

FIRST PRINT

## CREDIT (AMENDMENT) BILL 1993

NEW SOUTH WALES



### EXPLANATORY NOTE

**(This Explanatory Note relates to this Bill as introduced into Parliament)**

At present, section 170 of the Credit Act 1984 empowers the Commercial Tribunal to fix maximum annual percentage rates in respect of regulated contracts. That section also provides that a regulated contract is void if the annual percentage rate in respect of the contract exceeds the maximum rate fixed in relation to the contract. However, this power to fix maximum rates has not been exercised by the Tribunal in the past.

The object of this Bill is to replace section 170 with a new section which prohibits a credit provider from entering into a regulated contract if the annual percentage rate in respect of the contract exceeds the "maximum rate" (the rate that is 4 times the prescribed rate of interest under the Supreme Court Act 1970). That prescribed rate is currently 10.5%. However, the annual percentage rate can, in certain circumstances where the amount financed in respect of a new credit contract is not more than \$2,000, exceed the "maximum rate".

The new section also provides that a regulated contract entered into with an annual percentage rate exceeding the "maximum rate" is void. It also provides, as is presently the case, that if the contract is void by the operation of the section, the debtor is entitled to recover from the credit provider any amount paid under the contract. Regulations may be made to provide for statements relating to annual percentage rates and the maximum rate to be included in regulated contracts.

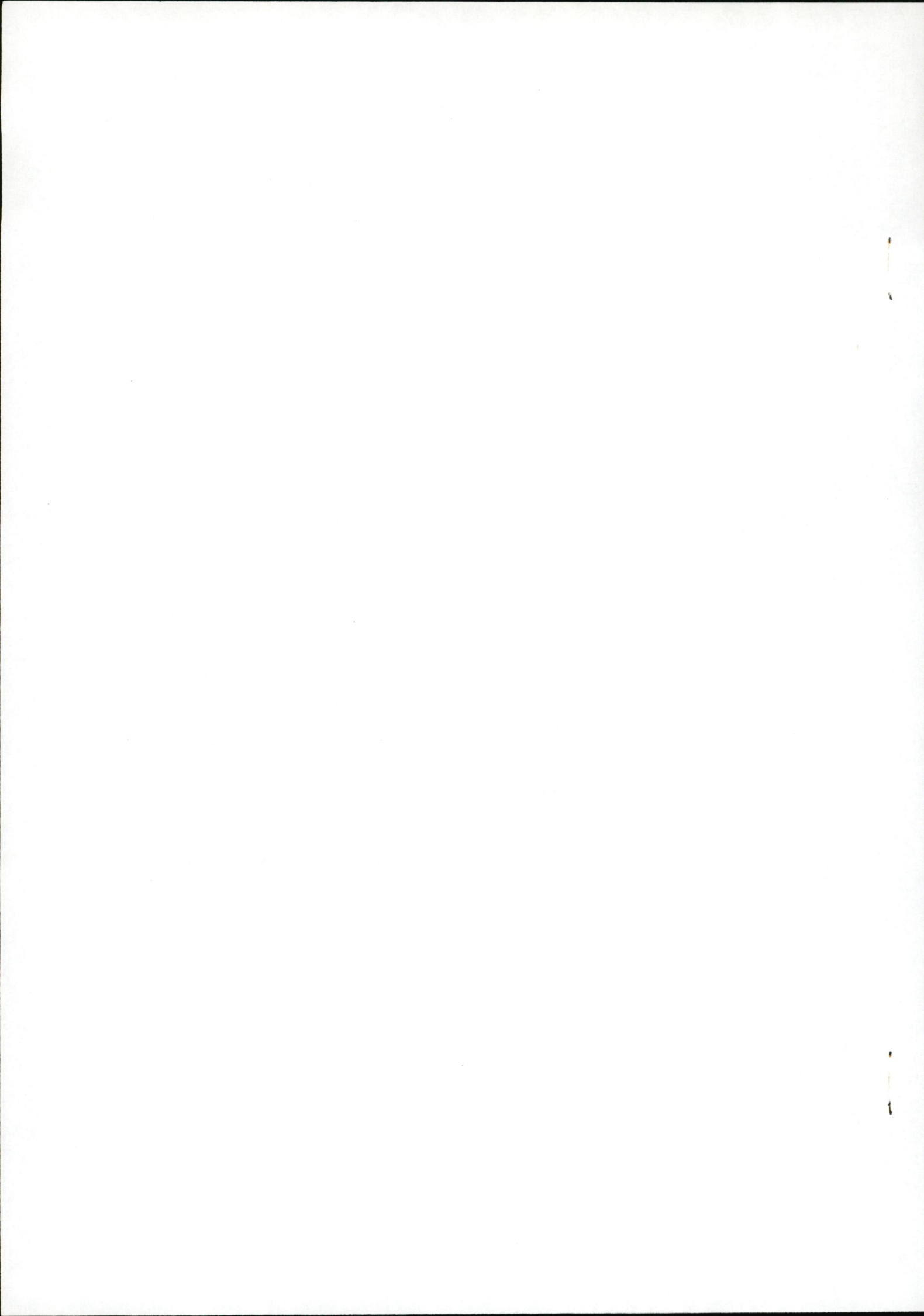
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**Clause 1** specifies the short title of the proposed Act.

**Clause 2** provides that the proposed Act will commence on a day to be appointed by proclamation.

**Clause 3** amends the Credit Act 1984 in the manner described above.

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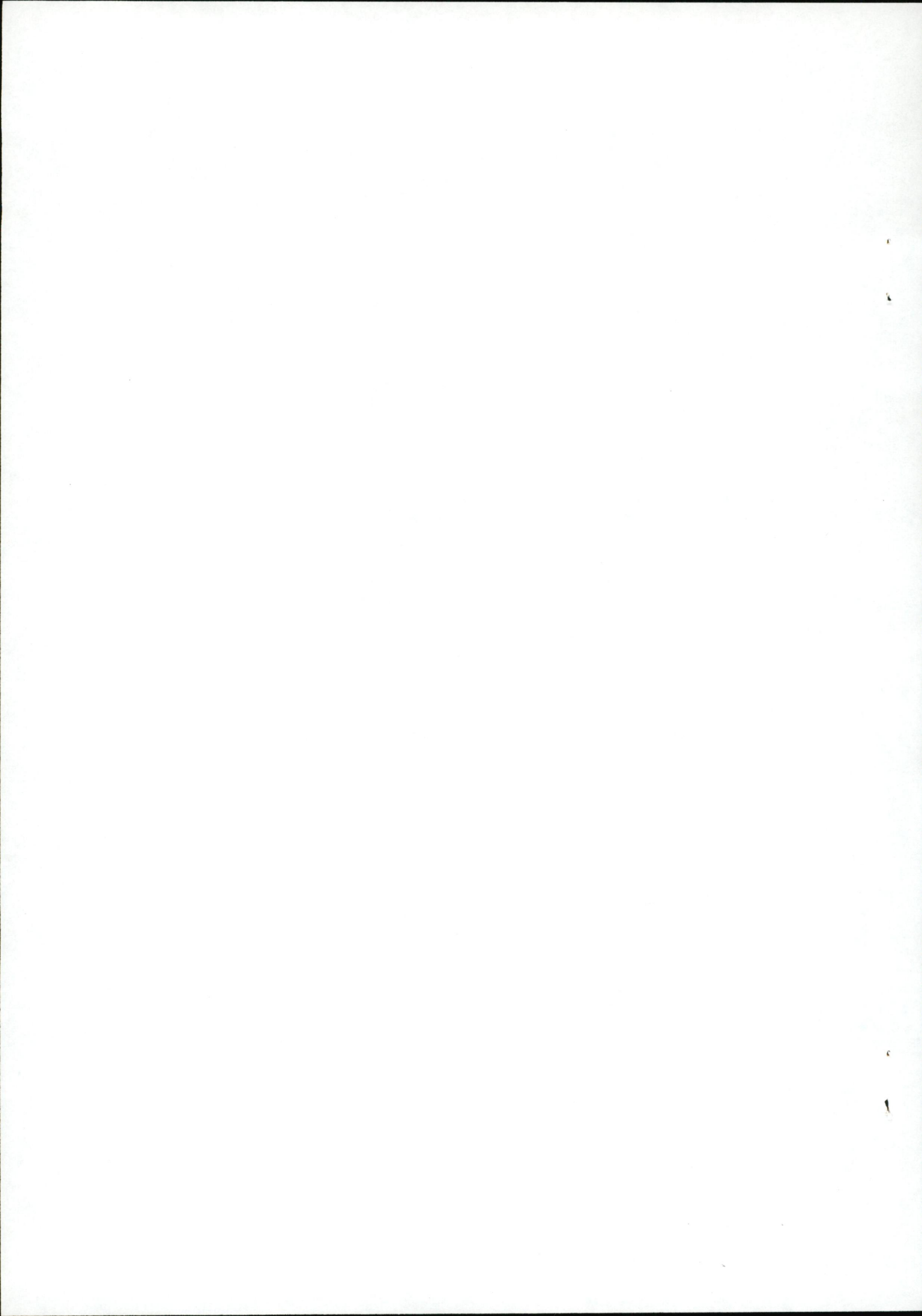
**CREDIT (AMENDMENT) BILL 1993**

**NEW SOUTH WALES**



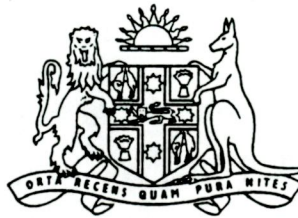
**TABLE OF PROVISIONS**

1. Short title
  2. Commencement
  3. Amendment of Credit Act 1984 No. 94
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**CREDIT (AMENDMENT) BILL 1993**

NEW SOUTH WALES



No. , 1993

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**A BILL FOR**

An Act to amend the Credit Act 1984 in relation to the maximum annual percentage rate for regulated contracts.

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*Credit (Amendment) 1993*

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**The Legislature of New South Wales enacts:**

**Short title**

1. This Act may be cited as the Credit (Amendment) Act 1993.

**Commencement**

- 5 2. This Act commences on a day to be appointed by proclamation.

**Amendment of Credit Act 1984 No. 94**

3. The Credit Act 1984 is amended by omitting section 170 and by inserting instead the following section:

**Contract void if annual percentage rate exceeds the maximum rate**

- 10 170. (1) A credit provider must not enter into a regulated contract if the annual percentage rate in respect of the contract exceeds the "maximum rate". The maximum rate, for the purposes of this section, is 4 times the rate of interest prescribed under section 95 (1) of the Supreme Court Act 1970 at the time the contract is entered into.

- 15 Maximum penalty: 25 penalty units.

(2) A regulated contract (including any mortgage in so far as it relates to the contract) is void if it is entered into in contravention of subsection (1).

- 20 (3) However, it is not a contravention of subsection (1) for a credit provider to enter into a regulated contract in respect of which the annual percentage rate exceeds the maximum rate if:

- (a) the amount financed under the contract does not exceed \$2,000; and  
25 (b) the credit provider has not, within the period of 2 years before the date of the contract, engaged in any business with respect to the provision of credit to the debtor, the debtor's spouse or any member of the debtor's family residing with the debtor at the date of the contract; and  
30 (c) the annual percentage rate calculated by reference to the credit charge payable under the contract, reduced by an amount which is the lesser of 7% of the amount financed or \$35, does not exceed the maximum rate.

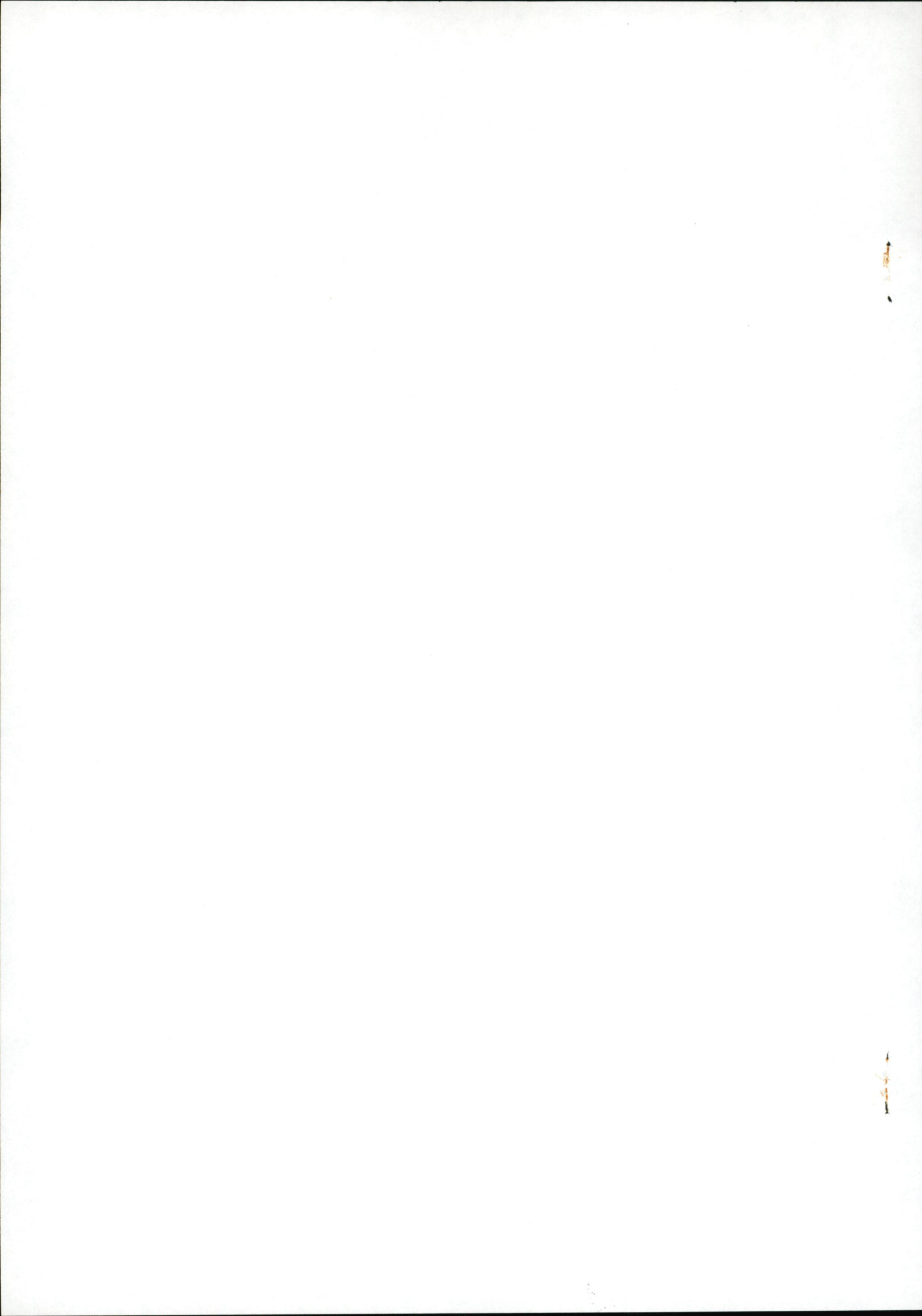
- (4) If, by the operation of this section, a regulated contract is void, the debtor is entitled to recover from the credit provider as a debt any  
35 amount paid to the credit provider under the contract.

*Credit (Amendment) 1993*

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(5) The regulations may make provision for the inclusion in any regulated contract of a statement relating to the annual percentage rate of the contract or to the maximum rate (or to both).

(6) Nothing in this section affects the powers of the Tribunal under Part 9 in relation to a contract or mortgage that is not, by reason of this section, void.





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**CREDIT (AMENDMENT) BILL 1993**  
**SECOND READING SPEECH**  
**LEGISLATIVE COUNCIL**

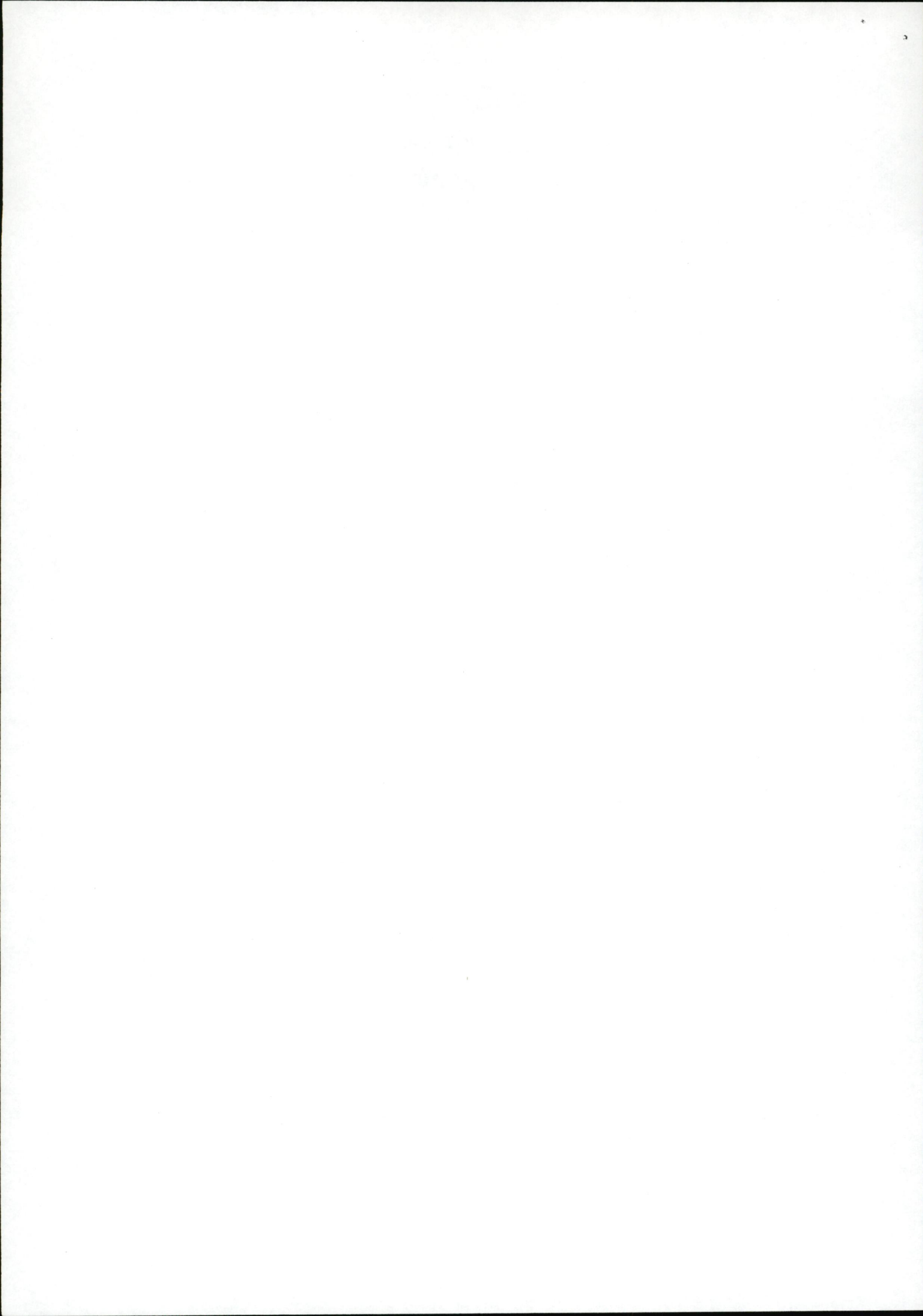
MR PRESIDENT,

I move that this Bill be now read a second time.

The purpose of the Bill is to amend the Credit Act 1984 to prohibit a credit provider from entering into a regulated credit contract with an annual percentage rate that exceeds the maximum rate. The maximum rate is fixed by the Bill at four times the prescribed rate of interest under the Supreme Court Act 1973. On 1 September 1993 the Supreme Court interest rate was fixed at 10.5% so that the maximum annual percentage rate is 42% at this time.

An exception is made for new contracts where the amount financed is not more than \$2000. The Bill permits the annual percentage rate to exceed the maximum rate in accordance with a prescribed formula. This allowance is made because of the relatively high proportion of costs which are properly attributable to the establishment of a new relationship with a potential borrower of small short term loans.

At present, the Credit Act empowers the Commercial Tribunal of NSW to fix a maximum annual percentage rate. This Bill removes that power from the Tribunal.



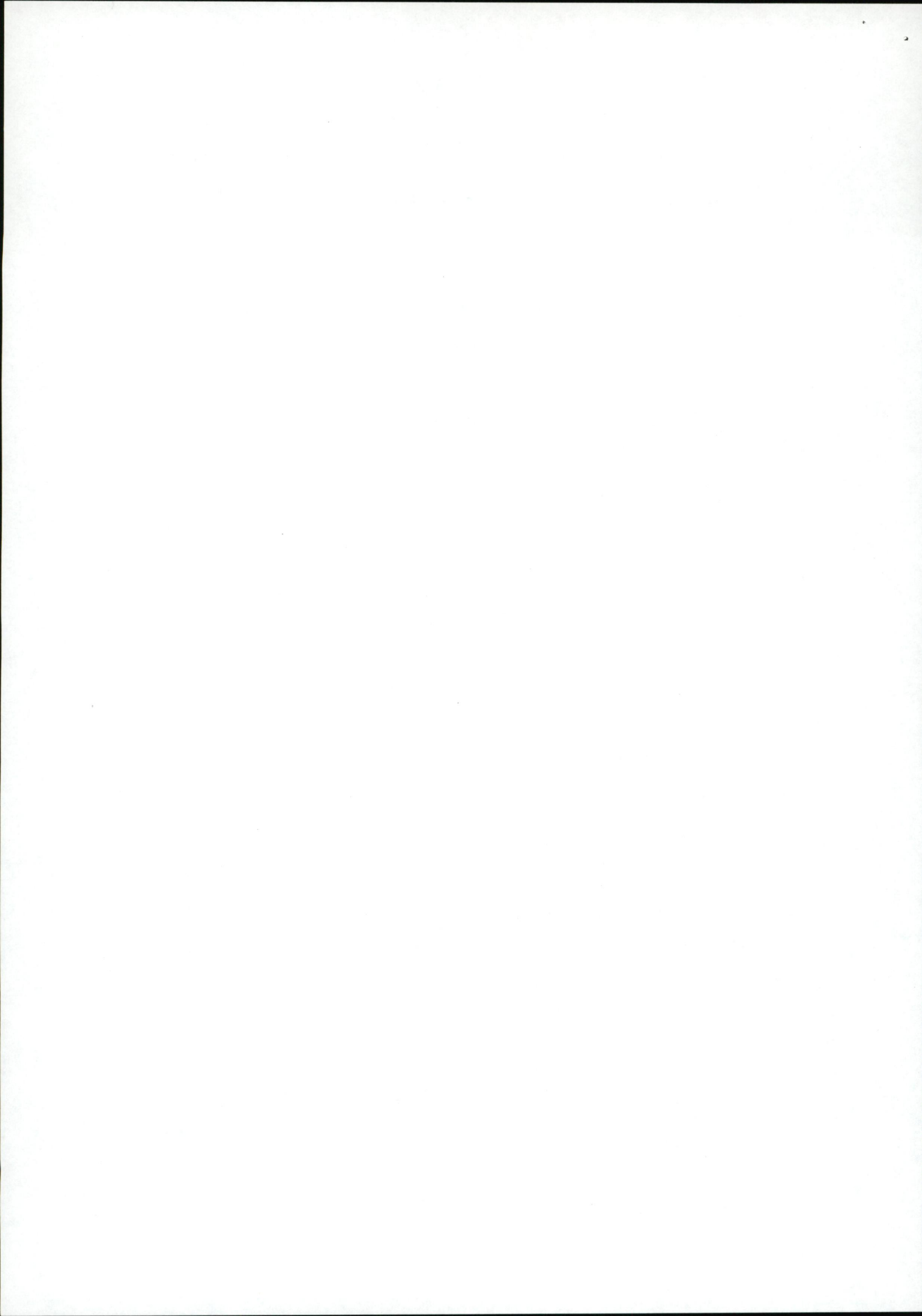
The question of whether a maximum annual percentage rate should be fixed has been under consideration by the Government for some time.

On 25 October 1991 the then Minister for Consumer Affairs appointed the Commercial Tribunal to inquire:

- . whether or not a maximum annual percentage rate should be fixed in respect of all regulated contracts or a class of regulated contracts (as defined in the Credit Act 1984) and if so what such a maximum annual percentage rate should be; and
- . whether any other measures should be adopted which might reduce the need for consumers to resort to high interest credit contracts.

The Tribunal reported to the Minister in April 1992 and the Report was tabled in the Legislative Assembly on 8 May 1992.

The major recommendation in the Tribunal's Report was to amend the Credit Act 1984 to set a maximum annual percentage rate of 48% on consumer credit contracts for \$20,000 or less. While recognising the arbitrary nature of choosing a rate, the Tribunal gave its reasons as first, the precedent in Victoria where such a rate had applied for many years; and second, the fact that it was high enough to avoid any likely effect in relation to mainstream lenders.



After careful consideration the Government accepted the need for a maximum rate because it is the most effective way of controlling the very small but exploitative "high interest" segment of the consumer credit market without interfering with the competitive lending of mainstream financiers.

However, the Government does not believe that it should be directly involved in determining a rate. Instead, the maximum should be set by reference to a rate which is independently set having regard to rates prevailing in the marketplace. The Supreme Court judgement debt interest rate meets those criteria. The rate is reviewed every six months, in February and August, and notified in the Government Gazette.

Mr President, this Government has no intention of controlling interest rates for the vast majority of the finance industry who are competing at rates substantially below the proposed maximum. The Commercial Tribunal Inquiry found that high interest lenders account for approximately 0.15% of the personal finance market. They are concentrated in the small loans market - amounts between \$200 and \$2000 - with annual percentage rates over 100%.

Mainstream lenders - banks, building societies, credit unions and major finance companies - do not compete in the small loans market. Small loans are considered by these lenders to be unprofitable because of the high administrative costs involved.



High interest lenders tend to be fairly small family businesses often operated from the home. Lending practices were found by the Inquiry to be inefficient and the cost of credit to be excessive. Nevertheless, the lenders appear to be providing a service for this particular section of the community.

The borrowers tend to be on low incomes with a substantial proportion of them receiving social security. The purpose of the loan is most frequently for household expenses such as utility bills, school expenses or car expenses.

Transactions frequently take place at the home of the borrower. The borrowers do not appear to have any concept of the meaning of annual percentage rate and many are not aware of its relevance on the credit contract. Its use for comparing costs would be in any case be limited because most borrowers would not be able to attain credit elsewhere.

While acknowledging the need for finance to be available to this sector of the market, the Inquiry nevertheless found that high interest lending practices are inefficient and that the majority of lenders are making unduly high levels of profit.

The Inquiry concluded that competition had not had any effect in reducing rates, partly because lenders tend to operate in discrete areas, and also because the borrowers are not sufficiently aware to compare prices.





It is therefore desirable to give some rate protection to this relatively unsophisticated sector of the market while ensuring that efficient lenders are able to continue to operate to provide a service.

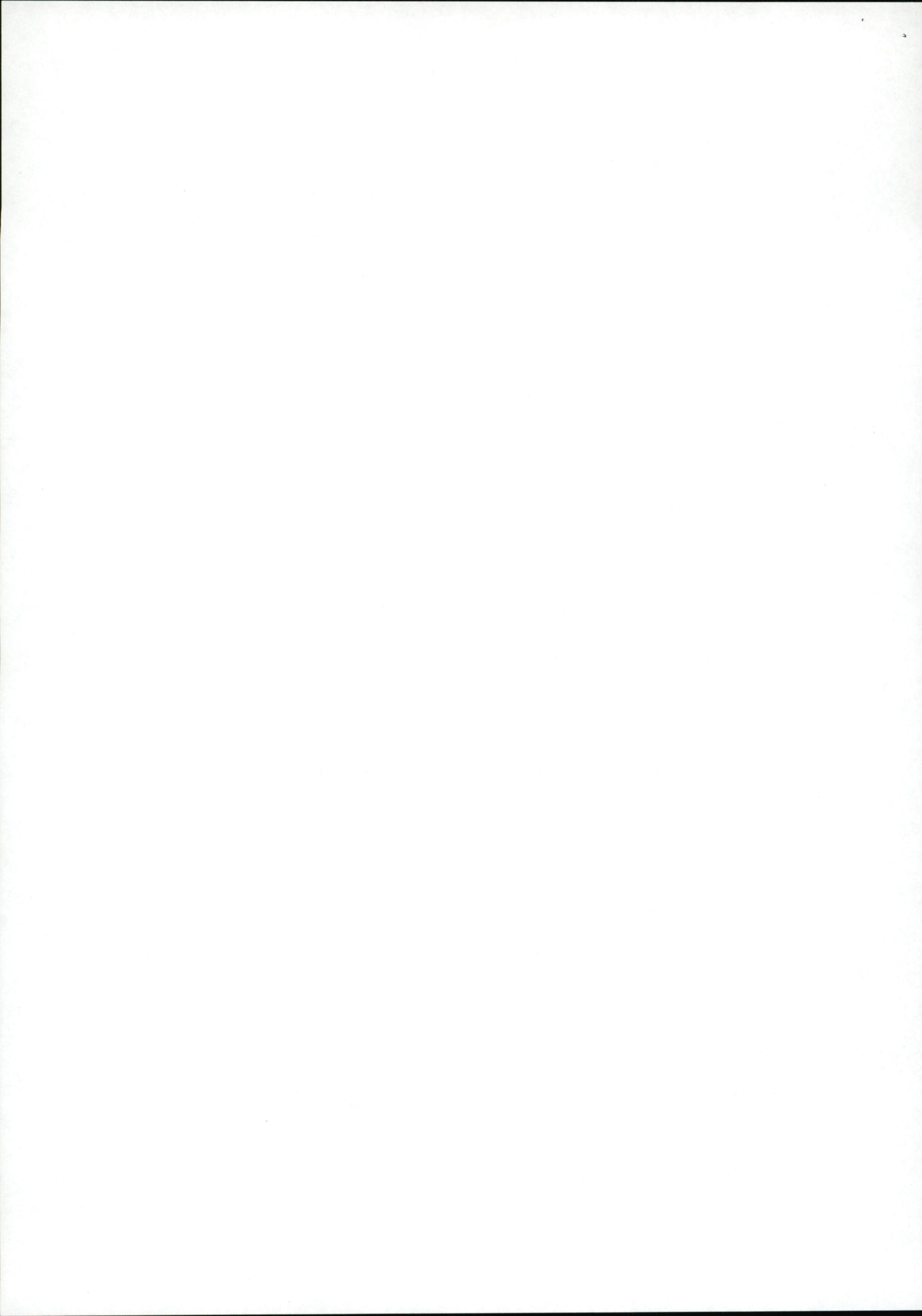
I turn now to the provisions of the Bill.

Clause 3 amends the Credit Act 1984 by omitting section 170 of the principal Act and inserting a new section 170.

The original s.170 enabled the Commercial Tribunal of NSW to fix by order in the Gazette maximum annual percentage rates for regulated contracts. The Tribunal has never exercised this power and recommended in its Report of the Inquiry into the question of a maximum annual percentage rate that s.170 be repealed. The Tribunal stated in the Report that "it has harboured doubts as to the circumstances in which it would be appropriate for a Tribunal exercising quasi-judicial powers to undertake a function of enacting delegated legislation". The Government accepted this recommendation.

Subsection (1) of the new s.170 provides that a credit provider must not enter into a regulated contract if the annual percentage rate exceeds the maximum rate in force at the time the contract is entered into.

This provision makes it clear that the only relevant maximum rate is the one applicable when the contract is originated. If at the time of its six-monthly review the Supreme Court rate is altered, leading to



a change in the maximum rate, there will be no retrospective effect on existing contracts.

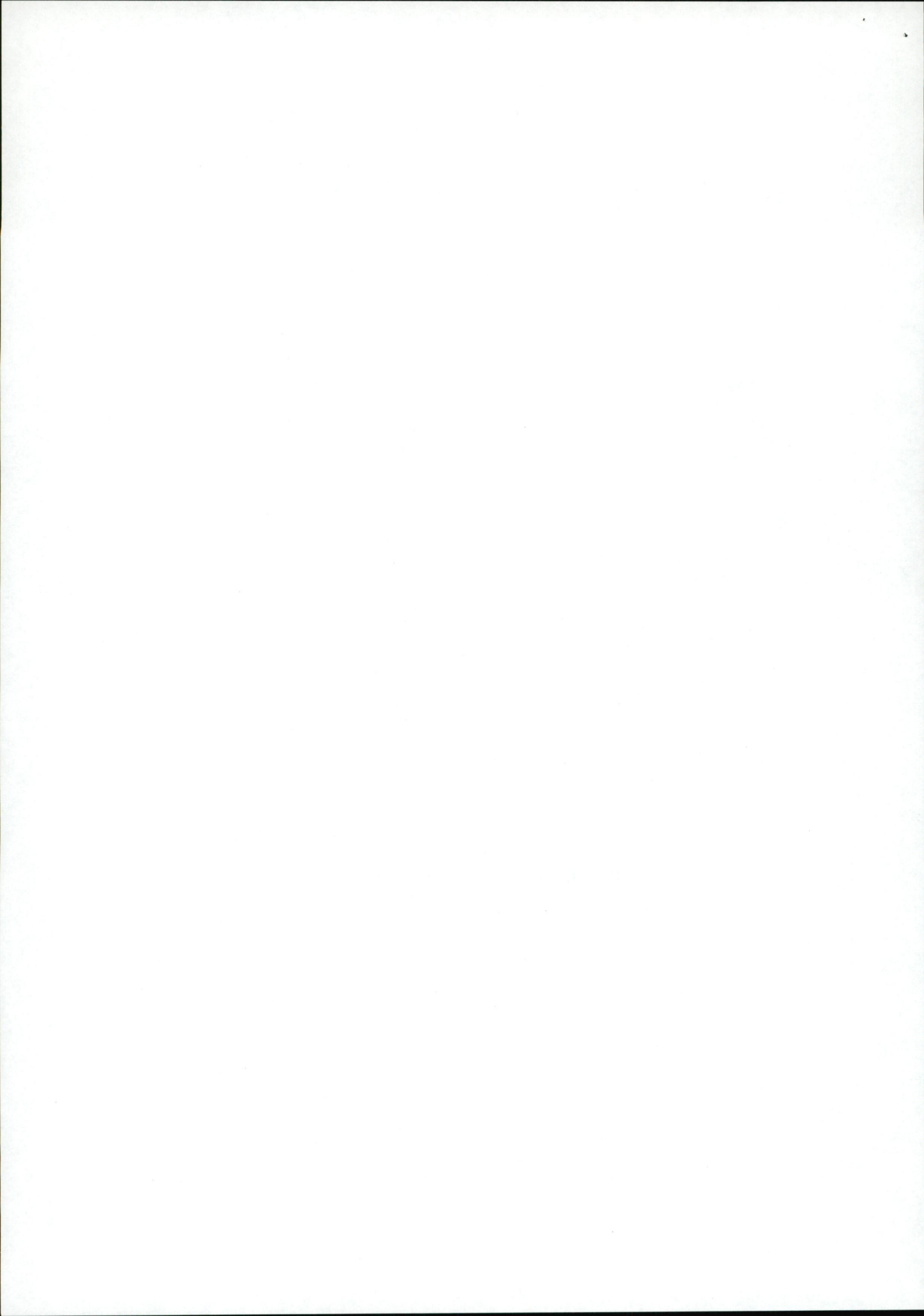
The maximum penalty for entering into a contract in breach of this provision is 25 penalty units, or \$2500.

Sub-section (2) provides that a regulated contract, including any mortgage in so far as it relates to the contract, is void if it is entered into in contravention of sub-section (1).

Sub-section (3) outlines the circumstances in which a credit provider may enter a contract in which the annual percentage rate exceeds the maximum rate, but not contravene sub-section (1).

Those circumstances are the following:

- . the amount financed under the contract does not exceed \$2000;
- . the credit provider has not, within the period of 2 years before the date of the contract, engaged in any business with respect to the provision of credit to the debtor, the debtor's spouse or any member of the debtor's family residing with the debtor at the date of the contract; and third
- . the annual percentage rate calculated by reference to the credit charge payable under the contract, reduced by an amount which is the lesser of 7% of the amount financed or \$35, does not exceed the maximum rate.

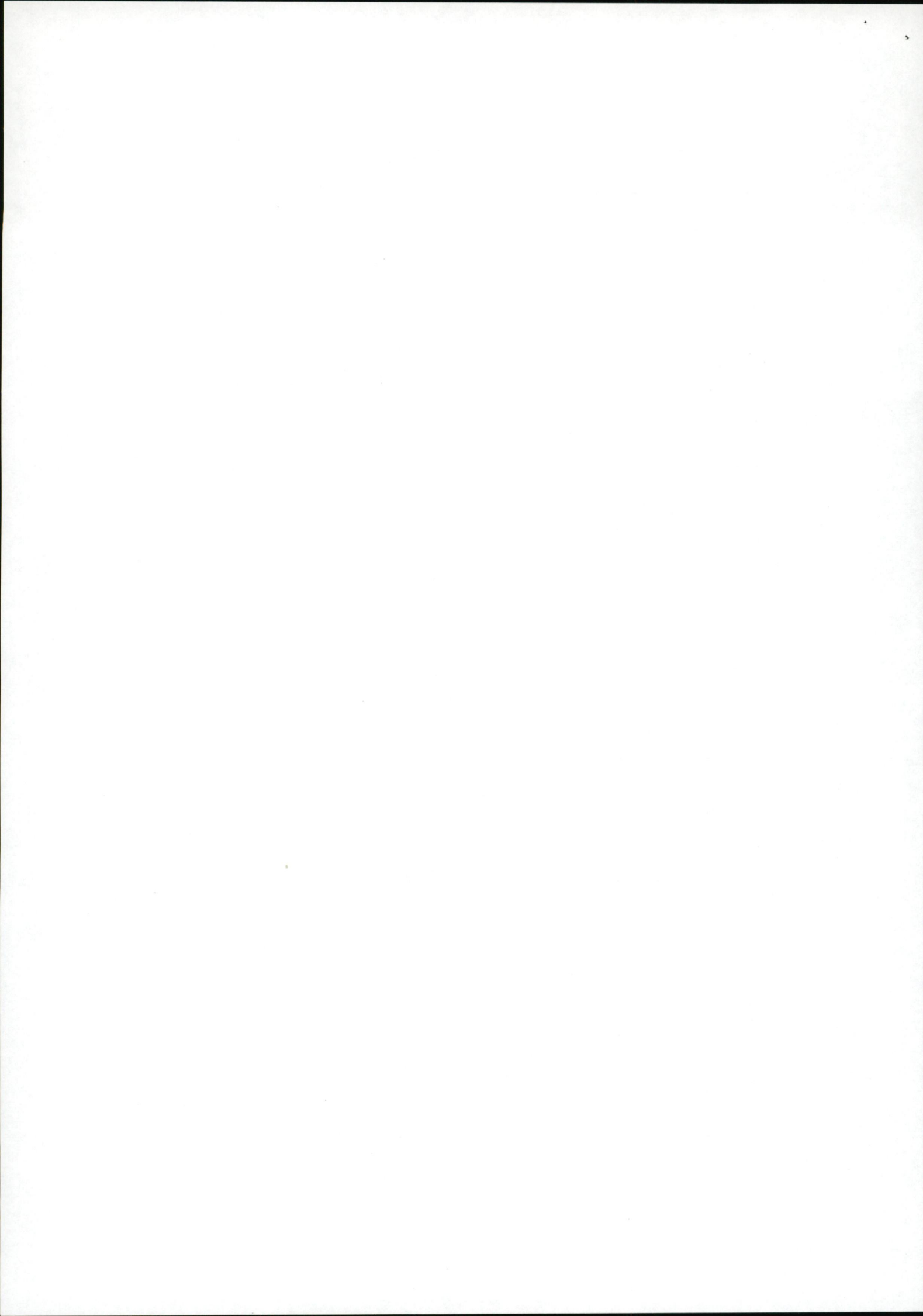


It is important to understand the thinking behind this provision. It is based on a recommendation made by the Commercial Tribunal in its Inquiry Report.

The Tribunal found that small lenders charge rates which are inflated by unduly high levels of profit and inefficient business practices. However, the Tribunal did not consider that the imposition of a maximum rate ought necessarily result in a total withdrawal by small lenders from the consumer credit market. The Tribunal felt, and the Government agrees, that there is significant scope for small lenders to reduce their high profits and to modify their current inefficient practices so as to reduce their operating costs.

At the same, the Tribunal recognized that the higher cost of small loans reflects, to a certain extent, the fact that administrative costs involved in the provision of credit tend not vary greatly according to the amount of the loan. The recovery of such costs by the lender will translate into a high annual percentage rate where the loan is of a small amount and is repayable over a short period.

The Tribunal concluded that it would be appropriate to take account of the costs of establishing an account for a small loan, but only in relation to the establishment expenses associated with a new relationship with a borrower. A common feature of lending by "high interest" lenders is that loans are refinanced on a regular basis, and the establishment costs involved in dealing with repeat customers are minimal. The Tribunal concluded that a repeat customer is

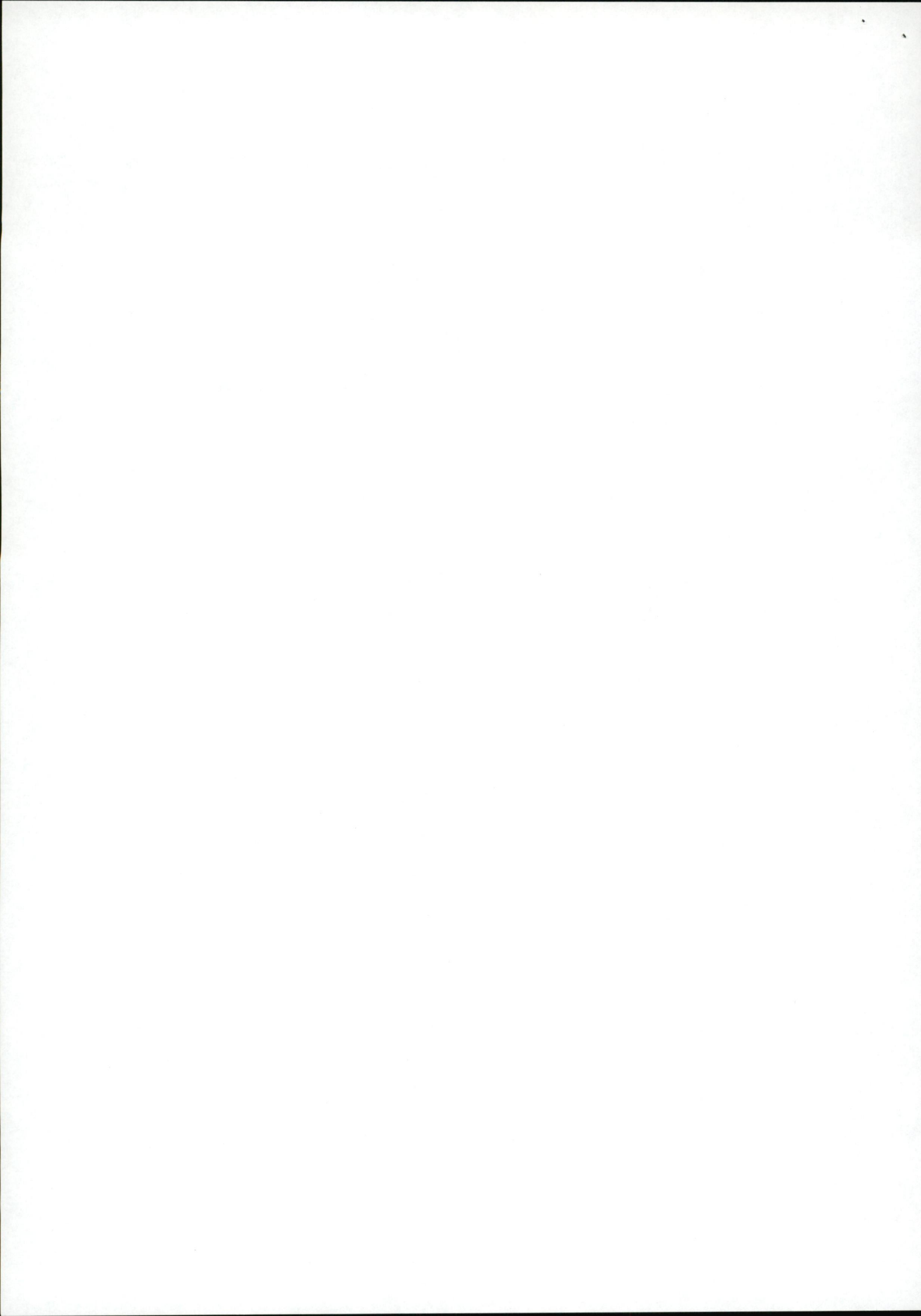


someone with whom the lender has carried on the business of providing credit within the last two years.

Under the Credit Act, the annual percentage rate is a measure of the relationship between the total cost of the provision of credit (the credit charge) and the total amount of credit provided (or the amount financed). The Act prohibits separate fees and charges so small lenders must recover their establishment cost through the credit charge. The Tribunal did not consider that small lenders should be permitted to charge establishment fees in addition to the credit charge, but recommended that they be permitted to "reduce" the credit charge by the amount of a "notional establishment fee" and to calculate an annual percentage rate with reference to this reduced credit charge. If the annual percentage rate so calculated is lower than the maximum rate, then the contract is not in contravention of proposed s.170(1).

The "notional establishment fee" is the lesser of 7% of the amount financed or \$35. The Tribunal recommended this amount having regard to the costs and fees charged by credit unions (which are not covered by the Credit Act in NSW) when they make small loans.

Small lenders do not have to disclose the notional establishment fee, the reduced credit charge or the annual percentage rate so calculated. They do have to disclose the annual percentage rate calculated in accordance with the total credit charge, as do all credit





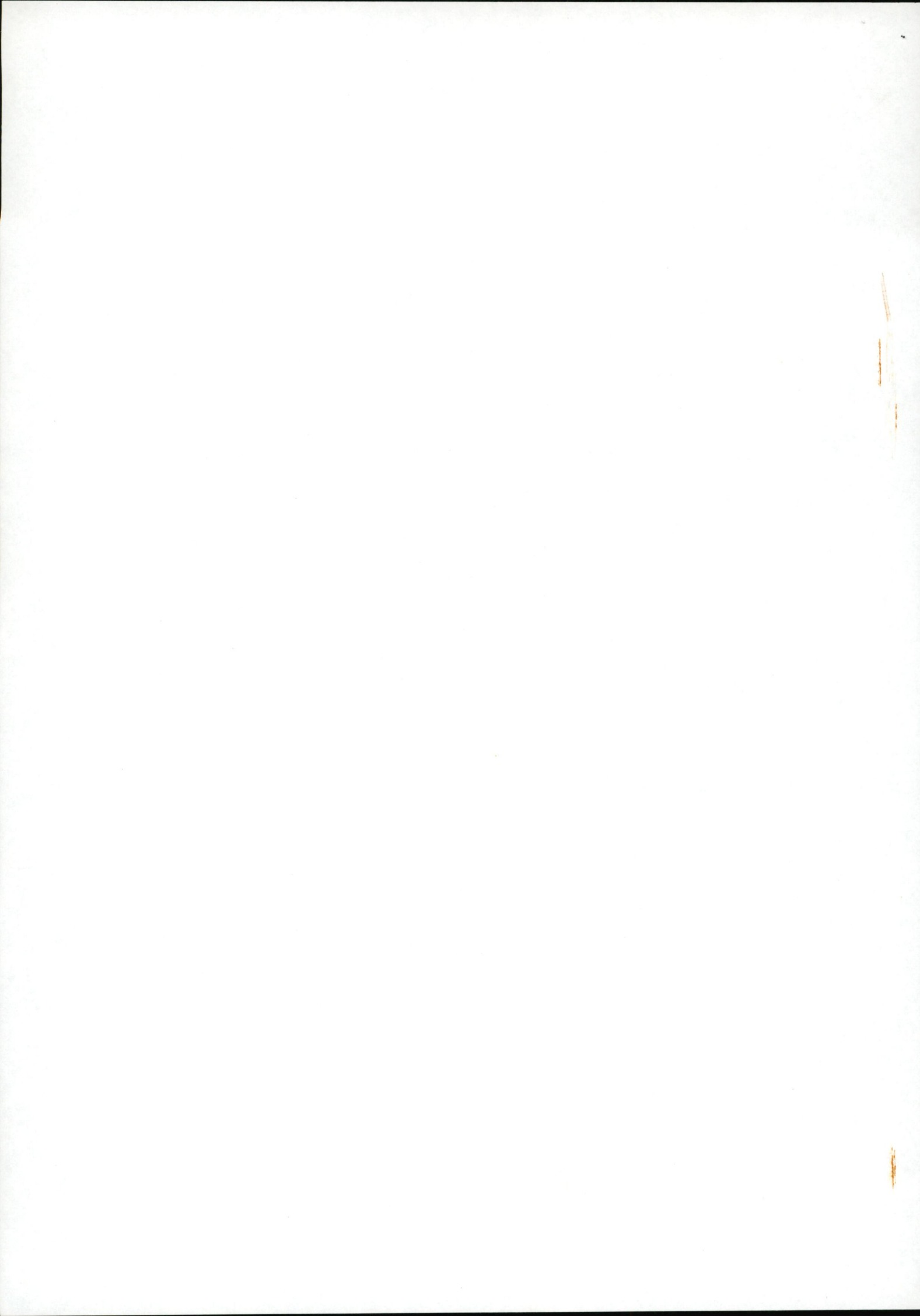
providers, so that the true cost of the credit is known to the borrowers.

Proposed sub-section (4) provides that if a contract is void because it contravenes sub-section (1), the debtor is entitled to recover from the credit provider as a debt any amount paid to the credit provider under the contract. The original s.170 contains a similar provision.

Proposed sub-section (5) is a regulation-making power. The Tribunal recommended that all regulated contracts should contain a prominent statement of the annual percentage rate, with an explanation of its use as a comparator. The Tribunal also recommended that contracts where the annual percentage rate exceeds the maximum rate in accordance with proposed sub-section (3) should contain a warning statement for the information of borrowers. It is intended that the finance industry and financial counselling organisations will be consulted about regulations to give effect to these recommendations.

Proposed sub-section (6) preserves the Tribunal's power to re-open unjust contracts which are not void by reason of the new s.170. The original s.170 contains a similar provision.

I commend the Bill.



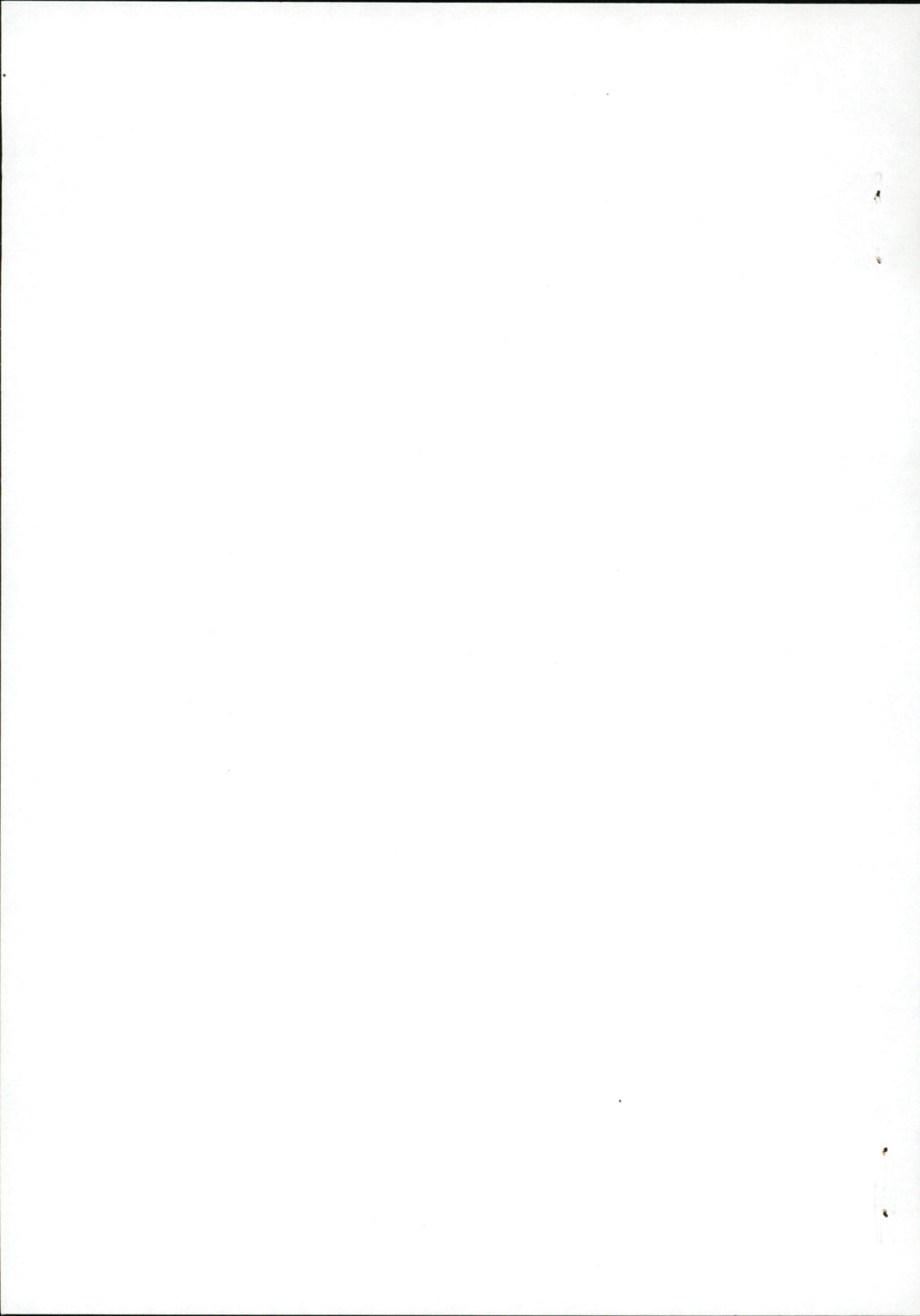
# **CREDIT (AMENDMENT) ACT 1993 No. 71**

**NEW SOUTH WALES**



## **TABLE OF PROVISIONS**

1. Short title
  2. Commencement
  3. Amendment of Credit Act 1984 No. 94
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# CREDIT (AMENDMENT) ACT 1993 No. 71

NEW SOUTH WALES



Act No. 71, 1993

An Act to amend the Credit Act 1984 in relation to the maximum annual percentage rate for regulated contracts. [Assented to 18 November 1993]

**The Legislature of New South Wales enacts:****Short title**

1. This Act may be cited as the Credit (Amendment) Act 1993.

**Commencement**

2. This Act commences on a day to be appointed by proclamation.

**Amendment of Credit Act 1984 No. 94**

3. The Credit Act 1984 is amended by omitting section 170 and by inserting instead the following section:

**Contract void if annual percentage rate exceeds the maximum rate**

170. (1) A credit provider must not enter into a regulated contract if the annual percentage rate in respect of the contract exceeds the "**maximum rate**". The maximum rate, for the purposes of this section, is 4 times the rate of interest prescribed under section 95 (1) of the Supreme Court Act 1970 at the time the contract is entered into.

Maximum penalty: 25 penalty units.

(2) A regulated contract (including any mortgage in so far as it relates to the contract) is void if it is entered into in contravention of subsection (1).

(3) However, it is not a contravention of subsection (1) for a credit provider to enter into a regulated contract in respect of which the annual percentage rate exceeds the maximum rate if:

- (a) the amount financed under the contract does not exceed \$2,000; and
- (b) the credit provider has not, within the period of 2 years before the date of the contract, engaged in any business with respect to the provision of credit to the debtor, the debtor's spouse or any member of the debtor's family residing with the debtor at the date of the contract; and
- (c) the annual percentage rate calculated by reference to the credit charge payable under the contract, reduced by an amount which is the lesser of 7% of the amount financed or \$35, does not exceed the maximum rate.

(4) If, by the operation of this section, a regulated contract is void, the debtor is entitled to recover from the credit provider as a debt any amount paid to the credit provider under the contract.

*Credit (Amendment) Act 1993 No. 71*

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(5) The regulations may make provision for the inclusion in any regulated contract of a statement relating to the annual percentage rate of the contract or to the maximum rate (or to both).

(6) Nothing in this section affects the powers of the Tribunal under Part 9 in relation to a contract or mortgage that is not, by reason of this section, void.

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*[Minister's second reading speech made in—  
Legislative Assembly on 7 September 1993  
Legislative Council on 9 November 1993]*

