Min-it Software

Financiers Association of Australia

Joint Submission –

TREASURY Consultation –

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

15 August 2018

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Background Information

This submission is made on behalf of the Financiers Association of Australia ("FAA") and Min-IT Software clients.

The Financiers Association of Australia ("FAA") and Min-it Software ("Min-IT") welcomes the opportunity to submit this submission on Treasury's consultation on the design, distribution obligations and product intervention powers of financial and credit products.

The FAA, having been established since the 1930's, is an organisation for individuals and companies involved in the fields of finance and credit provision. The FAA's members are either non-ADI credit providers, providing loans up to $5,000 over terms of up to 2 years, mortgage financiers or business financiers.

Aside from the software produced in-house, specifically by or for franchised organisations, Min-IT Software is a leading loan management software supplier to the micro-lending sector of the Australian market. Additionally, it has a number of clients providing motor vehicle finance as well business loans and consumer leases.

The vast majority of Min-IT's clients are not affiliated with any industry association.

Introduction

With the many Treasury consultations requiring submissions that were requested in the latter months of 2017, we must admit to having missed the 2017 draft consultation on this Bill. Thankfully, we now have opportunity to comment on a Bill that is pure Orwellian in nature. As one of our Board members commented, the risk of arbitrary rule at the whim of a few bureaucrats makes it impossible to plan rationally for the future.

We note that the Regulation Impact Statement ("RIS") in the Explanatory Memorandum states at 1.3 that the Financial System Inquiry's Final Report in November 2014 recognised the "shortcomings of the existing disclosure regime" and that the Government accepted its recommendations to introduce "a targeted and principles-based product design and distribution obligation."

We suggest the desire to close much of this activity arose much earlier than this as in 2013, as part of the Regulation Impact Statement to Phase Two of the National Credit Reforms: Addressing Avoidance of the National Consumer Credit Protection Act 2009, it contained similar ideology that addressed anti-avoidance measures such as those proposed in this Bill. Australian Securities and Investments Commission ("ASIC") at that time sought powers to declare anything "a scheme" which amounted to what either the regulator or consumer advocates saw as a non-compliant business model.

Fortunately, the Minister at the time, the Hon Bill Shorten, recognised the argument this was likely to cause confusion and uncertainty and scrapped it but here we go again with ASIC being able to declare anything a financial or credit product.

The current intent

The RIS states the “existing regulatory framework governing financial products relies heavily on disclosure, financial advice and financial literacy. However, disclosure can be ineffective for a number of reasons, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy. Many consumers do not seek advice, and those who do may receive poor-quality advice. Many products are also distributed directly to consumers.” It notes “[s]uch issues contributed to consumer detriment from financial investment failures… agribusiness schemes and unlisted debentures” and the “FSI was also concerned that certain less complex add-on insurance products may not meet the needs of some consumers."

When one looks at these items, they are all generally products offered by entities that are regulated under an AFSL and controlled by ASIC under the Corporations Act. We note, though, the initial use of this legislation would be to regulate the following products:

- Funeral expenses insurance;
- Certain extended warranties that are functionally equivalent to add-on insurance; and
- Certain short-term credit products;

all of which are either currently not regulated under Chapter 7 of the Corporations Act (“CA”) or exempt under the National Consumer Credit Protection Act (“NCCP”).

Whilst we thoroughly welcome the current intent of the Bill and the products it's looking at targeting initially, this is yet another instance of Treasury overly complicating what is already very complex legislation under either the CA or NCCP. Poor drafting exacerbates the problem even further and it leaves the door open to a great deal of unintended consequences for both consumers and businesses alike.

Definition of "significant consumer detriment"

As noted at 2.31 of the Explanatory Memorandum, "significant" is not defined in either the CA or NCCP and its meaning "is intended to take its ordinary meaning in the context of the new provision. Generally, this would require the detriment to be sufficiently great to justify an intervention, having regard to the circumstances of the case and the object of the intervention power ".

The Merriam-Webster dictionary defines the adjective 'significant' [1] as

"1 having meaning; especially: suggestive
a significant glance

2 **a**: having or likely to have influence or effect: important
a significant piece of legislation; also: of a noticeably or measurably large amount
a significant number of layoffs
producing significant profits

b: probably caused by something other than mere chance
statistically significant correlation between vitamin deficiency and disease"

whereas the Oxford Living Dictionaries[2] defines it as being

"1 Sufficiently great or important to be worthy of attention; noteworthy.

[1] Merrian_Webster, 2018. Definition of 'significant'. Available online https://www.merriam-webster.com/dictionary/significant viewed 11 August 2018

[2] English Oxford Living Dictionaries, 2018. Definition of 'significant'. Available online https://en.oxforddictionaries.com/definition/significant viewed 11 August 2018

‘a significant increase in sales’

2 Having a particular meaning; indicative of something.

‘in times of stress her dreams seemed to her especially significant’

2.1 Suggesting a meaning or message that is not explicitly stated.

‘she gave him a significant look’

3 Statistics

Relating to or having significance.

Example sentences

‘The first study fell short of showing a statistically significant benefit.’

‘All of these physiological parameters showed significant differences statistically.’

‘Just as for the acentrics, group and radiation dose were statistically significant predictors.’

‘When we found the effect of sex to be statistically significant we regressed the male and female data separately.’

‘We considered a P value of less than 0.05 to be statistical significant in all comparisons.’ “

The term significant therefore has both qualitative and quantitative meanings that ASIC may apply to get the results it wants.

This leads to total uncertainty as to how the regulator may interpret what constitutes ‘significant consumer detriment’. For example, the consumer advocates have continually claimed that SACC’s cause significant consumer detriment yet they have never once quantified this. We do not dispute there are some borrowers that have or do suffer such detriment at an individual level but that does not mean such detriment is widespread when consideration is taken into account of the number of such contracts are entered into nationally. The

advocates have never once provided any evidence as to who are the 'desperate and vulnerable' and how many are actually affected.

Poor drafting

In this Bill, the definition of a credit product is defined by s.301D (1) (a).

Under s.301D (1), it states that ASIC may order that an entity must not engage in the specified credit activity in relation to the product, either entirely or in accordance with conditions it sees fit to impose if it is satisfied that:

a) in relation to a credit contract, mortgage, guarantee or consumer lease (**credit product**) or a proposed credit product; and
b) the credit product has resulted in, or will or is likely to result in, significant detriment to consumers.

Under s.301D (5), "conduct covered by a product intervention order must be limited to conduct in relation to a consumer."

In our opinion, this is very poor drafting. The definition should be stand-alone and not part of a clause requiring a satisfaction condition. We would also argue it must be sufficiently clear and distinct so as not cause confusion with the somewhat similar definition existing already under s.159 of the Code for "*consumer credit product* ". That definition relates to "any form of facility for the provision of credit (other than under a continuing credit contract) provided to debtors by a credit provider".

The need for far more oversight

Importantly, under s.301D (2), an order under subsection (1) is not a legislative instrument and so there is no requirement or ability for Parliamentary oversight or to challenge it. We regard this as a major issue of concern.

ASIC already has immense powers but doesn't use them. For example, under s.109 of the NCCP, it can override the NCCP's legislative and regulatory requirements for any class of persons, entity, a class of credit activities or credit product but this new Bill goes much further as it seeks powers to regulate products by controlling their distribution and design if they:

i. fall outside of the Code through the use of an exemption under s.6;
ii. are products which are currently unregulated under the CA;
iii. are currently regulated credit products under the Code; or
iv. are currently regulated financial products under the CA;

simply by defining them as "credit products" or "financial products" that cause "significant consumer detriment".

Whilst we do have concerns with some of the products that currently use an exemption under s.6, our primary concerns are with the ongoing credit products that are currently regulated credit products under the Code. There should be no encompassing catch-all provisions such as this Bill seeks to provide that cover credit products by distorting the legislative requirements simply to suit a bureaucratic objective.

Subsidiary legislation has evolved to the point where there's becoming less and less opportunity for stakeholders to effectively challenge the Commonwealth's promulgation of a legislative instrument but when no legislative instrument is required, there's virtually no ability if the powers have been used as delegated.

In our view, any order issued under these provisions should be made by Regulation and be required to have to run the gauntlet of disallowance by the Parliament. If necessary, ASIC officers could be questioned and required to justify its decision.

We see this as extremely important as ASIC would have the power to financially impact any entity offering what it, in its sole discretion, sees fit to regard as a credit product that may or is likely to cause significant consumer detriment by possibly closing its operations down after the issuance of a product intervention order at a day's notice. Depending on how its powers are used, the Bill would effectively provide ASIC with an anti-avoidance tool of its own making or one that could be used to control every individual's financial situation by denying a choice of financier or ability to use a specific financial or credit product.

Equally, given the current ongoing review by the Hon. Michael Sukkar of the proposed Small Amount Credit Contract and Consumer Lease Bill that consumer advocates and the Labor Party have been agitating for passing in the Parliament, it might be possible for ASIC to argue such products do cause significant consumer detriment and act independently of Parliament by the issuance of product intervention orders. The examples given at 2.39 of the RIS on the breadth of possible intervention orders is noticeably silent in this regard. We and most industry participants we have discussed the Bill with would see this as a total abuse of bureaucratic power.

Can ASIC's decision-making ability be relied on?

History has shown ASIC's ability to make the correct decision cannot always assumed to be correct where the Courts have found for the defendants. In regard

to credit products, for example, in *Australian Securities and Investments Commission v Teleloans Pty Ltd [2015] FCA 648*[3]*,* the Federal Court determined a fee charged by Teleloans for loan application services to Small Amount Credit Contract ("SACC's) applicants to Finance & Loans Direct Pty Ltd was not a fee under the credit contract.

The credit contract was deemed to be covered by the short term credit exemption under section 6(1) of the Code rather than being regulated under it. As a result, the Court found in favour of Teleloans, even though we and other specialist credit lawyers thought the Court had made an error in regard to one of its main determinations. ASIC chose not to appeal that decision.

It is important to note Judge Logan's comments in that case at [42][4] where he states:

> "*even though there is no general anti-avoidance provision in either the Act or the Code, s 6(2) of the Code contains some particular anti-avoidance measures. The presence of these would make it difficult to conclude that some more general doctrine ought to be imported. It is to be remembered, too, that the Act and the Code were enacted after Australian Finance Direct and Bahadori. Had Parliament wished further to extend the definition of "contract" or the anti-avoidance measures found in earlier State consumer credit models so as to extend to "helpers", it could have done so*."

The Court was clearly of the opinion that the NCCP or Code should have been amended if it was intended that certain forms of contract were not to be exempt. Notwithstanding these new proposed powers for ASIC to do almost what it wants

[3] . Federal Court of Australia, 2015. Australian Securities and Investments Commission v Teleloans Pty Ltd [2015] FCA 648 (30 June 2015) http://www8.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2015/648.html viewed 09 August 2018.
[4] Ibid 4

under Parliamentary delegated authority, the Court may well feel the same applies because otherwise, why does any exemption in the legislation exist at all? Indeed, one could argue why have the legislation at all?

If ASIC has an issue with the NCCP or Code provisions, then the relevant legislation should be amended accordingly. That means if any of the Code's current s.6 exemptions need removing or amending, or even the definition of what constitutes 'credit' itself under s.3 of the Code, then that would be a far better alternative than the provisions encompassed under this Bill.

Product order limitation

Under s. 301D (4) of the Bill, it specifies that ASIC may not impose on an entity when it issues a product intervention order :

a) that it meet a professional standard, other than a standard prescribed for the person by or under this Act; or
b) a condition that a person who is not required to hold a Australian credit licence become a member of an external dispute resolution scheme.

If ASIC declares a product to be a credit product under the provisions of this Bill, we cannot see why it should not require an entity to hold an ACL and be a member of an external dispute resolution scheme as required for any regulated credit provider. At 2.41 of the RIS, it states this "would not be appropriate". We disagree.

ASIC consultation

Under s. 301F (1) (a), ASIC must consult persons who are reasonably likely to be affected by the proposed order. Furthermore, under s. 301L (3) (b), ASIC must describe the consultation it undertook in relation to the order and publish

this on its website. In the past, we have seen ASIC issue reports based on a limited sample and interpolate its conclusions as likely to apply to all entities engaging in a particular credit activity or providing a specific product. We are of the opinion that ASIC should look at far more than just a few entities.

At 2.49 of the RIS, it states that "ASIC is taken to have complied with the requirement to consult affected parties if it undertakes a public consultation process". We suggest this form of consultation should be the default so that Industry representatives may be consulted and able to make submissions as it is likely a consumer advocate group will have brought the matter to ASIC's attention and the regulator should be seen and act fairly, unbiased and transparently.

Inability to provide legal advice

As the Explanatory Memorandum states at 2.36, a " product's compliance with existing provisions of the law may be relevant to whether it is likely to cause significant consumer detriment. However, a product may cause such detriment even if it complies with all applicable laws. In particular, a product may result in significant detriment to consumers even if a person has complied with all applicable disclosure requirements, and with the person's design and distribution obligations, in relation to the product."

As we stated earlier, ASIC already has the ability to exempt any entity or credit product from compliance with both the NCCP and Code but this proposed legislation gives the regulator unfettered impunity to override it even further and declare anything a credit product or financial product and issue a product

distribution prohibition order that could have an almost instantaneous and disastrous financial effect. This is because a legislative instrument or notifiable instrument commences on the day after the instrument is registered, or on another day provided by the instrument. Depending on how ASIC issues the order, it could last for 18 months or more without any real Parliamentary or judicial oversight. There is no requirement, for example, for the Minister to report to Parliament should ASIC wish to permanently ban a product. The Minister merely has to "give approval". We submit it requires more than a 'rubber-stamping' exercise.

In April, one article[5] states that "[c]lose to 1 million Australians are experiencing mortgage stress with 921,000 households feeling the pressure in December 2017" and this was repeated in an interview on radio station 2GB in July[6] when Chris Kenny interviewed Martin North of Digital Finance Analytics. In the latter interview, North suggested substantial mortgage stress would occur if "the big 4 banks …..increase their standard variable rates by as little as 0.15% over the next few months".

Mortgage stress has been exacerbated in recent months by tightening lending standards that have been largely driven by both ASIC, the Australian Prudential Regulation Authority ("APRA") and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ("Royal Banking

[5] Destroyer Home Loans, 2018. *Mortgage Stress In Australia*, 4 April 2018. Available online https://debtstroyerhomeloans.com.au/mortgage-stress-in-australia/ viewed 12 August 2018.
[6] YouTube, 2018. *Talking Mortgage Stress*, 11 July 2018. Available online https://www.youtube.com/watch?v=Ce2QLe5VDN8&feature=youtu.be viewed 12 August 2018.

Commission"). David Ross writing for News.com.au article[7] states many consumers have become "mortgage prisoners" and are simply unable to refinance their loans as a result. Those who were in interest-only loans that have now been able to refinance into Principal and Interest have been severely caught as the extra repayment amount has eaten into disposable income. There is anecdotal evidence that most consumers are just a few pay cheques away from being homeless and its little wonder that homelessness is on the rise.
With this sort of data, everything from mortgages up to short-term personal loans are fair game for targeting by the regulator under these provisions. With the possible exception of the No Interest Loans offered via Good Shepherd Microfinance, which does not operate as a commercial entity, we are of the opinion no financial or credit product is off limit to possible ASIC action under these proposed powers. This can only lead to total uncertainty as to how the regulator may interpret what constitutes 'significant consumer detriment'.

Under this Bill's widespread provisions, there appears to be no impediment for ASIC to declare what is currently a credit product from being a financial product. If that were to occur, there would be major issues with the duty to act in the consumer's best interest and requirement to provide financial advice. We believe the definition of credit product should explicitly contain wording that makes it clear ASIC cannot declare a credit product to be a financial product.

We have previously mentioned the definition of 'credit product'. In providing legal advice, we would also argue clients and lawyers alike will have difficulty in

7 News.com.au, 2018. Aussie homeowners trapped in 'mortgage prison', July 24 2018. Available online https://www.news.com.au/finance/real-estate/buying/aussie-homeowners-trapped-in-mortgage-prison/news-story/5467fbbdc933cbe18ab9019e81381885 viewed 12 August 2018.

satisfactorily separating the two definitions of 'credit product' and 'consumer credit product'. Even though both apply to consumer products, there is a slight difference in meaning.

One specialist credit lawyer we know of has been advised by a number of potential overseas financial institutions that Australia is now a place they will not invest in. Put simply, these entities feel the law cannot be relied on as everything is open to the determination of the regulator's whim and the alleged safeguards are insufficient to provide any degree of comfort.

For these reasons, we suggest it is likely to become almost impossible for any lawyer to give unequivocal legal advice because no one knows how or when ASIC might declare a credit product as causing significant consumer distress.

Ability to restrict competition and industry viability

The Bill's powers give ASIC the ability to restrict competition, for example, by issuing wholesale product intervention orders to all those offering such products. This may occur by specifying a class of consumer that may obtain such a product and/or the amount of revenue by way of fees, charges and/or interest the credit provider may receive. The factors to be taken into account are those specified under Section 301E (1).

As we said in a previous consultation on *Position and Consultation Paper 7: Strengthening Penalties for Corporate and Financial Sector Misconduct* that related to proposed penalties, we are left with an even more overwhelming opinion that ASIC wants to reduce the number of operators in the industry. These new ASIC powers enable it to restrict competition by either frightening off new

entrants or making it unviable for those already in the industry to provide certain products.

The RIS notes at 2.24 that ASIC seeks to intervene in short-term credit contracts that are currently exempt under s.6 of the Code. In our opinion, s.301E of this Bill should exclude any provision to amend the NCCP for any product currently regulated.

Under s.301E (3), it makes it clear that even if the Code and or NCCP requirement has been met, ASIC can still come along and declare the product a financial or credit product as causing significant consumer detriment. We submit such a decision should not be delegated under a legislative instrument regardless of the good intent that may currently apply.

The uncertainty on being able to rely on a specific exemption or non-regulatory item will kill off any innovation and we do not want to see ASIC using its powers to exempt a specific product or one supplied by a specified entity. This would lead to industry arguing ASIC is employing a degree of favouritism, either specifically or as a result of political pressure.

For example, it should not be forgotten that at least some of the short term credit entities that use the under 62 day short term credit exemption have arisen directly as a result of the Treasurer's fin-tech implementation. Examples of these are AfterPay Holdings Ltd and ZipMoney Ltd, both of which are ASX listed entities and EziPay Pty Ltd. Equally, industry looks at the somewhat bizarre exemption given to Principal Finance Pty Ltd. This credit provider, trading as easyBondpay™, was granted exemption from complying with the Code on 13 October 2015 on condition it enter into a Deed Poll for clients it supplies bonds to

for residential tenancies in South Australia under a credit contract. Under the Deed Poll:

i. the consumer can, by written notice, cancel the residential tenancy bond credit contract at any time without the credit providers consent; and
ii. if the contract is cancelled by any party to the contract, the consumer has no liability to the credit provider for the payment of the bond or any further payment under the contract except for any previously unpaid amounts and/or fees due up to and on the date of cancellation; and
iii. the credit provider has no claim or rights in relation to the bond.

To date, ASIC has chosen not to prosecute a number of large entities but instead used Enforceable Undertakings as its main tool of choice. As a result, the regulator has already been criticized, and is facing further scrutiny, for its inactions with the banks and superannuation trustees at the Royal Banking Commission. Last week, ABC News reporter Peter Ryan stated that the Australian Competition and Consumer Commission ("ACCC") founding chairman, Professor Allan Fels, has "slammed the corporate regulator for being weak and ineffective in fighting bank misconduct[8]". We suggest this could extend to the whole financial sector. If this were to occur, the ACCC would at least have regard to competition and viability which s.301E does not specifically require which is fundamentally missing.

We submit part of this issue has been caused by ASIC itself not requiring any party in the business of providing credit from requiring an Australian Credit Licence. Following the Treasury Credit Industry Working Group meetings that oversaw the implementation of the NCCP, we and many others were of the

[8] ABC News, 2018. *Former ACCC boss calls for ASIC to be stripped of powers over banks, Ryan, P, 2018-08-09.* Available online http://www.abc.net.au/news/2018-08-09/former-accc-boss-alan-fels-slams-asic/10092864 viewed 13 August 2018.

opinion that regardless of whether or not the credit product was regulated under the Code, an Australian Credit Licence ("ACL") was required. ASIC subsequently moved away from this view, no doubt as a means of reducing its administrative burden and ASIC requires only those that provide regulated credit products to hold an ACL. This Bill has the potential to alter that because as noted at .29 of the Explanatory memorandum, the Bill gives ASIC the power to declare anything a financial or credit product that would be subject to these new intervention powers.

Treasury stakeholder consultations and limited time for consultation

We note that the Regulation Impact Statement ("RIS") in the Explanatory Memorandum to this Bill indicates that "Treasury also met with key industry stakeholders and consumer groups as a part of these [earlier] consultation processes."

We certainly know that this organisation wasn't contacted and based on our investigations with other industry representatives, have no knowledge as to whom these key industry stakeholders might be as no one we have approached has said they were contacted. We would be pleased to receive advice of which industry representatives were contacted and why some were not. Treasury set up a Credit Industry Working Group, of which we were members. Despite numerous consultations since that time, such as this one, that will significantly affect the industry, it has not met since the Enhancements Bill was introduced. We consider this to be a gross oversight by Government for its failure to bring together all the organisations that make up that Group.

Equally, we must take exception to the short 18 business day time limit that has been made for this consultation, notwithstanding the earlier ones. Another Treasury consultation paper for the ATO, Designing a modern Australian Business Number system, also created on 20 July does not finish until 31 August. We must ask why the difference? One credit specialist lawyer is firmly of the opinion that the short time period is purely so as to reduce the number of responses. If this is the case, it does not provide for good government and would amount to yet another sham consultation. The time allowed for response simply does not allow for sufficient considered thought to the ramifications possible in respect of any widespread use of these proposed powers. We remain extremely concerned that this Bill gives even greater authority to the ASIC to override Parliament's intent.

Industry needs transparency, clarity and certainty and this Bill provides none of these.