are too broad. A "credit limit increase invitation" not only includes express offers[3] and invitations[4] to increase the limit of the contract but also has the practical effect of capturing any communication to the consumer that has the purpose of encouraging the customer to consider applying for an increase[5].

In doing so, the draft provision may serve to prohibit factual, generic customer communications regarding the ability of the customer to manage their credit limit, such as: notifying a customer that they can adjust their credit limit up or down; or, that a customer should review their credit limit, for example in instances where the customer regularly transacts above their credit limit.

Furthermore, the draft provision could also be interpreted as prohibiting communications that involve the provision of general information about credit card limits, credit services and general marketing materials. The ABA also questions whether this provision even allows providers to communicate to customers alerting them that they can provide express consent to receive CLI invitations and opt-in to hearing about offers.

The industry understands the Government's intention to prohibit personalised, pre-approved, fast tracked or 'tick-and-flick' invitations that utilise 'seductive language'. However, the reforms should not restrict a credit provider's ability to

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[2] Currently, customers can opt-out from receiving direct marketing CLIs and other direct marketing material (in line with the direct marketing provisions of the Privacy Act) whereas the new provisions in the Bill are an opt-in process i.e. to receive 'solicited' CLIs and other otherwise prohibited written communications. Customers can currently make a positive decision not to receive direct marketing material. For those customers that have not made the positive decision to opt-out this could be used as a proxy for informed consent. Existing provisions in relation to direct marketing under the Privacy Act could therefore be used as evidence that customers have given consent to receive direct marketing CLIs.

[3] Section 133BE (5) (i)

[4] Section 133BE (5) (ii)

[5] Section 133BE (5) (iii)

communicate with customers about their ability to increase, decrease or discuss their credit limits and other credit services or facilities. This is essential in order for credit providers to discuss responsible credit line management with their customers.

Therefore, the ABA believes the draft provision goes much further than necessary and will effectively prevent credit providers from communicating with customers regarding credit limit increases at all, even if an increased or decreased credit limit could be in the best interests of the customer, such as, during emergency and/or temporary relief situations or on the basis of a customer's transaction history (as mentioned above).

Credit providers should not be prohibited from contacting their customers to indicate that an option exists for a customer to change their credit limit if it would suit their circumstances (in line with responsible lending obligations). It is therefore important to distinguish between an "offer" and a "legal invitation to treat".

Express, pre-approved CLIs are an "offer" in that it exposes the offeror to a contract if it is accepted by the offeree. However, an invitation to treat does not. The election commitment is explicit in noting "unsolicited credit limit increase extension offers" which, on a plain reading, would not extend to an invitation to treat. This is an important legal distinction.

For example, the Bill currently restricts the ability to communicate to customers about why they may wish to alter their limit and how a customer may opt in to hearing about credit offers. These communications do not result in an automatic liability of the customer in that the customer will still need to take a proactive step after such communications, and the lender needs to assess their suitability, in order for the customer to be approved and become bound by an increased credit limit.

As noted previously, the practice of credit limit approvals is already tightly regulated by the responsible lending obligations under Chapter 3 of the NCCP. There is therefore no reason for the provisions in the Bill to impact these types of communications.

Furthermore, banks need to be able to mention credit limit management, such as increases and decreases, in general marketing materials as they form part of the product construct for a credit contract. It is difficult to conceive of any other industry where a supplier would be prohibited from communication with customers about services related to their customer's existing products.

Recommendation 3

The ABA respectfully submits that the scope of the prohibition on written communication regarding CLIs be reduced. Provisions should be restricted to personalised, pre-approved CLI offers. This is in line with previous understanding that the policy problem was around explicit, pre-approved, tick-and-flick invitations, not general marketing or credit service communication.

Credit providers should not be restricted in communicating to their customers about credit limit management, the ability for customers to change their existing credit limit or communications outlining how a customer can opt-in to receive offers. Finally, section 133BE(5) should expressly exclude generic marketing materials from the prohibition on UCLIs.

2.2 Division 5 – Use of credit card in excess of credit limit

Issue

Section 133BI entrenches a 'default buffer' of 10% in excess of a customer's credit limit. Section 133BI (2) states that the default buffer automatically applies to a credit card contract unless the consumer has elected not to have the default buffer apply.

Concerns

Whilst a credit provider retains the discretion to approve or reject transactions within the default buffer, the ABA remains concerned that a bank has no option but to have a default buffer facility available to customers, even though the bank has the discretion to approve or reject over limit transactions[6].

Section 133BI effectively precludes a credit provider from having a blanket policy of no over-limit transactions (i.e. no default buffer) or a buffer that is less than the default buffer of 10% (e.g. a 2% buffer) as a customer has a right in the Bill to be considered for over limit transactions up to 10% (unless the consumer has elected not to have the default buffer apply to the contract).

Therefore the Bill does not provide a bank with the appropriate discretion to decide whether to have the default buffer facility itself, or a buffer of less than 10%, because it is the customer that determines if the buffer is not to apply to their contract (by opting-out). The bank's only discretion is whether to allow or reject any over limit transactions within the legislated 10% buffer facility. The ABA continues to emphasise the need for this issue to be rectified.

The ABA submits that the Bill, by entrenching the 10% default buffer, in effect mandates that a bank has to consider offering a consumer more credit. It may be questioned whether this is the Government's intent and whether these are the types of messages, in relation to consumer credit, that the Government wishes to convey to consumers.

The inclusion of the default buffer in the Bill is also likely to raise customer expectations that they have a right to a 10% buffer on their credit card contract.

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[6] Note 2 to section 133BI seeks to allay concerns that the mandatory nature of the default buffer leads to a bank being bound to approve over limit transactions. The note states "The fact that the default buffer applies to a credit card contract does not of itself result in the licensee being obliged to approve any use of a credit card in excess of the credit limit for the contract".

This may result in increased complaints by customers whose over-limit transactions are declined by the credit provider and do not have access to the 10% default buffer. There is also a further risk that customers will assume their credit limits are 10% more than as stated.

Furthermore, the entrenchment of the default buffer in the Bill and the supplementary buffer operating in addition to the default buffer (see section 133BJ2(B)) do not accord with the election commitment. The election commitment stated that "credit card accounts will not be able to be drawn over their maximum limit unless the consumer specifically agrees to opt-in to the service".

Recommendation 4

The ABA recommends that the provisions related to over-limits are replaced by the following:

1. Customers can opt-in to a hard limit and advise the bank they do not want any over limit transactions approved[7].
2. Customers can opt in to a fee-based over limit transaction service. This option implements the original election commitment that "consumers are not charged over-limit fees unless they specifically agree that their account can go over the limit".

A residual discretion should be retained for banks to make a prudent judgment to allow customers who do not opt-in to options 1 or 2 to go over their credit limit.

The industry recognises that this discretion should apply to transactions that do not exceed 10% above the customer's credit limit. A bank would only allow these transactions where they are satisfied with the credit risk in doing so and in line with responsible lending obligations under the NCCP. This discretionary option would be fee-free and thus be consistent with the election commitment and policy intentions of the Government.

However, this residual discretion can be retained without the need for it to be legislated. Therefore reference to the default buffer (including the 10% threshold) should be removed from the Bill and replaced with options 1 and 2. This would allow current business practices to continue responsibly[8].

Finally, the legislation should reflect the proposition that any over-limit service is at the discretion of the credit provider in relation to transactions being approved, whether the over-limit service applies to a particular credit card contract and whether the facility is provided to its customer base at all.

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[7] However, there are some transactions that cannot be blocked because they might occur off-line or are the result of a contactless card transaction therefore these need to be expressly carved out in the regulations.

[8] Historically, banks have exercised their discretion to allow a customer to go over their credit limit provided the bank is satisfied with the credit risk in doing so.

2.3 30B Regulations about credit card contracts

2.3.1 Regulation making powers

Recommendation

A large proportion of the detail of the Bill has been conferred to regulation making powers and a number of other reforms associated with the Bill are to be dealt with entirely by regulations e.g. interest charges and minimum monthly repayment warnings. Therefore, the Bill should not be passed until the regulations are finalised.

2.3.2 Interest charges

Issue

Section 30B is designed to allow the regulations to make provisions in relation to how industry charges interest under a credit card contract.

Concerns

The regulation making power in section 30B for how interest is to be charged is extremely broad (it covers both credit card contracts and other documents or advertisements) and allows for significant government intervention. The ABA submits that this section needs to be removed or substantially re-drafted so that this regulation making power cannot be used irresponsibly to implement price controls.

Currently, the provision regulates the product as distinct from information about the product. Provisions related to the introduction of a prescriptive and standard methodology for the calculation of interest charges on credit card balances should be removed and replaced with a requirement for credit providers to disclose the method they use to charge interest to consumers. The method could be included in the terms and conditions of the credit card contract.

A disclosure requirement would provide better information to the customer about the methodology for charging interest (aiding product comparability) rather than prescriptively mandating an industry agreed standard methodology which could result in undue compliance costs, substantial systems and procedural changes and a potential loss of revenue.

It is noted that a similar proposal for interest calculation standardisation was put forward in the United Kingdom several years ago; however, this was rejected on the basis that such a scheme was too complex to implement, served no significant benefit to consumers and could prevent card issuers from offering products which met different consumer needs, as well as reducing product innovation[9]. Instead, the United Kingdom established a "Fuelwatch" style website to allow consumers to compare credit card products[10]. It should be noted that

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[9] See http://www.oft.gov.uk/OFTwork/markets-work/super-complaints/card

[10] See http://www.moneymadeclear.org.uk/

customers in Australia can already compare different credit card offerings for free on sites such as Cannex.

Recommendation 5

Remove 30B(1)(a) relating to a standard or prescriptive methodology for charging interest and replace it with an information disclosure requirement.

2.4 Penalties

Issue

The disproportionate nature of penalties and the cumulative effect of penalties that may apply to the one event.

Concerns

The ABA notes that the draft Bill contains extremely serious offences for breaches, for example, strict liability offences relating to over-limits, CLIs, and KFSs. The ABA questions the rationale behind this approach, and necessity of including strict liability offences which relate broadly to administrative functions.

For example, section 133AC states that a credit provider's website must provide the capacity to generate KFSs on standard home loans. Consequently, it would be a breach of section 133AC(2) if a licensee has a website, and does not provide capacity to generate a KFS that contains all the stated requirements. Therefore, if the tool fails, licensees would effectively need to shut down their entire website in order to avoid the penalties under section 133AC(3) and the strict liability offence contained in section (4).

The ABA notes that the Government has previously commenced a review of sanctions in corporate law with a view to revising certain provisions and removing disincentives for the implementation of best practices[11]. We consider that the introduction of strict liability offences is contradictory to the intent of this review.

Furthermore, it is not clear whether the civil, criminal and strict liability penalties operate separately or cumulatively[12] or the level at which liability operates. For example, a branch staff member could be personally liable for filling out a KFS form incorrectly under the Bill's home loans KFS provisions.

Recommendation 7

The necessity for strict and criminal liability needs to be re-examined. The ABA submits that at a minimum, the removal of strict liability offences should be effected through legislative amendment.

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[11] http://www.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf

[12] If a bank breached s133AC it would be liable for a civil penalty of 2 000 penalty units ($220 000), a criminal offence with a criminal penalty of 50 penalty units ($550) and a strict liability criminal offence with a criminal penalty of 10 penalty units ($220).

Recommendation 8

The legislation should explicitly state that the penalties operate separately rather than cumulatively.

2.5 Division 2 – Key Fact Sheets for Standard Home Loans

2.5.1 Commencement date

Issue

The Commencement date for standard home loans KFSs is established in the draft Bill as 1 September 2011.

Concerns

The ABA submits that 1 September 2011 is an unattainable time period for banks to develop and implement home loans KFSs, particularly in light of the fact that the final regulations may only be available at the end of June 2011.

The current commencement date of 1 September 2011 means that banks would have only three (3) months from 1 June 2011 to implement provisions on home loans. The industry is likely to require at least 12 months from the finalisation of the regulations to implement KFS provisions.

It is important to note that a number of banks and other credit providers are still making permanent technology changes to replace manual workarounds to ensure ongoing compliance with new consumer credit laws (Phase 1) and conducting development and preparation projects for additional changes (Phase 2).

Unfortunately, the provisions on KFSs and the proposed commencement date would have a significant impact on existing systems and processes and present substantial compliance risks for providers. Details on the practicalities of implementation and associated requirements were previously provided to Treasury. For example, the KFS is intended to be a customer specific document and banks will therefore need to undertake a considerable amount of work to build processes and systems that will generate a document that meets the proposed legislative provisions. The provision of pro-forma documentation will not reduce the substantial changes required.

Significant time is required by the industry in order to: develop new systems, implement systems changes, implement procedural and administrative changes, provide extensive staff training, undertake reviews on relevant areas of the bank e.g. legal, product and marketing. These requirements are further complicated by the number of distribution channels that may be impacted, the number of planned technology releases/changes per year and the complexity of the information to be provided.

The ABA believes that a commitment by the Government to fast track legislation does not necessitate a rushed commencement date. A decreased timeframe for implementation will only lead to increased business costs, increased risks of non compliance and the risk of unsatisfactory results for consumers.

Retaining the September 2011 commencement date could therefore result in widespread non-compliance or numerous cases where error has occurred because of a rushed implementation period. This would arise because banks will be forced to implement high risk manual workarounds or alternatively to seek relief from ASIC which will be time consuming and a significant burden on ASIC. Neither of these options are preferable to the option of setting an appropriate commencement date that reduces both business uncertainty and compliance costs.

Additionally, an appropriate transitional time period is necessary in light of the severe civil and criminal penalties (and in some cases strict liability) imposed on credit providers.

Recommendation 9

A commencement date should be at least 12 months after the Bill has been enacted and the final regulations have been Gazetted.

2.5.2 Personalisation

Issue

The Government's intention is for a personalised, customer specific KFS to be available for consumers.

Concerns

Personalisation of the KFS raises a number of concerns in relation to consumer expectations and perceptions and the potential for the KFS to mislead the customers, thereby resulting in increased customer complaints.

Personalising the KFS conveys the impression to a consumer that the amount stated in 'loan amount' is the amount a credit provider is prepared to loan the person, as the loan amount informs the other details of the KFS. Even with an appropriate disclaimer, the personalised KFS is likely to be taken by the consumer as a representation akin to a quote, another indicative offer of credit, or some form of commitment by the bank to offer a home loan on the terms set out in the KFS.

In reality, this form of commitment from the bank is not possible because at the point in time when a KFS is provided to a consumer, the consumer's credit worthiness, financial situation and objectives and requirements have not been assessed in compliance with the bank's responsible lending obligations. In addition, the KFS, when listing product features, does not take into account the suitability of the product to the consumer.

It is therefore a distinct possibility that, based on the timing of the provision of the personalised KFS, the KFS may be inconsistent with the responsible lending requirements of the NCCP which require credit providers to assess the customer's situation and suitability of the loan prior to recommending any particular product.

Furthermore, at the time the KFS is provided there is no certainty around key aspects included in the KFS such as loan amount, pricing, Loan to Value Ratio, fees and charges and repayments. In spite of the inaccurate and incomplete information, it is as a result of the personalisation of the KFS that the consumer is likely to misunderstand what the intended purpose of the KFS is.

Even if a disclaimer is included in the KFS consumers may still view the KFS as being comprehensive, accurate and akin to a quote or an indicative proposal, as it is addressed to the individual consumer, and based on their individual circumstances i.e. based on the information they have provided. In reality the generation of the KFS will not be rigorous, comprehensive or accurate enough to be relied upon by the consumer as it is based on a subset of relevant information and/or unverified information provided by the consumer which may be incorrect.

The ABA emphasises that unreliable and incomplete information used to generate the KFS means that the KFS does not represent the true cost of a credit contract. This could lead to poor decision making by customers, as under the Government's proposal, customers will use the KFS to help them decide which standard home loans loan product to choose.

The KFS supposedly facilitates greater consumer understanding and effective and efficient comparability, when in reality the comparability may be less effective, more confusing and misleading than if a consumer utilised the mortgage repayment calculators currently available on banks' websites.

The ABA therefore questions the reasoning behind personalising the KFS and providing a costly and highly detailed form of information to a consumer at points in time when the KFS may end up being impractical, irrelevant and incorrect.

Recommendation 10 – Non personalisation

The ABA submits that it would be preferable for the KFS to be non-personalised and the required information to be simplified in order to clearly suggest to a consumer that it is indicative and a rough guide to facilitate simple and rudimentary comparisons.

For example, the KFS could include indicative repayments based on a sliding scale of loan amounts. Further and more detailed information could then be sought through discussions with the credit provider. This proposal would effectively achieve the original policy intent i.e. facilitating the ability of consumers to effectively 'shop around' whilst removing the risk of complicated, confusing and potentially misleading information being provided to consumers.

Recommendation 11 – Removal of liability via the legislation

If the requirement of personalisation is retained the ABA submits that in addition to any disclaimer on the KFS, the legislation should provide protection to the issuer of the KFS from any liability as a result of a consumer's interpretation of the document as an offer, commitment, intention or other representation that the bank is prepared to grant a facility on the terms included in the KFS.

3. Conclusion

The ABA submits that the outstanding issues related to the drafting of the Bill, and associated regulation making powers, require various legislative amendments. These amendments are necessary in order to ensure that the Government's policy objectives are met and that the risk of unintended consequences and unsatisfactory results for consumers are avoided and that administrative and compliance costs to business are reduced.

Yours sincerely

Steven Münchenberg