Banking & Financial Services Law Association

The 26th Annual Banking and Financial Services
Law and Practice Conference

Sheraton Mirage Resort, Gold Coast

31 July -1 August 2009

National Credit Reform Take 3:
The Ascendance of the Commonwealth

Alix Gallo
Head
Consumer Credit Unit
Corporations & Financial Services Division
Commonwealth Treasury
Canberra

ALIX GALLO

MANAGER, CONSUMER CREDIT

CORPORATIONS AND FINANCIAL SERVICES DIVISION

THE TREASURY

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Banking and Financial Services Law & Practice Conference 2009

31 July 2009

Good morning. Today, I have been invited to update you on the work that the Australian Government is doing to reform the national credit laws. In particular, I have been asked to talk about how we developed the law and some of the challenges we faced along the way.

I would like to begin with a brief outline of the key elements of the national credit reform, then talk about how we got there; and where we go from here. Despite the title of this segment of the program, I hope to show you that this reform process has been (and needs to be) essentially a cooperative effort between the Australian Government, industry and consumer groups.

Creating national and consistent consumer credit law

On 25 June, a reform package was introduced into Parliament to modernise Australia's consumer credit laws.

The package will – for the first time – provide for one, standard, nationally consistent regime which applies equally to all credit consumers and all credit providers, right across the country.

The reforms include all consumer credit — mortgages, credit cards, and some r(esidential and margin lending) investment lending to over 5.7 million Australian households. It also covers brokers and credit advisers.

As well as providing consistency and certainty, the new regime will also reduce duplication and the compliance burden for business.

In effect, it will replace up to 2,500 pages of multiple State laws with one national regime.

The reforms follow the decision by the Council of Australian Governments in October 2008 to transfer responsibility for all consumer credit products to the Commonwealth. The agreement is part of COAG's vision for a seamless economy.

The primary legislation, the *National Consumer Credit Protection Bill 2009,* together with two ancillary bills – covering the *National Consumer Credit Protection (Transitional and Consequential Provisions) Bill*, and the *National Consumer Credit Protection (Fees) Bill*, will introduce two new elements into the consumer credit landscape.

These are a comprehensive national licensing regime enforced by a single regulator, and responsible lending requirements.

National licensing regime

Under the new regime, all lenders and providers of consumer credit broking services, including intermediaries, will be required to obtain an Australian Credit Licence from the national regulator, ASIC, which will have significantly boosted enforcement powers.

Industry participants will need to be registered or licensed if they:

- provide credit or consumer leases;
- collect money due under a credit contract or a consumer lease;
- exercise rights as a mortgagee or the beneficiary of a guarantee;
- act as an intermediary between the borrower and the lender. This principally covers finance brokers, however the definition also covers bodies such as mortgage managers and aggregators; or
- suggest or provide assistance in respect of a specific credit contract or lease with a particular credit provider.

To help industry adjust to the new regime, there will be a transitional phase.

The licensing process will start on 1 January 2010. Before that date, anyone engaging in credit activities will need to be registered with ASIC, and must apply for registration between 1November 2009 and 31 December 2009.

They will then have the six-month period between 1 January 2010 and 30 June 2010 to apply for an Australian Credit Licence.

Anyone who engages in credit activities for the first time on or after 1 January 2010 must apply for, and receive, an Australian credit licence before starting business.

To qualify for an Australian Credit Licence, lenders must meet minimum training requirements and have adequate financial and human resources to meet their obligations.

Licensees must also meet enhanced standards of conduct including the requirement to act honestly, efficiently and fairly. They must also properly train and supervise people who act on their behalf.

As well, licensees must be members of an external dispute resolution scheme. This means that, for the first time, consumers will be able to resolve consumer credit disputes outside the court system at no cost.

ASIC will be given the power to take action promptly to cancel or suspend a licence, or to ban people from engaging in credit activities.

A national licensing scheme means that a person who is banned or loses their licence or registration will be excluded Australia-wide. Currently, there is nothing to prevent a person banned in one State or Territory from continuing to operate as a broker or lender simply by moving to a different jurisdiction.

Authorised Deposit-taking Institutions can be streamlined to a licence because we are confident that these institutions already satisfy the entry requirements.

Responsible lending obligations

The Government is also providing an enhanced level of consumer protection by requiring all brokers and lenders to play their part in lending responsibly.

The National Consumer Credit Protection Act will establish new responsible lending conduct requirements.

When offering any form of consumer credit, lenders and other financial advisers such as finance brokers, will be required to do two key things.

First, they must assess that the loan is not unsuitable for the consumer. And secondly, they must assess whether they reasonably believe the consumer would have the capacity to repay the loan. In making this assessment, they will need to make reasonable inquiries and verify the details provided to them.

All consumers applying for credit will be provided with a Credit Guide which will inform them of key information early in the process of a credit-related transaction. It is important that the consumer knows who they are dealing with, that the credit provider is licensed — and has therefore met the stringent entry requirements of participating in the credit market — and also has early advice of any fees and costs.

As part of the responsible lending requirements, licensees will also have to let consumers know, upfront, what fees and charges they will need to pay before the loan is suggested or entered into. As well, lenders and brokers will need to disclose general information about fees and commissions, complaints resolution - and information considered helpful to inform consumer choice. These provisions will help consumers to make better informed choices.

New mandatory dispute resolution mechanism

The new regime will introduce for the first time, a mandatory industry-wide three-tier dispute resolution system for consumer credit issues, making it easier and less costly for consumers to resolve disputes.

The three-tier system will give consumers access to:

- the licensee's internal dispute resolution process;
- an ASIC-approved external dispute resolution scheme; and
- the Federal Court, Federal Magistrates Court and the courts of the States and Territories (including the Magistrates or local Courts).

Lenders, brokers and other credit service providers will be required to provide consumers with access to both internal and external dispute resolution.

What is new however, is that consumer access to the courts has been enhanced via a new "opt-in" streamlined procedure for hardship matters, and compensation claims for loss or damage up to $40,000.

The "opt-in" streamlined procedure will provide consumers with informal court proceedings where legal forms and technicalities do not have to be observed and legal representation is not required.

This is a robust system designed to provide consumers with access to justice. In developing the model, we took care to ensure continuity with the current arrangements, and to allow effective low-cost court options to remain available for consumers.

Boosted enforcement powers for ASIC

The Government is backing its tough stance on consumer protection with substantially increased powers for ASIC.

The regulatory framework is supported by a tiered approach to the sanctions and enforcement regime, which includes:

- criminal penalties for licensee misconduct, including possible imprisonment for up to two years for those who lend contrary to the responsible lending requirements;
- civil penalties for licensee misconduct which enable ASIC to seek fines of up to $220,000 for an individual and $1.1 million for a corporation;
- infringement notices enabling ASIC to act quickly to penalise certain breaches of the law; and
- consumer remedies, such as compensation, which allow consumers to seek redress for their loss and damage from a licensee.

These provisions are consistent with the *Corporations Act 2001* and other Commonwealth consumer protection laws. They are targetted at preventing consumer detriment through deterence; and ensuring that ASIC is fully equipped and able to take appropriate and proportionate action to deal with breaches of the law.

Transition and ASIC's role

To ease the transition for industry and allow the national credit regime to be implemented in a sensible and practical fashion, ASIC will have a pivotal role in the period ahead.

During the transition period, ASIC will undertake intensive stakeholder consultation to explain and clarify the regulatory requirements to stakeholders. ASIC will also work closely and cooperatively with industry to develop guidance material to help industry in the shift to the new regulatory environment.

This work has already begun. ASIC has already begun to issue consultation papers in line with its program of industry engagement to provide guidance and clarity on key elements of the new law – such as competency and training, general conduct obligations; compensation and financial resources arrangements for credit licensees.

PART B – Reflections on the development of the law

I'd like to turn now to the process of developing the reform package. I'd like to offer some general reflections on how we approached it, the challenges we faced and the key tensions and principles that shaped the final package.

Developing the National Credit Law

Our Starting Point

In March last year, COAG agreed that the regulation of mortgages, mortgage broking & margin lending will be transferred to the Government. This was followed by an agreement in July, that the C/W would assume regulatory responsibility for all consumer credit.

As this is a massive undertaking, the Government agreed that the transfer of regulatory responsibility from the States to the Commonwealth would be achieved in two phases.

The Government's blue print for reforming consumer credit were canvassed in the Financial Services and Credit Reform Green Paper — *Simplifying & standardizing financial services & credit regulation*) released in June 2008 — which drew heavily from the recommendations of the Productivity Commission's report, *Review of Australia's Consumer Policy Framework,* released in May 2008.

Submissions received in response to the Green Paper signaled overwhelming support for the C/W to assume regulatory responsibility for all consumer credit & for ASIC to be the national regulator.

There was unanimous agreement that any attempt to limit the scope of the new regime to certain credit products & services was sub-optimal and would give rise to 'boundary line' problems.

Policy objectives and guiding principles

While all levels of government were keen to move quickly on this reform, the impact on business and consumers was of paramount consideration.

The Government stipulated two requirements. Firstly that the transfer should be as smooth and seamless as possible, with minimal business disruption. And secondly, that the reform package maintain the level of consumer protection that exists today – and where possible enhance those protections.

We recognised early in the process that an optimal regulatory framework would need to strike a balance between enterprise, on the one hand, and protection of consumer interests, on the other. To maximise our chances of achieving the right regulatory balance, we sought to build our regulatory framework around some key principles, two of which are **flexibility** and **transparency.**

The tension between certainty and flexibility featured prominently in the development of the national credit framework.

Clearly, certainty is important for those who are subject to the regulation. But flexibility is also important, as it allows rules and regulations to be adapted to address unforseen, new or changing situations. This flexibility provides the space, and the incentive, for markets and industries to innovate and thrive.

This is why we have deliberately adopted a principle-based legislative approach, with broad regulation making powers, to allow quick responses to changing market circumstances. This undelines much of the thinking behind our regulatory design of the licensing regime and the conduct obligations. Our preference was not to be prescriptive in the law by setting out in detail what must be done to comply with the law.

Transparency is a fundamental principle of the regulation. It is the result of disclosure of information, which enables market participants to assess and compare the quality of the service or product being offered.

The responsible lending obligations require brokers and credit providers to disclose certain information to consumers. And hopefully, this will result in better outcomes for consumers.

But of course, regulation which possesses the key attributes of certainty, flexibility and transparency will not necessarily guarantee successful regulation.

The success of any regulatory reform will depend, to a large extent, on the commitment of regulators and policy makers to constructively engage with the parties that continue to have a stake in the evolution of the reform agenda — that is consumers, industry; and State governments and key regulatory agencies.

Development Issues

The project was also shaped by a number of imporatnt factors: the timetable was set at eth direction of COAG had been brought forward by six months.

A key policy decision was taken early on to construct the core of the new law around the existing State Uniform Consumer Credit Code (UCCC). This reflected a promise to industry that the current regime would continue; and recognition that the UCCC was fundamentally sound, but had significant gaps, which the States had sought to address through the development of draft NSW finance brokers Bill and other amendments.

A complete overhaul of a systems-intensive regime like the UCCC, would have been extremely costly and disruptive to industry and could not be justified. Hence it was logical to adopt the UCCC and enhance it by building a national licensing system around it and adding other reforms. In that way reforms already in contemplation by the States could be picked up as appropriate. This approach also had the advantage of building on the existing systems experience and expertise.

As I've mentioned, a significant decision was to proceed by stages. In the initial stage, it was decided to focus our efforts on areas of systemic gaps – for example licensing and the absence of broker regulation, elements which the states had sought to introduce for some time.

The process of replicating the credit code into Commonwealth law posed unique challenges – in so far as the code had to be made to harmonise with areas of Commonwealth policy such as criminal law and Commonwealth judicial power – and this was a key factor in our system design.

Role of the State and Territory Governments and Referral of Power

The state governments are key stakeholders in the COAG credit reform agenda, which is based on a sustained cooperative effort between the states and territories, and the Australian Government. At the heart of the reform is the referral of state constitutional power to eth Commonwealth. This will be supported by agreement on the arrangements involved in 'switching-off' state responsibilities for credit regulation and the 'switching-on' of national credit laws with the transfer of state powers to the Australian Government.

A referral of state constitutional powers is a complex process which requires the Australian Government and the State Governments to determine the scope and the form of the referral. Importantly the States have agreed to refrain from legislating in this area. The withdrawal is fundamental to the COAG reform agreement.

The States are committed to delivering on the agreement. They will continue to make available their regulatory experience to the development of future Commonwealth legislation in Phase 2. Importantly, they are committed to directing their policy development in this area to support the overall credit reform agenda.

Consultation of key stakeholder groups

Following the consultation process that started with public submissions to the Green Paper, we consulted extensively with stakeholders. The consultation for all its strengths and weaknesses, should be seen against the background of previous state government efforts to regulate brokers and introduce other reforms to address predatory lending – amid extensive debate and policy analysis.

To promote public understanding of the task at hand, a series of public information sessions were undertaken in capital cities. We also implemented a comprehensive consultative process with our key stakeholders — State government regulators, industry groups and consumer bodies.

A consultation group was established consisting of peak industry associations and consumer groups. Regular meetings were held with this group to develop the policy underlying the legislation. The group also had the opportunity to review draft legislation and regulations before it was exposed for public comment in April.

In addition, specialised consultative groups were established

- to provide input into the design on specific issues such as the regulation of margin lending, and a simplified product disclosure statement for margin loans; and
- to oversight the replication of the UCCC into Commonwealth statute to ensure that the policy of the code, was as far as possible preserved.

Stakeholder Issues and response

The consultation process has been important and enlightening. It has exposed some important arguments and differences of view and left us, we hope, with a more robust statute than might otherwise have been the case.

It was instructive in revealing, not only the shortcomings of our framework, but also its strengths. Overall however, there was broad concensus that:

- an appropriate regulatory balance had been struck;
- it was desirable to have a level playing field across industry by requiring all industry participants to meet required conduct obligations and standards; and
- licensing should over time work to lift industry standards; and that if that necessarily meant those who cannot comply exit the industry, this is not necessarily a bad outcome.

In response to views expressed by stakeholders following public exposure of the Bills, we made some important policy adjustments. In particular, to minimise the compliance burden for business and consumers, transition periods have been extended to give industry stakeholders, especially lenders, more time to prepare their systems for the introduction of the new regime.

Firstly, we have simplified the way in which the proposed responsible lending arrangements will apply. We have removed the requirement for lenders to meet credit assistance conduct obligations when providing assistance in relation to their own credit products.

Secondly, we have delayed the commencement of the responsible lending obligations to 1 January 2011. This will give industry more time to implement the necessary changes to support responsible lending.

Thirdly and importantly, the Government has given ASIC greater flexibility to exempt or modify the licensing and registration requirements in the law.

Another key change in response to stakeholder submissions was the introduction of a provision [section 47(2)] to allow for the level of compliance to vary according to the nature, scale and complexity of the crdit activities engaged in by a licensee.

The Government has given ASIC greater resources to ensure it will be active in assisting industry to comply with the law. ASIC has already commenced an intensive industry consultation to explain and clarify the licensing requirements, and will work closely and cooperatively with industry. This is in stark contrast to the Financial Services Reform (or FSR) experience – where regulatory implementation did not occur in tandem with industry engagement.

The Government will continue to be closely engaged with industry, consumer groups and State governments throughout the implementation and transition to the new national regime.

Phase 2 implementation

The second implementation phase will take this project even further.

In Phase 2, the Australian Government will focus on enhancing the regulatory framework by considering regulation to address specific unfavourable lending practices. One example of an unfavourable lending practice is deceptive or misleading advertising. Mechanisms for more comprehensive coverage of consumer credit, targetting obvious avoidance techniques are proposed. It will also include consideration of further measures to address equity stripping practices, where credit is provided that effectively results in a transfer of significant amounts of equity from the borrower to the lender or broker.

ASIC's 2008 report, *Protecting the Wealth in the Family Home*, reviewed three borrowers in detail and found that the refinance cost them on average 27% of the equity they had accumulated in their home, and a minimum of $20,120 in fees and charges.

We will also consider what regulation and tailored disclosure is needed for reverse mortgages and other equity release products. Reverse mortgages allow a person to borrow cash against the value of their home.

The main feature of these loans is that regular repayments are not necessary as fees and interest are added to the loan balance. The total amount owing is then deducted from the sale of the home when you die. While this may be one way of accessing the stored equity in your home, particularly when you don't have sufficient income for a normal loan, it is usually a very expensive source of funding.

The problem is that it is highly likely that the amount of the loan will finally exceed the value of the home, and the resident — who by this stage is usually very elderly — could be evicted so that the home can be sold to pay the debt.

As well, during Phase 2, we will also consider the possible extension of the new national scheme, beyond just consumers, to the provision of credit for small business and investment loans – where there are net benefis for regulatory intervention.

The legislation to implement Phase 2 is scheduled for completion by mid-2010.

Conclusion

As you can see, the new reform package introduces generational changes to our consumer credit laws. As well as making the consumer credit system fairer, more consistent and more workable, the new regime is designed to provide a far higher level of protection to consumers.

And over time, it will lead to an improvement in industry standards.

We have a lot more work to do before we can say we are fully exploiting the opportunities of a uniform national credit approach, but we are on the way. In fact we are nearing the beginning of the real challenge — implementing the new regime and making it a success in practice.

Will the new regime succeed? Ultimately, its success will depend on close collaboration between ASIC and all market participants, industry and consumers alike.

By working together, ASIC and all market participants now have a very real opportunity to create a world-leading regulatory system and Australia will be a better place for it.

Thank you.