Min-it Software

Financiers Association of Australia

Joint Submission -

National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014

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Foreword

We would like to thank Treasury for this further opportunity to contribute to the discussions on the proposed National Credit Code regulations.

Whilst we agree with the aims and intentions of the proposed Regulations, with the exception of Regulation 4D for the reasons we will cover in detail below, we question the way this is being implemented. In at least one instance, the poor drafting will have unintended consequences for lenders that are not trying to circumvent the specific responsible lending and loan suitability obligations that apply to Small Amount Credit Contracts whilst others appear to be unnecessary and merely add more 'red tape'.

Regulation 4D: Definition - Small Amount Credit Contracts

It is useful to consider why there is even the need for regulation 4D, as the author advised the former Senior Adviser of Treasury's Disclosure and International Unit, Retail Investor Division in a number of emails in May 2013 about the serious implications of the way Treasury was interpreting the Small Amount Credit Contract definition under the Consumer Credit Legislation Amendment (Enhancements) Act 2012 ("Enhancements Act").

In my initial email dated 5 May 2013, I stated that "*having spoken to a number of lawyers and advisers on this matter, [this issue]…is causing us a great deal of anguish and pain*"[1] because of Treasury's insistence that the $2,000 adjusted credit amount limit for this type of credit contract was also the credit limit, even though it excluded fees and charges. We argued, with three specialist credit lawyers in agreement, that this contravened the National Consumer Credit Protection Act's ("NCCP Act") definition requirements.

In that email, it was pointed out that the Enhancements Act inserted definitions, under s.5(1) of the NCCP Act, for both 'short-term credit contracts' and 'small amount credit contracts' ("SACC") and under s.204(1), the definition of a 'medium amount credit contract'. All three definitions include the use of the phrase '***credit limit*** '.

Section 5(1) of the NCCP Act already contains the definition of "*credit limit*" and it "*means the maximum amount of credit that may be provided under the contract*." The author, having an extensive credit management background and having taught the subject in three countries, stated in a further email dated 7 May 2013 that the maximum amount of credit, by definition and in general industry terminology used worldwide, includes any up-front credit fees and charges that are financed under the contract. For this reason, as both I and another representative stated in the earlier Industry Working Group consultation meetings on this matter and in this email that, "*in determining the maximum adjusted credit amount that can be given for a loan to qualify as a small amount credit contract where neither the permitted establishment fee or the permitted monthly fee is paid by the consumer at the time the contract is entered into, the adjusted credit amount* ***can not exceed $1612.90*** *in order for the credit limit not to exceed $2,000*[2]".

Whilst the purpose of the proposed 4D Regulation is to allow ASIC Class Order CO13/818 issued 28 June 2013 to lapse, given there was never any consultation on this matter, we repeat our assertion there is no need for this regulation. It is superfluous, based on:

1. the Supplementary Explanatory Memorandum to the Enhancements Bill[3], as used by the Members of Parliament and Senators in determining whether or not to support the Bill, makes it absolutely plain the $2,000 amount is the **credit limit** and *not the adjusted credit amount* the Minister and Treasury asserted it to be and this is repeated in the Revised Explanatory Memorandum[4]; and
2. our argument that, if Parliament had intended there to be a different definition for a small amount credit contract, it would have amended the s.5 (1) definition from the outset. Parliamentarians and Senators were repeatedly warned by one industry representative, through emails and faxes, prior to the Bill being passed in both Houses that the Enhancements Act did not operate as they thought. As no one tried to pass an amendment on the question of the definition, then it must be assumed that all MPs and Senators fully understood the credit limit issue; and
3. the need to maintain consistency with **every other** loan type where the standard s.5 (1) definition of credit limit is used, i.e., the credit limit is the principal plus all other up-front credit fees and charges financed under the contract.

Furthermore, we would argue that given the NCCP Act and the Code contain all the other definitions, why would anyone even look for a regulation that amended one of main NCCP Act's or Code's definitions for a small amount credit contract? We suggest it is not the norm and is outside of convention. If the definition must be amended, a Regulation is not the way to correct this situation and the NCCP Act itself must be amended.

The new definition introduces yet more new terminology, such as "*first amount of credit*" and "*prescribed amount of the credit limit*", neither of which is defined. These terms are foreign to the finance industry worldwide and Treasury should abandon any attempt to modify the existing definition contained with s.5 (1) for "*credit limit*" whose meaning is plain and fully understood.

As was stated in an email to Treasury dated 13 June 2013[5], "[t]he regulatory fix for SACC's creates a whole new approach and is creating total confusion around the thresholds." As an example, I asked Treasury to consider *"[w]hy would an unsecured loan for 12 months of $2,000 plus the establishment fee and permitted monthly fee (with the total amount of credit being initially supplied equalling $2,480) be regarded as a SACC but a loan of $2,100 with an establishment fee of $380 plus interest not be? Both are for identical amounts of credit*."

This situation would not occur if the credit limit for a SACC was applied in the same manner as to any other contract type. For these reasons, we do not support the implementation of Regulation 4D in its entirety. It should be removed from the draft regulation and request Treasury apply the definition of 'credit limit' to SACC's as we originally requested.

Regulation 50A: Small amount credit contract—fees and charges

Under s.31A of the Code,

"*A small amount credit contract must not impose or provide for fees and charges if the fees and charges are not of the following kind:*

(a) a permitted establishment fee;

*(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;*

(c) a fee or charge that is payable in the event of a default in payment under the contract;

(d) a government fee, charge or duty payable in relation to the contract."

We are concerned with both the intention and the drafting of this regulation.

Based on the Explanatory Notes, the intention is to capture:

1. A fee for providing the credit through a stored value card;
2. A fee or charge for obtaining a membership (however described) which is a prerequisite to the debtor obtaining access to a service to receive funds paid by cheque as cash; and
3. Account keeping fees (however described).

Draft regulation 50A states that for s.6 (1) (b) of the Code,

a) "*credit fees and charges imposed or provided for under a contract are taken to include a fee or charge specified in the following table if the fee or charge is a credit fee or charge within the meaning of section 204 of the Act; and*

b) *the fee or charge is taken to be included whether or not it is payable under the contract*."

Whilst we understand the intent of this regulation, we question if this regulation is really necessary as s.31A is abundantly clear as to what can and can't be charged. With one

exception, any fee or charge, such as the examples given, would normally be included in the types of permitted fees and charges allowed as the contract would have to provide for them. If the fee or charge exceeds the amounts permitted or are prohibited, then the credit provider is in breach of s.31A. The exception we see to this would be where the cheque cashing fee is charged by a credit provider. If this occurs, is the credit provider providing a different financial service? Should the fee be applicable after the contract has been issued and is payable to the credit provider providing a different financial service, then we suggest this needs further discussion before proceeding. The industry was advised Government intended implementing national credit legislation that applied to all credit licence holders but we are seeing markedly different levels of differentiation, based on size or credit contract types that are departing from that standard.

We alert Treasury to these issues:

1. If a “Membership fee” is levied by a credit provider, how is the fee to be taken into account if more than one credit contract is provided to a consumer? The draft wording provides no ability to take into account any pre-paid fee that may have been charged on an earlier contract;
2. Where a fee is provided for under the contract but is unascertainable at the time of execution, being based on an event of default, it would appear the drafting of this regulation would require the credit provider to include it in the permitted establishment fee as an up-front fee due to the wording of Regulation 50A(b). This will not only affect the credit providers that are using the exemption but also those that may apply a fee such as an administration fee to cover further monitoring when the account is in default;

3. If the intent is to capture other fees or charges that are payable to a third party for a service, then any credit provider that provides a cheque rather than cash to a consumer must possibly also include any fee charged by an ADI for a special service request for cashing the cheque. As the ADi's all have different express cheque cashing fees, what amount should be included?;
4. What and where is the definition of an "*ADI account*"?;
5. If the borrower decides to simply deposit the cheque into an ADI account, why should the credit provider be required to take into an account and reduce its profitability for a fee that may never be paid to anyone?

We suggest this is totally unacceptable. The regulation is neither all-encompassing and is poorly drafted. The cheque cashing exception outlined could easily be accomplished in a more defined way by better drafting.

In regard to the application of any account keeping fee as part of the establishment costs, we believe the approach taken is contrary to all other Code requirements in respect of unascertainable fees, regardless of whether or not the fee is charged by the credit provider or a third party and should be removed from the draft regulation.

In any event, however, this regulation does not impact at all on other methods currently being used by some credit providers providing SACC contracts such as those that create contracts that:

a) have just two payments, one due one week after draw down and the other at the end of the 16 month term. The contract is then rescheduled over a far smaller number of

weeks that would have made the contract, if done for the same term and amount as rescheduled, a SACC; and

b) where the payments do not start for months in advance of the draw down date.

Regulation 51: Exempt credit – maximum charges

Whilst we can understand the need for this regulation, we would argue it is also poorly drafted and ill-defined. There are two issues to be dealt with. These are:

1. When is a continuing credit contract closed?; and
2. The problem more correctly lies with a credit provider that provides credit under a continuing credit contract when there is no intention of ever providing further credit under it.

We have always taken the view provided by John Barron, the former Credit Compliance Officer with the Office of Fair Trading, Queensland who believed the contract was closed when the account balance was $0.00 and no further credit was to be provided.

If a credit provider only provides credit under a continuing credit contract but requires the balance to be brought to $0.00 each time before being granted further credit under a separate contract or sub-contract, we suggest this is misleading and deceptive and it is not continuing credit in an accepted sense. ASIC has the power to take action for:

1. misleading and deceptive conduct under s.1041H of the Corporations Act 2001(Cth) and under s.12DA of the ASIC Act 2001 (Cth); and possibly

2. failing to do all things necessary to ensure that they provided the financial services efficiently, honestly under s.912A (1) (a) of the Corporations Act.

We suggest Treasury remove this from the draft regulation pending further discussions with ASIC as to why it believes it is necessary to its enforcement activities and it be re-drafted in consultation with industry and consumer representatives to ensure effectiveness.

Regulation 70AE: Small Amount Credit Contracts - Prescribed persons

We fully support the implementation of this regulation.

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[1] Min-it Software, 05 May 2013. Email to Christian Mikula, Treasury

[2] Min-it Software, 07 May 2013. Email to Christian Mikula. Treasury

[3] Parliament of Australia, 2012. Supplementary Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012, p.13, 1.45 where it states
"*Item 1 of Schedule 3 inserts a definition of short-term credit contract into Schedule 3. A short-term credit contract is defined as being a contract that is not a continuing credit contract, where the credit provider is not an ADI, the credit limit of the contract is $2,000 or less and the term of the contract is 15 days or less*."
Available online
http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4682_ems_b9d82b8b-af71-481c-8975-088be001d298/upload_pdf/370236.pdf;fileType=application%2Fpdf and accessed 03 March 2014
and repeated in Revised Explanatory Memorandum, p.55, 4.13 which states
"*Licensees will be prohibited from providing credit assistance by either suggesting that a consumer apply for, or assisting a consumer to apply for a short-term credit contract (in general terms, a contract where the credit provider is not an ADI, the credit limit of the contract is $2,000 or less and the term of the contract is 15 days or less).*"
Available online
http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr4682_ems_c32e12a9-c183-4f19-80e3-c65d5e591d71%22 and accessed 03 March 2014.

[4] Ibid 1, p.19, Table 1.1: Summary of tiered cap on costs (refer section for Small amount credit contract)

[5] Min-it Software, 13 June 2013. Email to Christian Mikula, Treasury