

11 October 2019

By email: ProductRegulation@treasury.gov.au

Manager, Financial Services Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Madam/Sir

Exposure draft consultation: Corporations Amendment (Design and Distribution Obligations) Regulations 2019

Thank you for the opportunity to comment on the exposure draft *Corporations Amendment (Design and Distribution Obligations) Regulations 2019* (Cth) (**the Regulations**) and explanatory materials.

The following organisations have contributed to and endorsed this submission:

- Consumer Action Law Centre
- Financial Counselling Australia
- Financial Rights Legal Centre
- CHOICE

Details about each contributing organisation are contained in **Appendix 1**.

Our comments relate to: the extension of the design and distribution obligations (**DADOs**) to additional products subject to DADOs (draft regulation 7.8A.03) and products excluded from the DADO regime (draft regulation 7.8A.04). In particular, we support the proposed extension of the DADOs to basic bank accounts. However, we consider that some of the proposed exclusions are unwarranted, particularly those related to small business credit and pawnbroking.

Our organisations strongly support DADOs applying to financial products as defined in the *Australian Securities and Investments Commission Act 2001*, which includes regulated and unregulated credit. This ensures that products that are designed to exploit regulatory loopholes, such as the *National Consumer Credit Protection Act 2009* (national credit laws) exemptions, are captured. In particular, we support BNPL providers being captured by the DADO regime. Regulators must be empowered to encourage a more consumer-centred approach to product design and distribution, particularly given evidence of consumer harm associated with these products.

Our comments are detailed more fully below.

Additional products subject to DADOs

Basic banking products

As stated in our previous submission on the draft regulations, we support extending the DADO regime to basic banking products. Some basic banking products can attract fees that are quite significant for Australians on low-incomes.¹ This was an issue canvassed at length during Round 4 of the Royal Commission into Misconduct in the Banking, Insurance and Financial Services Industry (**the Royal Commission**).²

We note that people in receipt of Centrelink benefits are generally entitled to a fee-free basic bank account, which is often the most suitable account for their circumstances. There are at least 11 banks currently offering these accounts.³ There would be significant benefits to consumers if the DADOs regime applied to basic banking products, as it would make it less likely that people on low incomes would be offered accounts that attracted fees, when instead this group would be eligible for more suitable no or low fee account options.

Similarly, term deposits (another basic banking product) need to be covered by the DADOs, particularly due to previous issues relating to rollovers. This occurred where some banks rolled over the term deposit at an interest rate lower than would have been offered to a new customer. This would avoid a set-and-forget approach being used to keep customers in unsuitable products if there are more suitable or better value deposit products available.

Given there are distinctions between different basic banking products, there are some products that are more suitable for certain classes of consumers than others. As Commissioner Hayne made clear in the Royal Commission, it is important to avoid creating loopholes in the law. Ensuring there is a broad application of the DADO regime including an extension of DADOs to basic banking products is therefore appropriate.

Authorised representatives

We also support the extension of the definition of 'regulated person' to authorised distributors of basic bank accounts, general insurance and bundled consumer credit insurance products. We understand the intention of this regulation is to ensure that such authorised distributors are caught by the regime which would otherwise not be captured due to pre-existing legislative instruments. Given authorised distributors are important actors in the delivery of certain banking and insurance products, it is essential that these people are covered by the regime.

Products excluded from DADOs

Credit provided for business purposes

The draft regulations exclude credit which is provided wholly or predominantly for business purposes from the scope of the DADOs. This creates a risk where sham business loans, which currently avoid consumer credit laws, will also enjoy a carve out from the DADOs. Our organisations regularly see significant avoidance activities where, for example, credit providers advise (and in many cases actively assist) consumers to obtain an ABN, or even set

¹ Senate Economics Legislation Committee, Proof Committee Hansard, *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018*, 31 October 2018, p. 7, available at: https://parlinfo.aph.gov.au/parlInfo/download/committees/commsen/5bd43047-942a-4f53-8121-d4d9059b690b/0000%622-d4d9059b690b/toc_pdf/Economics%20Legislation%20Committee_2018_10_31_6730.pdf;fileType=application%2Fpdf#search=%22committees/commsen/5bd43047-942a-4f53-8121-d4d9059b690b/0000%622.

² For example, Royal Commission into Misconduct in the Banking, Insurance and Financial Services Industry, Hearing Transcript, 6 July 2018, available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/transcripts-2018/transcript-6-july-2018.pdf>.

³ Australian Banking Association, *Affordable Banking*, access 12 November 2018, available at: <https://www.betterbanking.net.au/better-products/affordable-banking/>.

up a company, in order to obtain a business loan rather than a personal loan, thereby avoiding responsible lending and the national credit laws. Again, this creates a loophole that is dangerous and unnecessary.

We also see situations where individuals may have a small business operation and hold an ABN. In such cases, the individuals may seek credit and claim the loan is for 'business purposes' when in fact the loan is in large part for personal use – a car loan for example. Many of these contracts are unsuitable for the clients we speak to. Exempting small business credit from the DADO regime creates a further incentive for lenders to use avoidance tactics given they will have lesser regulatory obligations.

The regulations should not exempt credit provided for business purposes from the DADOs. While the national credit laws may exempt this type of lending from obligations such as the individual-based responsible lending test, the DADOs regime operates at a more general level and is designed to ensure products are suitable for a target market. On that basis, it will not be onerous for small business lenders to comply. Furthermore, small business lenders operate in mass markets and the community expects that credit provided to them will be suitable.

Treasury should remove small business credit from the list of exemptions or alternatively narrow the definition of what does and does not constitute credit provision for business purpose. We propose AFCA's definition of small business be used as a guide, which states a small business has less than 100 employees and should not be exempt.⁴

Business loan case study: Di's Story

Di (not her real name) called through on the NDH in June in relation to a business loan she had obtained from Lender number 1, secured by way of caveat over her home. She instructed us that the funds were required to repay loans that she had obtained from friends and family over the years, as well as medical expenses for her husband, and not for business purposes. She did have vague thoughts she might start a new business in the future but no current intent. She had an existing standard mortgage over her of approximately \$600,000. Neither our client nor her husband were working when she applied for the loan.

With the assistance and encouragement of a broker who introduced her to the lender, she signed a business purpose declaration and with the brokers help and encouragement set up a company entity. The loan was for \$160,000 repayable within 3 months and with an interest rate of 10% per month advanced to the company, and secured by way of personal guarantee by Di over her home. She only received \$80,000 of the loan principal as the 3 months interest of \$48,000 was prepaid from the funds, as well as solicitor and broker fees of \$32,000. The default interest rate on the loan was 15% per month. When she contacted us the loan term had ended and default interest was already accruing. The lender had sent Di a letter of demand for \$209,000 and was threatening to exercise its right to sale of the property.

Case Study Provided by Financial Rights Legal Centre

Removing the exemption for small business credit, would also curb the detriment caused to third party guarantors who may have a business loan secured by their principal place of residence and who receive no direct benefit from

⁴ Australian Financial Complaints Authority, *Information for small business*, <https://www.afca.org.au/what-to-expect/small-business/>

the loan. These guarantors are often a family member who is providing a guarantee as a favour and has no understanding of the risks of the loan.

Pawnbroking

Pawnbrokers should not get a carve out of the DADO regulations on the basis that the regulation of pawnbroking is the responsibility of States and Territories. Pawnbrokers enjoy an unjustified loophole in the national credit laws, despite targeting some of the most marginalised and disadvantaged people in our community.

It is not correct to say that pawnbroking is not a Federal responsibility. While pawn agreements are subject to state-based legislation, pawnbrokers are subject to the unjustness provisions in the National Credit Act. While broader exemptions from Federal law (including the obligation to maintain membership of the Australian Financial Conduct Authority) causes consumer harm, a lack of direct Federal legislation does not mean that pawnbroking should be carved out of the DADO regime.

Our organisations have long argued that the loopholes enjoyed by pawnbrokers should be closed. Ensuring the DADOs apply to pawnbroking will be a positive step to protecting vulnerable consumers who are exploited by pawnbrokers who take advantage of the carve out from responsible lending obligations and other related laws.

In Victoria, there are no caps on the fees that a pawnbroker can charge. When a person pawns an item in exchange for a cash loan, they may end up paying more interest than the total value of the item. We have seen examples of pawnbroking agreements carrying an effective interest rate of between 360% and 420% per annum.⁵ These exorbitant fees are particularly unfair given that the person will lose their pawned item if they miss an interest repayment or cannot repay the loan in full. Items pawned are often low in monetary value but high in sentimental value, such as jewellery and family heirlooms. This keeps people making high interest repayments month after month and extending loans so as not to lose their item.

Pawnbroking case study: Kye's Story

Kye (name changed) is a middle-aged man with significant health issues. His current source of income is the Disability Support Pension.

Since 2015, Kye has entered into 35 pawnbroking contracts with a well-known pawnbroking franchise. 23 of these contracts were entered into during a confined 15-month period.

Under each contract, Kye was required to repay the principal amount loaned to him as well as extremely high monthly interest charges in order to recover the items he had pawned. Kye was able to redeem most of his items, but often had to pay the interest charges for several months in order to keep the items on hold. In some cases, Kye was unable to keep up with the repayments and the items were sold at a substantial profit to the pawnbroker without Kye's knowledge, even though the store's policy said they would notify Kye if this was going to happen. In several other instances, Kye purchased his own items back from the pawnbroker on laybuy at more than double the amount which was originally loaned to him.

In total, Kye has paid the pawnbroker over \$6,000 – more than double the amount originally loaned to him – and lost a number of his items.

⁵ See ABC Radio Melbourne, 'Pawnbrokers charging 420 per cent interest in unregulated industry, 'profiting from misery' say low income earners', 16 July 2015: <https://www.abc.net.au/news/2015-07-16/pawnbrokers-profiting-from-desperation/6622310>.

From the start, the credit extended to Kye under these contracts caused him severe financial hardship and he struggled to keep up with repayments. We are continuing to assist Kye with this matter.

Case Study Provided by Consumer Action Law Centre

Pawnbroking case study: Olive's Story

Olive (name changed) had pawned her car which she had purchased for \$4500 4 months earlier for \$700. Olive contacted us when the car was about to be sold as she was unable to pay back the loan within the 3-month pawn period, she had to pay \$1580.

Olive is Aboriginal, a single mother and subsists on Abstudy and Family Tax Benefit payments. She and her daughter are domestic abuse survivors, in relation to which her ex-partner is now serving a lengthy jail term.

Olive attended the pawn shop with her daughter straight after doing the school pick up. She wanted to borrow \$400 to pay that week's rent; and she was told the minimum she could borrow was \$700, with monthly interest payments of \$220. Olive told them she could not afford that, but was told it was her only option. Feeling she had no choice, and her rent due, Olive agreed, signed the paperwork and handed over her car.

When the pawn expired, Olive was contacted by the pawn shop (who also operate a car dealership) and was told her car had to be sold. By this stage, Olive was homeless (on the waiting list for emergency accommodation) and surviving on the charity of a local church organisation as she struggled to maintain her ongoing rent anyway. Olive offered to pay \$50/fortnight, but this was refused.

Case Study Provided by Financial Rights Legal Centre

Aside from the fact that the unjustifiable loophole in the National Credit laws must be closed, pawnbroking should not be exempt from the DADOs. Including pawnbroking in the DADO regime will ensure pawnbroking credit contracts are more fairly targeted, adequately consider an individual's financial situation and do not extort Australians struggling to make ends meet as is currently the case.

RECOMMENDATION 1. The DADOs regulations should not exempt credit provided for business purposes

RECOMMENDATION 2. The DADOs regulations should not exempt pawnbrokers

Please contact Policy Officer Patrick Sloyan at Consumer Action Law Centre on 03 9670 5088 or at patrick@consumeraction.org.au if you have any questions about this submission.

Yours Sincerely,



Gerard Brody | CEO
CONSUMER ACTION LAW CENTRE



Karen Cox | CEO
FINANCIAL RIGHTS LEGAL CENTRE



Erin Turner | Director – Campaigns and Communications
CHOICE



Fiona Guthrie | CEO
FINANCIAL COUNSELLING AUSTRALIA

Appendix 1

About Consumer Action

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

About Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took close to 25,000 calls for advice or assistance during the 2017/2018 financial year

About Financial Counselling Australia

FCA is the peak body for financial counsellors in Australia. We are the voice for the financial counselling profession and provide support to financial counsellors including by sharing information and providing training and resources. We also advocate on behalf of the clients of financial counsellors for a fairer marketplace.

About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most. To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns

