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## STRENGTHENING PROTECTIONS AGAINST UNFAIR CONTRACT TERMS (UCT)

The Australian Finance Industry Association (AFIA) appreciates the opportunity to provide a submission.

AFIA is a leading advocate for the Australian financial services industry. We support<sup>1</sup> our members to finance Australia's future. We believe that our industry can best support Australia's economy by promoting choice in and access to consumer and business finance, driving competition and innovation in financial services, and supporting greater financial, and therefore social, participation across our community.

AFIA represents over 100 providers of consumer, commercial and wholesale finance across Australia. These banks, finance companies, and fleet and car rental providers, and fintechs provide traditional and more specialised finance to help businesses mobilise working capital, cashflow and investment. They are also at the forefront of financial innovation in consumer finance.

## OUR INTERIM SUBMISSION

AFIA members are currently in the process of implementing seven key regulatory reform programs. These are due to be delivered over the next three weeks. In addition, they are working to limit the impact of the COVID-19 global pandemic on our economy by supporting consumer and business customers impacted by lockdowns, and more generally, ensuring continuing access to credit across our economy.

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<sup>1</sup> [Australian Finance Industry Association \(afia.asn.au\)](http://Australian Finance Industry Association (afia.asn.au))

AFIA is concerned that the finance industry does not have sufficient time to make informed commentary on the proposed changes to the unfair contract terms (UCT) legislation, which will likely have a substantial and material impact. Therefore, we will outline our initial views in this interim submission, while we gather further input and data relevant for the government's deliberations, and we will provide an addendum to this interim submission as soon as possible.

The following summarises our concerns with the proposed changes to the UCT legislation.

### **Some of the proposed changes are likely to have a negative impact on economic recovery**

AFIA notes that at the meeting of the Legislative and Governance Forum on Consumer Affairs held in November 2020<sup>2</sup>, the Ministers agreed that reforms were necessary to provide better protections for consumer and small business customers from unfair contract terms.

AFIA understands the policy principles underpinning the UCT laws to ensure standard form contracts do not impose unreasonable obligations or unreasonably diminish the rights of customers.

Specifically, the UCT laws would deem a contract unfair if:

- it causes a significant imbalance in the parties' rights and obligations arising under the contract, and
- the term is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term, and
- it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

AFIA supports ensuring customers have access and choice in credit as well as adequate protections from potential detriment or harm caused by unfair contract terms. We also support legislative and regulatory reform when it is proportionate and scalable, so changes are targeted to deliver the policy intent, while supporting the offer of financial products, services, and technologies from a range of different providers through a range of different business models.

AFIA supports the policy intent to strengthen and improve certainty with UCT laws, including adoption of recommendation 4.7 of the Financial Services Royal Commission. However, we are concerned that the Legislative and Governance Forum on Consumer Affairs have proposed additional reforms without thorough consideration of the legal and economic implications and the potential for these changes to inadvertently and adversely impact on the availability and cost of credit for all customers.

While we support increasing consumer protections, this should seek to create more optimal conditions for consumers and small businesses, rather than increase costs, limit access and choice, or hinder participation.

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<sup>2</sup> [Joint Communique - 6 November 2020 \(consumer.gov.au\)](#)

### [The rebuttable presumption](#)

The new rebuttable presumption, i.e. terms that have been found to be unfair and are subsequently included in relevant *contracts in the same industry* (emphasis added) seems not to be proportionate and scalable, but more of a 'one size fits all approach' to regulation.

Early indications on the implication of this presumption are members will adjust their internal settings if they become *aware* of potential litigation, *not if it is proven* by a court some years later. The reputational risk and the consequences from recent regulatory reforms<sup>3</sup> mean that members cannot wait until a court makes a final decision. To support this, we note that the recent Federal Court<sup>4</sup> case associated with UCT breaches by the Bank of Queensland took four years for a decision to be finalised.

The outcome of the inclusion of the rebuttable presumption is that it will likely impact the availability and/or cost of consumer and small business lending products as lenders will have to make material changes to their legal and compliance settings, including upfront changes to their contracts and loan documentation, updates to their credit policies, and new training programs for their frontline and customer service staff as well as credit assessment and financial hardship teams.

Additionally, lenders will need to make additional investments in monitoring programs to ensure ongoing assessment of the external landscape to determine if similar providers may be under investigation for UCT breaches.

### [Removal of the contract value threshold](#)

Contract value thresholds have been subject to scrutiny and debate during the development of UCT legislation and have been considered in a many subsequent reviews.

The contract value test is the only test that does not fluctuate in comparison to the number of employees or a turnover. The proposed removal of this threshold will impact lenders who offer products to both retail and wholesale clients and who do not obtain information about a customer's number of employees.

### [The imposition of new penalties](#)

AFIA is not aware of material increased misconduct leading to sufficient detriment or harm to consumers to warrant the introduction of new pecuniary penalties if a person relies or purports to rely on an unfair contract term.

These proposed changes will likely impact on the availability and/or cost of credit across the economy. On the one hand, the increased regulatory and compliance burden may impact on credit availability, with some lenders unable to operate at scale and absorb the increased operational costs. On the other hand, the increased operational costs may impact of the cost of credit, with some lenders passing those costs to customers.

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<sup>3</sup> Reforms such as increased penalties arising from Breach Reporting, implications on Accountable Persons under the Finance Accountability Regime, potential class actions, remediation costs going back several years

<sup>4</sup> [21-215MR Court declares Bank of Queensland used unfair contract terms | ASIC - Australian Securities and Investments Commission](#)

It is concerning that proposed changes are to be implemented at precisely the time when the Federal Government is seeking to expand access to credit to accelerate economic recovery, increase competition and innovation to promote capital efficiency and customer choice, and introduce law reforms to support these outcomes, such as through changes to the credit laws.

### **Recommendation**

AFIA recommends that the proposed changes be halted, and Treasury should convene a roundtable to discuss industry's concerns and the impact the proposed changes may have on the credit market as well as the potential next steps.

As Chair of the Financial Industry Council of Australia (FICA), AFIA would be pleased to assist the Treasury in organising such a roundtable.

### **Proposed changes overlap with some of the current regulatory change programs**

The proposed changes intend to strengthen the remedies and enforcement of the UTC laws by:

- providing courts with the power to impose a pecuniary penalty for a contravention... of an UCT in a standard form contract, in addition to the current ability to declare it 'unfair'
- streamlining the powers of a court to make orders to void, vary or refuse to enforce part or all of a contract (or collateral arrangement)
- making clear a court's power to make orders that apply to any existing consumer or small business standard form contract that contains an UCT that is the same or substantially similar to a term the court has declared to be an unfair contract term
- making clear a court's power to issue injunctions against a respondent with respect to existing or future consumer or small business standard form contracts entered into by a respondent, containing a term that is the same or is substantially the same as a term the court has declared to be an unfair contract term.

The purpose behind such action is to address the imbalance 'due to consumers and small businesses generally lacking the resources and bargaining power to effectively review and negotiate contract terms or challenge their enforcement'<sup>5</sup>.

AFIA is in the process of gathering more information but, in the interim, it seems that the extension of the court's powers is a duplication and overlap of some of the powers that have been given to the financial services regulators (and other bodies) to act if they see similar issues.

The following sections identify these overlaps.

#### [ASIC and APRA](#)

The Product Intervention Power (PIP) allows ASIC to temporarily intervene in a range of ways, including to ban credit products when there is a risk of significant consumer detriment. Just like a court, civil and criminal penalties are applicable to contraventions of the new obligations.

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<sup>5</sup> [Treasury Laws Amendment \(Measures For A Later Sitting\) Bill 2021: Unfair Contract Terms Reforms - Exposure Draft Explanatory Materials](#)

Failure to report a breach under the new breach reporting guidelines<sup>6</sup> is an offence and can also lead to criminal or civil penalties.

ASIC and APRA are co-regulators under the Financial Accountability Regime.<sup>7</sup> As part of this, the regulators will focus on the conduct of financial services providers and can impose significant civil penalties to accountable entities for breaches of their obligations.

### [ACCC](#)

If the Australian Competition and Consumer Commission (ACCC) believes there is a breach of the *Competition and Consumer Act 2010*, they can initiate legal action that can lead to similar penalties as those in the proposed changes to the UCT laws.

### [AFCA](#)

The Australian Financial Complaints Authority (AFCA) investigates complaints from customers about the conduct and actions of financial services providers. They have an explicit focus on fairness, so can address some of the potential information asymmetry outlined as a reason behind the proposed changes to the UCT laws.

### [ASBFEO and Small Business Commissioners](#)

The role of the Australian Small Business and Family Ombudsman (ASBFEO)<sup>8</sup> is to support small businesses and family enterprises to enable them to grow and thrive, including joint work with ASIC<sup>9</sup>. Similarly, Small Business Commissioners across the states can act on behalf of small businesses, for example, in NSW, the *Small Business Commissioner Act 2013* outlines<sup>10</sup> that the Commissioner can investigate allegations of unfair treatment or unfair contracts.

### [Code compliance committees appointed to oversee compliance with industry codes](#)

While not able to issue civil or criminal penalties, the Code Compliance Committees associated with overseeing industry codes, such as AFIA's Online Small Business Lenders Code and AFIA's Buy Now Pay Later have sanctions that can be imposed to address concerns with industry practices.

## **Recommendation**

AFIA recommends that to avoid legal and compliance complexity for financial institutions as well as to avoid legal and regulatory overlap for industry and the financial regulators, a further review should be undertaken to ensure the proposed changes address any legal or regulatory gaps and clarify the circumstances in which a court can intervene.

This approach would be consistent with the Federal Government's approach to ensure legal and regulatory efficiency and effectiveness, including the introduction of the Financial Regulator Assessment Authority.<sup>11</sup>

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<sup>6</sup> [21-235MR ASIC publishes guidance on breach reporting | ASIC - Australian Securities and Investments Commission](#)

<sup>7</sup> [Financial Accountability Regime \(FAR\) | Deloitte Australia | Audit & Assurance](#)

<sup>8</sup> [What we do | Australian Small Business and Family Enterprise Ombudsman \(asbfeo.gov.au\)](#)

<sup>9</sup> [ASIC and ASBFEO hold banks to account on unfair contract terms | Australian Small Business and Family Enterprise Ombudsman](#)

<sup>10</sup> [Our legal powers | Small Business Commissioner \(nsw.gov.au\)](#)

<sup>11</sup> [Inaugural Financial Regulator Assessment Authority members appointed | Treasury Ministers](#)

It would also align with the work of the Australian Government's Deregulation Taskforce<sup>12</sup> as well as reduce the likelihood of a further perpetuation of legal and regulatory 'whack a mole'.

### **The proposed timeline for implementation of the proposed changes is too short, especially given the cumulative impact of regulation on the finance industry**

The finance industry is currently involved in a substantial regulatory reform program, many of which revolve around implementation of the recommendations of the Financial Services Royal Commission. We support these recommendations and their intent to improve conduct and governance practices across the financial services industry and raise consumer protection standards to achieve better customer outcomes.

Furthermore, AFIA believes that the finance industry can best support Australia's economy by promoting choice in and access to consumer and business finance, driving competition and innovation in financial services, and supporting greater financial, and therefore social, participation across our community.

However, AFIA is concerned about the timeline for implementation of the proposed changes to the UCT laws given this cumulative impact of regulation on the finance industry and the ongoing challenges associated with the COVID-19 global pandemic.

Currently, AFIA is engaging with its members and the Federal Government and financial regulators on 40 separate and substantial reforms. Attachment 1 provides a summary of priority reforms for AFIA members. We are undertaking further work to better understand the broader work program of the whole of the financial services industry through FICA and anticipate this number to increase significantly.

### **Recommendation**

AFIA recommends that if the proposed changes to the UCT laws are introduced, the industry must be provided with an implementation timeframe of at least 12 months, preferably 18 months, after the legislation is passed and receives Royal Assent. This approach will allow our members to focus on supporting the national plan for economic recovery post the COVID-19 global pandemic as well as complete the current reform program.

### **CLOSING COMMENTS**

AFIA recognises the proposed changes to the UCT laws aim to address a potential imbalance due to consumers and small businesses generally lacking the resources and bargaining power to effectively review and negotiate contract terms or challenge their enforcement.

AFIA's initial concerns are not intended to reject the policy principle of improving protections that reduce the incidence or potential for detriment or harm.

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<sup>12</sup> [Progressing Australia's Deregulation Agenda | Deregulation \(pmc.gov.au\)](https://www.pmc.gov.au/progressing-australia-s-deregulation-agenda)

However, we are concerned about the substantial and material changes being proposed. In particular:

- new pecuniary penalties
- a new rebuttable presumption
- a broader definition of small businesses in scope and the removal of the contract value threshold
- the implementation timeframe.

The impact of implementing these changes, without evidence substantiating that they will provide additional benefits for consumers and small businesses particularly, is likely to adversely impact on the availability and cost of credit and more generally, activity, which would impede our economic recovery.

Yours sincerely

Diane Tate  
**Chief Executive Officer**

## Treasury

- Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Regulations 2021: breach reporting
- Treasury Laws Amendment (Corporate Insolvency Reforms Consequential) Regulations 2021
- Deferred sales model for add-on insurance – exemptions
- Hawking of financial products – exemptions
- Consumer Data Right – Rule amendments and Future directions
- Enforceability of industry codes
- Regulation of debt management firms
- POS exemption
- Review of the Australian Payments System (Farrell Review)
- Reporting regime for sharing economy platform providers
- Cyber Operational Resilience Intelligence-led Exercises (CORIE) framework
- Proposed Financial Institutions Supervisory Levies for 2021-22

## ATO

Insolvency reforms to support small businesses recovery – implementation of any recommendations

## AFCA

- Independent review of the Australian Financial Complaints Authority (AFCA) – Terms of Reference
- Revision of role in customer remediation
- Determination of fairness principle (Fairness Project)

## DPMC

- Public Governance, Performance and Accountability Act – implementation of any recommendations
- Regulator performance framework – regulator best practice and performance
- 2020 Women's Economic Security Statement – implementation of initiatives including promotion of financial capability and protection of women (financial abuse)
- Deregulation Taskforce – streamlining overlapping regulations, modernising business communications

## Federal Parliament – Bills and Inquiries

- Financial Accountability Regime Bill 2021
- Treasury Laws Amendment (Measures for Consultation) Bill 2021: Compensation Scheme of Last Resort
- Treasury Laws Amendment (Measures for Consultation) Bill 2021: Use of technology for meetings and related amendments
- National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020
- Financial Sector Reform (Hayne Royal Commission Response – Better Advice) Bill 2021
- Security Legislation Amendment (Critical Infrastructure) Bill 2020
- Treasury Laws Amendment (2021 Measures No. 4) Bill 2021
- Spam Regulations 2021
- PJC – Mobile payments and digital wallet financial services
- PJC – Regulation of the use of financial services such as credit cards and digital wallets for online gambling in Australia
- Senate Select Committee – Financial Technology and Regulatory Technology
- Senate Legal and Constitutional Affairs References Committee - Adequacy and efficacy of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime

## Self-Regulation

Reviews and updates of industry codes – AFIA

*Incoming regulation impacting*

## ASIC

- RG 38: Anti-hawking
- RG 183: Enforceable code provisions
- RG 209: Responsible lending conduct
- RG 234 Advertising financial products and services (including credit)
- RG 256: Consumer remediation
- RG 271: Internal Dispute Resolution (IDR)
- RG 273: Mortgage brokers – Best Interests Duty
- RG 274: Product design and distribution obligations (DDO)
- RG 78: Breach reporting and CP 340: Breach reporting and related obligations
- CP 339: Deferred sales model for add-on insurance
- IS 257 ASIC reference checking and information sharing protocol and ASIC Corporations and Credit (Reference Checking and Information Sharing Protocol) Instrument 2021
- REP 672 – BNPL – update
- Product Intervention Power (PIP) – implementation of any recommendations
- ASIC Cost Recovery Implementation Statement 2020-21
- Monitoring financial hardship
- Review of ePayments Code

## RBA

Review of Retail Payments Regulation

## AUSTRAC

- Australia's non-bank lending and financing sector risk assessment 2021 – implementation of any recommendations
- Guidance – Reliance on customer identification and verification, Customer due diligence before providing a designated service, Correspondent banking relationships, Tipping off, Suspicious matters reports – implementation of any recommendations

## DSS

Financial Counsellor Funding Model

## Productivity Commission

- Inquiry into vulnerable supply chains
- Inquiry into small and medium business access to finance

## AGD

- Consultation on financial products and the Personal Property Securities Act
- Review of the bankruptcy system and the impacts of coronavirus

## National Transport Commission

- Heavy vehicle 2021 charges determination

## ACCC

- Customer Data Right (Open Banking) – phase 1 for non-major ADIs (basic banking products), phase 2 for non-major ADIs (home mortgages, lending), phase 3 for non-major ADIs (overdrafts, business finance)
- Inquiry into home loan pricing – implementation of any recommendations
- Amalgamation of payment platforms

## States – Bills and Reforms

- Real Property Amendment (Certificates of Title) Bill 2021 – abolish paper certificates of title (NSW)
- Proposed changes to property tax and stamp duty (NSW)
- Pending changes to CTP insurance premiums (QLD)
- Proposed changes to electric vehicle taxes (SA and VIC)
- Implementation of Building and Construction Industry (Security of Payment) Bill 2021 (WA)
- Implementation of transfer of Queensland Titles Registry to Queensland Future Fund (QLD)
- Implementation of new Digital Driving Licences framework (NSW)

## APRA

- ADI capital reforms package (APS 111 Measurement of capital, APS 110 Capital Adequacy, APS 112 and APS 113 Approaches to Credit Risk Capital)
- APS 115 Capital Adequacy: Standardised measurement approach to operational risk
- APS 117 Interest Rate Risk in the Banking Book
- APS 110 Leverage ratio requirement for ADIs
- Consultations on treatment of loans impacted by COVID-19, revisions to Restricted ADI licensing pathway, ADI preparedness for zero and negative interest rates, proposed changes to reporting requirements, publication of statistics and data, including APRA Connect, remuneration practices, governance, recovery and resolution planning

## ALRC

Review of legislative framework for corporations and financial services regulation

## ARCA

CR Code amendments for hardship reforms

## finance companies in Australia in 2021





11 October 2021

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## **STRENGTHENING PROTECTIONS AGAINST UNFAIR CONTRACT TERMS (UCT) – AFIA SUPPLEMENTARY SUBMISSION**

The Australian Finance Industry Association (AFIA) appreciates the opportunity to provide a supplementary submission on the impact of the proposals to change the Unfair Contract Terms (UCT) legislation. This additional information and data have been provided by our members.

### **OUR SUBMISSION**

AFIA remains concerned about the substantial and material changes being proposed to the UCT legislation, particularly:

- new pecuniary penalties
- a new rebuttable presumption
- a broader definition of small businesses in scope and the removal of the contract value threshold
- the implementation timeframe.

### **Additional costs and time to undertake contract reviews not factored into the Regulation Impact Statement**

Additional member feedback indicates that the compliance burden and costs (outlined in Enhancements to Unfair Contract Term Protections – Decision Regulation Impact Statement (RIS)<sup>1</sup>) may have been underestimated.

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<sup>1</sup> <https://treasury.gov.au/sites/default/files/2020-11/p2020-125938-ris.pdf> at page 77.

This RIS assumed that the industry would incur additional legal costs to meet the proposed expansion of between \$3,000 - \$10,000 per contract. In aggregate, the RIS outlines increased year one compliance costs of \$52 million<sup>2</sup>.

However, AFIA members, which includes small, medium, and large lenders, have indicated that legal costs are more likely to be in the range of \$5,000 to \$50,000, depending on the number of contracts that will need to be reviewed and the complexity of the contract and lending arrangement.

While the RIS did not provide any assumptions on the number of contracts potentially in scope, the upper end assumption of \$10,000 / contract seems to be materially underestimated. Therefore, the estimate of the additional compliance cost of \$52 million in the first year is also substantially underestimated. Without details of how the RIS data was calculated, it is possible that it has been underestimated by potentially a quantum of 5 times.

The RIS also assumes that after the first year, there will be minimal ongoing compliance costs. However, with the introduction of the rebuttal presumption and the 6-year limitation period, our members have advised that they will need to continue to monitor the external environment and seek ongoing legal reviews to ensure compliance frameworks are robust and continue to meet the law. Therefore, a review of standard form contracts will need to be undertaken at least every two to three years. The cost of this ongoing review needs to be built into further analysis.

Due to the COVID-19 global pandemic, there is a substantial shortage of skilled legal professionals, with external lawyers in the financial services industry already fully engaged on various other pieces of regulatory reforms. These labour shortages will result in additional costs and/or delays in the contract review process. Therefore, our members estimate that the timeframe for an external review of standard contracts under the proposed regime will be a minimum of 6-12 months. These process considerations have not been factored into the RIS.

### **Recommendation**

AFIA recommends that further analysis of the direct and indirect impacts of the proposed changes is required to avoid adverse and unintended consequences to access to finance and to fully appreciate the initial and ongoing costs for industry, and therefore, their customers.

### **Wholesale funding market expectations need to be considered**

When considering the extent to which the rebuttal presumption can be applied, the role of wholesale funders, who finance smaller ADIs and non-ADI lenders, is important.

To ensure compliance with wholesale funding documentation, lenders will need to provide certainty to their funders that their contracts will be enforceable. This is important so investor expectations on price, term, and yield of facilities continue to be met. Investors will also inevitably expect changes to their investment covenants as part of these funding arrangements.

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<sup>2</sup> <https://treasury.gov.au/sites/default/files/2020-11/p2020-125938-ris.pdf>.

The current drafting of the rebuttable presumption means that a civil penalty could apply for each breach of a standard form contract for every affected customer. This will impact smaller and specialised lenders in a number of ways, including:

- increase uncertainty for both funders and lenders, due to penalties of up to 10% of turnover for each unfair contract term applying
- likely lead to alternative contractual arrangements needing to be introduced into contracts to manage the uncertainties and liabilities, which would be at odds with attempts by the finance industry to simply and reduce 'lending covenants' in their contracts with small business
- likely lead to lenders having to hold additional capital or raise provisions for contingent litigation, especially as the proposed amendments allow an application for remedies to be made up to six years after a term has been declared an UCT.

As mentioned in our initial submission, this will likely impact on the availability and/or cost of credit across the economy. Importantly, the proposed changes will disproportionately impact smaller and specialised lenders, which will impact competition and innovation in lending markets.

### **Recommendation**

AFIA reiterates our recommendation that, given this additional insight, the proposed changes should be halted. Treasury should convene a roundtable to discuss industry's concerns and the impact the proposed changes may have on the credit market as well as the potential next steps.

### **CLOSING REMARKS**

AFIA understands the policy principles underpinning the UCT laws to ensure standard form contracts do not impose unreasonable obligations or unreasonably diminish the rights of customers.

AFIA supports ensuring customers have access and choice in credit as well as adequate protections from potential detriment or harm caused by unfair contract terms. We also support legislative and regulatory reform when it is proportionate and scalable, so changes are targeted to deliver the policy intent, while supporting the offer of financial products, services, and technologies from a range of different providers through a range of different business models.

However, we remain concerned that the legal and economic implications of the proposed additional reforms to the UCT legislation have not been thoroughly considered, which may inadvertently and adversely impact on the availability and/or cost of credit for all customers.

Kind Regards,

**Diane Tate**  
Chief Executive Officer