SUPPLEMENTARY SUBMISSION

TO THE

SENATE ECONOMICS LEGISLATION COMMITTEE

PRODUCT INTERVENTION POWERS BILL

Provided at the request of Senator Jane Hume, by Phillip Smiles, in his capacity as a witness before the Committee on Wednesday 31 October 2018, in Melbourne.

Finance Industry Delegation

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SUPPLEMENTARY SUBMISSION:

TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BILL 2018

Introduction

In his evidence before the Committee on Wednesday 31 October 2018, Phillip Smiles provided six relevant brief comments, which support the information included in this invited supplementary submission.

The substantive content of this invited supplementary submission supports specific amendments to the National Consumer Credit Protection Act (NCCP) and Regulations and the Product Intervention Powers Bill 2018.

We list the six comments, inclusive of some further detail, to place the requested legislative amendments and additions in context.

Comments 1-5

1. That the very wide opportunities for ASIC to impose Product Intervention Orders, proposed in the Bill, would be a major contribution of arbitrary uncertainty in regard to what constitutes compliant lending behaviour and business models, and what is required for non-bank lenders. This is particularly so for those lending Small Amount Credit Contracts (SACCs) and Medium Amount Credit Contracts (MACCs), where certainty would be better provided with appropriate amendments to the National Consumer Credit Protection Act 2009 and its Schedule 1, the National Credit Code, and the National Consumer Credit Protection Regulations 2010.

2. That non-bank lending - typically loans $300 to $30,000 and, in the National Credit Code called SACCs (up to 1 year, up to $2,000); MACCs (up to 2 years, up to $5,000) and All Other Credit Contracts (over 2 years, over $5,000) - called AOCCs by the industry sector - have been “tacked on” to the proposed Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.

   That means they were not the subject of, or included in, the inquiries and reviews that led to the push for the legislation.

   It was only when the legislation was drafted that it became somewhat clear that this sector of the finance industry, represented by the Finance Industry Delegation, the Financiers Association of Australia and one other representative entity, was included in the draft Bill. That is what makes the Committee’s review so important for this sector.

3. That neither the Federal Court, ASIC and its enabling legislation, nor the Commonwealth Constitution recognise ASIC as having law making powers. All recognise that this is a function of the Commonwealth Parliament. However, the complete discretion offered to ASIC in the proposed legislation - largely without any right of appeal - would allow ASIC to ignore the National Consumer Credit Protection Act 2009 and associated Regulations and effectively create its own laws concerning products, with the issuing of an Intervention Order manifesting the new law, and not even subject to Ministerial approval.

   In this context, it may be relevant for the Committee to note that the National Consumer Credit Protection Act 2009, including its Schedule 1 (which is the National Credit Code) is highly prescriptive as to what constitutes compliant lending.

   Section 17 clearly outlines what must be in a credit contract, and Divisions 3, 4 and 4A clearly specify permitted ascertainable fees and interest rate/annual cost rate caps, together with their calculation. Similarly the Act itself, at Division 3, Part 3-2, is very prescriptive in relation to all matter of things associated with responsible lending and the actual issuing of a credit contract to a consumer.

There is no gaping void in the regulation of non-bank lending that ASIC needs to fill with the exercise of highly subjective and uncertain powers, as proffered in the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.

Pincus J, in *Gauntett v Repatriation Commission* (1991) 32 FCR 73, at 77, by analogy said that, what is applicable, "*…is the constitutional function of Parliament, and not that of judges, to correct any anomalies thought to arise from applying the plain language of legislation*".

In its media release 15-165MR, dated Tuesday 30 June 2015 and entitled "*Decision in Teleloans and Finance & Loans Direct civil action*", ASIC acknowledged this and accepted that its role was to enforce law made by the Parliament. In part, the release stated -

"*In its judgement, the court noted that it was a matter for Parliament to modify any anomalies that might arise from the meaning of the plain language of the legislation. ASIC reminds lenders that the language of the National Credit Act has been changed. Fees and charges imposed by lenders will now be assessed by ASIC against the new wording.*

In particular, on 13 June 2014, Reg 50A of the National Consumer Credit Protection Regulations 2010 commenced which clarified the fees and charges that must be included for the purposes of the s6 exemption in the National Credit Code".

The proposed legislation effectively gives ASIC law making powers that sit uncomfortably with ASIC's own recognition of its role, which is included in the first pages of every one of ASIC's Regulatory Guides. With little variation since 2010 and between guides, the words include:

"*Regulatory guides give guidance to regulated entities by: …explaining how ASIC interprets the law...*" (Note - <u>not creates</u> the law), and

"*This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the credit legislation and other applicable laws apply to you, as it is your responsibility to determine your obligations*".

Note: ASIC is not prepared to give definitive advice and presumes advice on certainty of compliance can be sought from professional advisers - not ASIC. ASIC considers itself capable of creating definitive law, but in circumstances where the professional adviser will have no idea what ASIC thinks before ASIC strikes and the client victim faces a Product Intervention Order - for a product that has never before been considered illegal and which is otherwise compliant with all relevant credit law.

4. After 8 years of operation under the National Consumer Credit Protection Act (and National Credit Code) commencing July 2010, and 5 years of operation under the additions to the National Credit Code introduced by the (Enhancements) Act, commencing July 2013, there has been plenty of time and effort available to identify the loopholes and inadequacies of the credit legislation in regard to non-bank lenders.

This identification involves relatively few opportunities to create adverse conditions for consumers that could be addressed by product intervention. All can be easily addressed by simple amendment or omission in the current credit legislation. This can and would avoid any necessity for all the ugly regulatory features identified in the Finance Industry Delegation's initial submission to the Committee.

There is no need for ASIC to be given highly dictatorial and subjective law making powers in regard to non-bank lending. There is no need to invite a High Court challenge as to whether or not the proposed intervention powers are ultra vires the Commonwealth Constitution, or otherwise in conflict with provisions in the ASIC Act.

This supplementary submission expands the brief comments made in evidence before the Committee by Phillip Smiles and, in more detail, provides comment on the relatively few areas that require Parliamentary amendment attention to the National Consumer Credit Protection Act 2009 (including the National Credit Code) and the National Consumer Credit Protection Regulations 2010.

5. The Finance Industry Delegation seeks amendment to existing credit legislation, to establish certainty and a level commercial and regulatory playing field -

   (a) not the uncertainty of ASIC power that may be exercised at the whim of ASIC against a particular lender, while ignoring others with the same business model; and

   (b) not the opportunity for ASIC to continue what appears to be a policy of one law for the big companies and another for the smaller companies. This we allege has been evidenced with ASIC's treatment, to date, of Cash Converters - as opposed to Fast Access Finance and Channic.

   Cash Converters was ignored by ASIC, or was subject to an Enforceable Undertaking, without giving any attention to the personal liability of company directors or key persons, while the two smaller companies faced punitive prosecution that dragged out over 2 years, including personal prosecution of the principals. This followed up to 2 years of investigation, with both companies sent into receivership and one principal sent into bankruptcy.

   The cost to the taxpayer, particularly in the prosecution of the Channic case, is another concerning issue. The Delegation does not have confidence that, as lawmaker, judge and jury, ASIC will be diligent in the cost effectiveness of its enforcement.

Areas for amendment

In response to the request for detail from the Committee Chair, the Finance Industry Delegation has identified the following as appropriate for the Parliament’s attention.

Please note that the Finance Industry Delegation does not make any allegation that the identified companies have acted or are acting illegally, only that the various companies’ interpretation of the existing law and compliant practice appears at variance to the views of the majority of lenders in the industry sector and their compliance advisers.

The Finance Industry Delegation seeks only to establish a level commercial and compliance playing field that is certain. To do this, Finance Industry Delegation supporters seek clarification of the law, with appropriate regulatory drafting attention.

It is the Delegation’s view that only the following legislative and regulatory sections, which have been evident at some stage over the last 5 years, need specific attention and the circumstances outlined should not be left to arbitrary chance - according to the whim of an ASIC officer. The Delegation is aware that all the lending models listed below have attracted substantial criticism from consumer advocates.

<u>Regulation 50A and associated National Credit Code sections</u>

As indicated in the quotation from the ASIC media release noted above, this regulation was introduced after the Federal Court decision in the Teleloans Case.

In a judgement universally condemned as wrong by the industry sector, the Court was not prepared to accept that, in facilitating loans, Teleloans was acting as a broker and that, under existing legislation, any fee charged for such services had to be included in the 20% permitted establishment fee for SACCs, or the 48% annual cost rate (now generally referred to as interest) cap for all other loans. These as provided in Sections 31A, 32A and 32B of the National Credit Code.

In the alternative, the Court was not prepared to accept that a payment from Teleloans to a closely related credit provider, however calculated or described, was a potential breach of the Section 6(1) exemption from the Code that, as one part, depends on fees not exceeding 5% of the amount of credit.

The judge appeared to accept that the use of different terminology to “brokerage” (as it has been referred to for 400 years), or “credit assistance provider” (as the 2010 credit legislation refers to it), and the labelling of payments between Teleloans and the lender as “*consultation and business advice*” and “*consultation regarding systems, legislation and regulations*” was of significance and to be taken literally.

This provided Teleloans with an opportunity to charge relatively substantial amounts for its “*fee for service*” and the company was acknowledged as a “helper”, not a broker, without any credit connection to the lender, Finance & Loans Direct. This despite the causal connection between Teleloans and Finance & Loans Direct associated with the provision of credit.

Despite the resulting additional regulation, Teleloans appears to have changed its trading name to Cigno and appears to continue to trade using the same or a similar model.

With this in mind, it would appear some strengthening of the regulation might assist ASIC to revisit the business model and do what the judge was not prepared to do, but what many in the industry sector think appropriate - and what consumers deserve.

The necessary amendments must address:

(a) That a fee entitled a “*financial supply fee*” can be deemed a credit assistance provider fee and the test is the function performed - not the name given to the billing in an invoice.

(b) That Sections 32B(3) be amended to clarify that any fee paid to a facilitator (being any third part, whatever called) to facilitate a loan larger than a SACC, from a lender, is included in the calculation of the 48% annual cost rate cap, whether or not paid from the loan arranged, or directly by the consumer to the facilitator.

(c) That Regulation 50A be amended to clarify that any fee paid to a party to facilitate a loan from a lender, whether or not excluded from being paid for from the SACC loan principal, must be included in the calculation of the permitted 20% establishment fee.

    It is suggested that Item 1 in the table included in Regulation 50A might be amended to read -

    “*A fee or charge payable to the credit provider by the debtor or any third party, in connection with or being a prerequisite to the supply of the amount of credit provided under the contract to the debtor*”.

(d) That Section 31A be amended to include any fee, paid to a facilitator, in the amount calculated as the SACC permitted establishment fee (whether or not paid directly by the consumer to the facilitator, or from the loan principal).

The Delegation notes that Section 133CC(3) in the National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017, (Reforms Bill 2017) released as a discussion draft by the Coalition Government (then responsible Minister Kelly O’Dwyer) and introduced into the House of Representatives in late October 2018 by MP Cathy McGowan, goes some way to addressing the issues raised above.

<u>Manipulation of continuing credit contract concept</u>

Albeit in ignorance as to whether or not ASIC has granted some form of exemption, of concern to many in the industry sector, has been Company A’s utilisation of the continuing credit contract provisions in the National Credit Code to facilitate, what appears to be, the charging of a $400 MACC statutory (permitted) fee, in circumstances where it could be considered that a SACC is actually involved, because the approved credit limit may be in excess of $2,001 - but the actual credit advanced is $2,000 or less.

Also in contention are the contract terms that have been declared on the company’s website of 66 and 100 days, and the associated opportunity for consumers to be granted a credit limit, take a partial drawdown, and then redraw up to the credit limit less any principal repaid.

Many in the industry sector have still to be convinced that this model reflects the provisions concerning continuing credit contracts in the Code. The industry view is that, under the definition of a continuing credit contract in Section 204(1) and Section 32B(8) of the National Credit Code, the expectation is that, at any time prior to, the debtor will be able to draw down the amount constituting the difference between the outstanding debt and the agreed credit limit, and that the only other condition is that the debtor will repay the agreed minimum amounts - as implied by Section 32B(b).

Company B has also offered a continuing credit contract that demands full repayment of the amount drawn down before another draw down. To many others in the industry sector, this does not appear to reflect the content of the two provisions relating to continuing credit contracts in the Code. They see such an arrangement as a series of SACCs.

To clarify, it would appear amendments to Regulation 4D and to Sections 204(1) - the definition of a continuing credit contract - are required to avoid what the Finance Industry Delegation regards as pseudo SACCs and MACCs.

This may well be achieved by simply omitting the word "ordinarily" in the Section 204(1) definition of a continuing credit contract, subsection (b), to read -

"*(b) the amount of available credit increases as the amount of credit is reduced, reflecting the amount of the credit limit prescribed in the continuing credit contract*".

It would also be useful to clarify the issues associated with the charging of any fees, while presenting a continuing credit contract model, by including mention of continuing credit contracts in Section 32A(1), to read -

"*(1) A credit provider must not enter into a credit contract or continuing credit contract if the annual cost rate of the contract exceeds 48%*".

Arguably, Sections 323A, 323B and 323C, in Reforms Bill 2017, go some way to addressing the issues of concern in regard to continuing credit contracts.

<u>Companies C and D lending model</u>

The lending model reportedly adopted by Company C and Company D, in which SACC repayments are not all equal, also deserves attention. It may be that this model was designed to extend the term of the contract to capture more 4% permitted monthly fees, as provided for in Section 31A(3) of the Code.

Some Finance Industry Delegation supporters allege that this model could be considered unconscionable. Section 31A(1) could be simply amended, with an addition to prescribe equal loan repayments as a prerequisite for collecting such fees -

"*Collection of ascertainable establishment and monthly permitted fees, plus any government fee, charge or duty payable in relation to the contract, to be paid by way of equal repayment instalments over the contract term*".

Section 133CE in the Reforms Bill 2017 is another approach at attempting to resolve this issue.

<u>Model charging all monthly fees</u>

The lending model adopted by a small group of lenders, advised by the same compliance adviser/solicitor, involving the charging of all the post-early payout permitted 4% monthly fees, is the final lending model adopted at some stage over the last five years that the Finance Industry Delegation considers requires attention and regulatory certainty.

It is considered that a simple re-wording of Section 31A(1)(b) would easily limit the imposition of this charge to only the monthly anniversary dates of when the contract was entered into, where there is still an outstanding balance to be repaid on the loan on that anniversary day.

This could be -

"*(b) a fee or charge (a permitted monthly fee) that is payable on a monthly basis, starting on the day the contract is entered into and concluding on the anniversary date of that day during the final month of the contract term, as originally contracted, or as a result of an early termination, whichever comes first*".

It is noted that this model is prohibited under a proposed new Section 31C in the Reforms Bill 2017.

<u>Section 6(1) exemption provision</u>

There has been exploitation of the exemption provision in Section 6(1) that relates to credit contracts that do not exceed 62 days, fees and charges that do not exceed 5% of the amount of credit and where the maximum interest rate is 24% or less.

This was another issue in the Teleloans Case, but has been referrable to a small number of other lenders since 2013.

The Finance Industry Delegation supports clarification of this exemption:

(a) to eliminate uncertainty such as that created by the Federal Court in the Teleloans Case; and

(b) because ASIC and a number of lenders who have attempted to use the exemption appear to be unable to understand the import of the introductory line -

"*This Code does not apply to the provision of credit if under the contract...*".

This line has frequently been misinterpreted to read, "This Code and therefore the whole of the National Consumer Credit Protection Act does not apply to the provision of credit if under the contract...".

The Delegation reminds the Committee that the National Credit Code is a schedule to the National Consumer Credit Protection Act.

The above misreading has meant lenders have offered credit without Australian Credit Licenses and/or without attention to the prescribed responsible lending requirements and/or consumer disclosure requirements, all contained in the Act but not in the Code.

Very clear presentation that the exemption is <u>limited to the Code</u> and does <u>not</u> include the Act, would be useful for uniform compliance -

"*(1) This Code, being Schedule 1 only and not the other provisions of the National Consumer Credit Protection Act, does not apply to the provision of credit if, under the contract: ...*".

<u>Definition of "credit activity"</u>

Associated with attention to Section 6 of the National Credit Code, and as another issue raised in the Teleloans Case, amendment of the sections that contribute to the definition of a "credit activity" is a major issue in regard to "buy now - pay later" arrangements.

The Finance Industry Delegation considers that such an amendment must offer a broader opportunity to recognise that a credit acquisition "helper", such as Teleloans (now Cigno) and "buy now - pay later" companies such as Afterpay, Zip Money, Certegy, Zip Pay, Oxipay and Latitude, with its card, are actually involved in the provision of credit - no matter how the payment for the facilitation is made, or by whom. These companies are facilitating an arrangement where the consumer "enjoys" a delayed payment arrangement. This is akin to repaying a legislated SACC or MACC loan.

The only difference is that, with Cigno, the borrower has the opportunity to pay Cigno direct for its facilitation services, rather than have the credit provider pay Cigno as a disbursement out of the loan funds borrowed by the consumer. Whereas with the "buy now - pay later" companies and the Lattitude card, the consumer appears to accept an inflated retail price, the retailer pays the effective "interest" to the finance company, being (say) 10% of the retail price, and then the consumer, over 4 payments or so (but under 62 days), pays 100% of the retail price to the financier.

With both models the consumer is hit hard with default fees from the financier if they do not honour their payment obligations - just like a traditional credit provider charges unascertainable fees in such circumstances. Some of the "buy now - pay later" financiers make 40% of their gross income from these default fees.

Section 3 of the National Credit Code requires:

(a) the words "and/or" to replace "or" in sub-section (1);

(b) a subsection (1)(c) -

"*and/or*

one person (a third party) makes a payment to a credit provider, however calculated and regardless of description chosen, as a result of a transaction between the debtor and that third party, to facilitate the provision of credit to that debtor whereas, in the absence of such payment, no provision of credit would occur".

Section 6(2) of the National Credit Code requires another exception to be listed under subsection (2)(c) -

"*(d) a fee or charge payable by a third party to the credit provider associated with facilitating a transaction between the third party and the debtor, which is financed under a repayment arrangement between the debtor and the credit provider*".

To avoid any uncertainty, Section 7 of the National Consumer Credit Protection Act requires an additional subsection -

"*(c) accepts payment in association with a transaction between a third party and a debtor, however calculated or described, and enters into a credit contract with the debtor in association with that transaction*".

Clarification of the presumptions

In the opinion of many critics in the industry sector, Sub-section 131(3A) provisions in the Act, which provide for rebuttable presumptions in regard to a debtor being in default under another SACC, or having two or more other SACCs during the 90 day period prior to applying for a loan - thereby rendering the current loan application unsuitable - requires attention.

The Finance Industry Delegation is conscious of this concern and considers that it is not a matter of rejecting the opportunity to rebut the presumption, but rather there is a requirement for a clear presentation of the evidence that supports rebuttal, to be included in the assessment demanded by Section 132.

To achieve this outcome, it could be useful if the following words were added to the concluding four lines in that Sub-section (i.e., after "*unless the contrary is proved*") -

"*and the evidence for this contrary view is included in the assessment prepared in accordance with Section 132*".

Line of credit (credit card) avoiding SACC consumer protection

Company E has offered a line of credit facilitated by a credit card, charging 47.6% APR (within the prescribed annual cost rate cap). However, the maximum credit offered is $2,000 or less, which delivers a SACC loan principal.

In the interests of establishing a level playing field in the market, the general view in the industry sector is that this model should attract the prescribed SACC consumer protections. It is considered that it would be appropriate to include additions to Section 133BA of the NCCP Act, namely a sub-section 133BA(7) -

"*When a credit card involves a continuing credit limit of $2,000 or less, then the consumer protection provisions relating to Small Amount Credit Contracts, as prescribed in Sections*

124A, 124B, 131(3A), 133CA, 133CB and 133CC, will apply as if the arrangement was a Small Amount Credit Contract".

and a Sub-section 133BA(8) -

"*Where a credit card contract involves a continuing credit limit of $2,000 or less, for a period in excess of 1 year, the credit provider will undertake an assessment in accordance with Chapter 3, Part 3-2, Division 3 of this Act, on the one year anniversary of entering into the contract and on each one year anniversary thereafter, and not more than 28 days prior to each anniversary, as if the debtor had applied for a new credit card contract on the date of the assessment*".

Comment 6

Concerning the opportunity to appeal a Product Intervention Order - as indicated at the Committee hearing, the Finance Industry Delegation is concerned that the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 appears to lack any opportunity for an affected party to appeal an ASIC Product Intervention Order.

This is a fundamental oversight that fails to recognise what Australian administrative law considers essential - the opportunity to appeal on substantive and procedural grounds.

Without this you open the door to tyranny and the possibility of abuse of power.

This is also contrary to applicable analogous provisions in the National Consumer Credit Protection Act 2009. In addition, it involves ASIC being made exempt from the Legislation Act 2003, which considers such matters for all Commonwealth authorities or entities.

The Delegation refers to those relevant sections of the Credit Act in the following request, as precedents for what we are recommending.

We request inclusion of the following concepts:

1. ASIC to provide a statement to the affected party, with the reason/s for the Product Intervention Order [see Sections 85(1) and 301(3)].
2. The content of that statement to include the following -
   (a) ASIC's investigation findings;
   (b) the evidence and other material on which the findings are based;
   (c) other matters ASIC considers appropriate; and
   (d) other matters as the Minister may direct.

   [See Section 250(3)].
3. Distribution of this written statement to be prescribed, involving Ministerial notification and notification of the person/company affected [see Sub-sections 251(1) and (3)].
4. The affected party to have the right to apply to ASIC for a hearing [see Sub-section 279(1)].
5. In the event that the affected party is not satisfied with the outcome of the hearing, the affected party must have the right to appeal to the Administrative Appeals Tribunal [See Section 327].
6. Any variation of the Product Intervention Order by ASIC to be considered a new Order, with the above applying [see Sections 85(2) and 301].

We thank the Committee for the opportunity to submit this supplementary submission and trust that it assists the committee's deliberations.

Finance Industry Delegation

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