1 October 2021

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Joint industry response: Treasury consultation on strengthening protections against unfair contract terms

The Finance Industry Council of Australia (**FICA**) welcomes the opportunity to provide feedback on Treasury's consultation on the Government's exposure draft legislation[1] in relation to strengthening the protections against unfair contract terms (**UCT**) for consumers and small businesses.

FICA brings together the leading financial services industry associations in Australia – Australian Banking Association (ABA), Australian Finance Industry Association (AFIA), Australian Financial Markets Association (AFMA), Australian Securitisation Forum, Customer Owned Banking Association (COBA), Financial Services Council (FSC), and the Insurance Council.

FICA members represent a diverse range of financial services businesses operating across the breadth of Australia's financial services industry. All have an interest in a competitive and innovative financial services industry, which consistently delivers positive outcomes for consumers and supports the Australian economy.

At a macro level, FICA members consider effective and proportionate governance processes with clear accountabilities within industry participants as an important means to achieving those outcomes.

While individual FICA members have provided their own detailed submissions, and these highlight several specific issues relevant to their membership, the purpose of this letter is to outline the key areas of common agreement between FICA members and suggested next steps.

Introduction of civil penalties

By its very nature, a standard form contract is likely to be used for a large number of customers. The proposed introduction of civil penalties gives courts very wide discretion to impose significant punitive measures for each separate contract with customers where the offending term applies. We believe this is disproportionately severe.

[1] Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Unfair contract terms reforms.

Accordingly, we **recommend** that civil penalties be limited to the circumstances specified in section 12BF(2C) of the ASIC Act. This would mean that the civil penalty would be applicable only where the contravening entity "applies or relies on, or purports to apply or rely on" the unfair term.

In addition, we **recommend** that a civil penalty (which is currently set at up to $11 million or 10% of turnover for each unfair contract term for a body corporate[2]) should apply only once for each term in a standard form contract, and not once for each customer holding that contract to avoid the maximum penalty being multiplied by a factor of potentially hundreds of thousands, or even more for a large portfolio.

Flexible remedies – Rebuttable presumption

The draft legislation introduces a rebuttable presumption that terms in a court proceeding will be considered unfair if they are the "same or substantially similar" to a term a court has declared to be an unfair contract term in a previous proceeding. Critically, the presumption applies where the term is part of a contract that is in the "same industry" as the contract that contained the original unfair term.

Both the concepts of "same or substantially similar" and "same industry" are open to overly broad interpretation. Given the volume of contracts and the breadth of providers in the financial services industry, this new inclusion is likely to have a material impact. The impact is heightened given there is little meaningful guidance on how a rebuttable presumption would work in practice and no clarity for industry as to how to correctly identify UCTs that would need to be changed to ensure compliance with other interacting regulations.

We recognise the policy intent of this reform to encourage contract-issuing parties to maintain thorough monitoring and record keeping of their contracts to ensure that unfair terms are removed from, or not included in, standard form contracts. However, we are concerned that the proposed rebuttable presumption would have the effect of casting a very wide net for terms being prima facie unfair and subject to challenge, without due consideration for the use of the term in different circumstances and the interaction of the term with the contract as a whole. In addition, the impact of the proposed rebuttable presumption would be compounded by the wide reaching and severe civil penalties discussed above, making the situation even more concerning for finance industry participants. We do not believe that this is the intended outcome.

In view of the above, we **recommend** that the new regime does not include the proposed rebuttable presumption. Notwithstanding, if the rebuttable presumption were to be introduced, we **recommend** that no civil penalties are attached to this new measure.

Flexible remedies - Injunctions

The draft legislation proposes amendments that would extend a court's existing powers regarding injunctions for unfair contract terms so that it can prevent businesses from including such terms in future contracts. This would mean that any future contract would have to comply irrespective of any future business need.

Businesses tailor products to meet a particular market demand, in line with their own risk appetites. One way of tailoring products is to exclude identified risks. If a risk cannot accurately be priced, then including that risk within the contract may prohibitively raise the cost of the contract, which in turn may result in additional costs for small businesses.

[2] Subject to a maximum of 2.5 million penalty units ($555 million).

We **recommend** that, before issuing an injunctive remedy, the court should be required to consider whether a legitimate business need for relying on the term may arise in future. Furthermore, there should be a clearly defined process to allow businesses to challenge such injunctions.

Existing remedies available under the UCT regime

In our view, the existing consequences on businesses for using UCTs are considerable and are sufficient to incentivise businesses to comply with the UCT regime without strengthening. Under the UCT regime, businesses using "unfair" terms are exposed to reputational damage, substantial legal costs and potential for private actions for damages. We also see areas where the proposed reforms would create a substantial degree of legal and regulatory overlap for industry and financial regulators.

More broadly, the proposed introduction of civil penalties and the breadth of proposed court sanctions raises questions of both affordability and prudential impacts. There are also flow-on implications for prudential standing. Financial services organisations are required to maintain capital adequacy, in accordance with prudential requirements set by APRA. Capital adequacy requirements require consideration of the risk profile of the business. Significant changes to risk profile may impact capital adequacy requirements.

FICA is also concerned 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 as well as increase competition and innovation to promote capital efficiency and customer choice.

Like many other sectors in the Australian economy, the financial services sector is supported by significant amounts of overseas capital, and we are concerned that this could be jeopardised by the proposals.

Given the foregoing, we **recommend** that the penalty and remedy aspects of the UCT regime be reconsidered against the Government's broader objective of supporting Australia's economic recovery, promoting Australia as a financial centre and protecting its historical standing as a safe jurisdiction for foreign investors to do business and invest their capital.

Definition of Small Business and Monetary Value of Contracts

FICA understands the intent of the proposed expansion is to align the definition with AFCA's jurisdiction, however, we wish to highlight that the proposed definition of a 'small business contract' goes beyond this scope. Removing the price threshold and making assessments on an individual entity rather than on a group basis will mean that a borrowing entity may be outside of the AFCA regime (due to its $5 million credit facility jurisdictional limit).

We note our concern that the proposed definition will extend to sophisticated buyers (for example, local subsidiaries of multinational corporations, financial services firms and superannuation trustees) who will effectively become unintended recipients of UCT protections. The proposal exacerbates already-existing discrepancies within Australian law regarding the definition of small business.[3] Conflicting definitions create confusion for industry and create unnecessary complexity for compliance.

We **recommend**, given the scope of these reforms, that further consideration be given to harmonising regulatory definitions of small business.

[3] See, for example, *Australian Securities and Investments Commission Act* s12BC(2), *Corporations Act* s761G(12), *Australian Small Business and Family Enterprise Ombudsman Act* s5.

Transitional provisions

We **recommend** that a transition period of at least 12, preferably 18 months is provided to bed down the current regime which has only this year been extended to insurance contracts. This will allow industry time to undertake deeper consideration of market and prudential impacts, and flow-on effects to certain areas of product affordability.

Further roundtable

Given the potential breadth of these reforms and impact, we request that deeper consideration of the draft legislation be undertaken before Parliamentary introduction. To support this outcome, we **recommend** that Treasury convene a further roundtable with FICA financial services representatives to fully explore these issues of concern.

Thank you for the opportunity to make this submission.

Yours sincerely

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