Submission No 4

INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

Organisation: Australian Finance Conference (AFC)

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4 October 2006

The Hon Christine Robertson MLC
Chair
Standing Committee on Law and Justice
Legislative Council
Parliament of NSW

Email: lawandjustice@parliament.nsw.gov.au

Dear Ms Robertson,

Inquiry into Unfair Terms in Consumer Contracts

The Australian Finance Conference (AFC) is a national finance industry association, representing the views of providers of consumer and commercial finance and members who are service providers to financiers. A list of AFC members is attached for information.

We welcome the opportunity to provide our views to the Committee to assist in its Inquiry. The AFC brings to the inquiry a perspective of consumer finance providers who are in effect nationally regulated by various laws under the auspices of several Ministerial Councils, particularly the Ministerial Council of Consumer Affairs (MCCA). The key law that regulates consumer credit contracts is the Uniform Consumer Credit Code (UCCC). The thrust of uniformity in this significant area of commerce reflects the fact Australia has a national consumer finance market.

As you would be aware, MCCA has in place a policy consultation and development process on unfair contract terms. The AFC provided input into that process over 2 years ago – a regulatory impact statement from MCCA is awaited. MCCA has sought to investigate policy options to address unfair terms in consumer contracts and the merits of adopting a more nationally consistent and effective regulatory regime. The AFC believes that this is the most appropriate approach to address unfair contract terms in consumer contracts. To assist the Committee's Inquiry, attached to our submission is a copy of our representations to MCCA.

Despite support for a nationally consistent approach on this issue, the AFC is of the view that the Uniform Consumer Credit Code already adequately manages unjust credit contracts through the s70 re-opening provisions. These provisions take the contract formation context into account, in addition to a broad range of factors, including contract terms that are not reasonably necessary for the legitimate interests of a party to the

contract (s70(2)(e)). The re-opening provisions allow for the contractual process to be assessed in its entirety and in context.

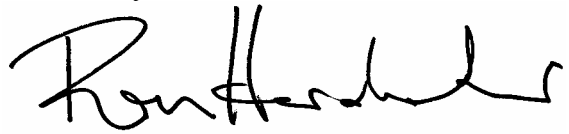
Consumer credit contract terms are not just dictated by the Code's requirements; they must also reflect a broader legislative context (including privacy, trade practices and securities laws) and the financial market structures that affect product pricing, delivery systems, and consistency and certainty of product offering. The complexity of this environment cautions against regulator prohibition or prescription of contract terms on the grounds of "fairness" to the detriment of product innovation and contractual certainty.

In addition, any unilateral move by a single jurisdiction, such as NSW, to regulate for unfair contract terms in relation to consumer credit would undermine national uniformity and place an unwarranted financial and administrative burden on national financiers to provide NSW-centric documents, processes and systems. Again, these requirements will impact on the cost of credit, which will be borne by consumers. To our mind though, the reality would be that if NSW were to legislate on this topic for consumer credit it will not only be pre-empting the MCCA process, but in practice, given the size of the NSW marketplace, will force all national providers of credit to adjust to the NSW legislation. We have made similar representations to the Victorian Government which has recently been deliberating on whether to extend its current unfair consumer contract law to cover currently excluded area of consumer credit.

In conclusion, the AFC believes the UCCC adequately addresses unfair contract terms in consumer credit contracts. If there is to be any change to develop unfair contract terms law for consumer credit, we are firmly of the view the regulatory response must be national, with decided outcomes incorporated into the Code rather than left dispersed among the various jurisdictions' fair trading regimes. We would not support any unilateral action by NSW, or any other jurisdiction for that matter, to introduce additional regulation of consumer credit contract terms as it undermines national uniformity and the benefits it brings to consumers and credit providers alike.

Kind Regards,

Yours truly,



Ron Hardaker
Executive Director

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Attachments:

- AFC membership list
- AFC submission to MCCA

AFC MEMBER COMPANIES

Adelaide Bank
Australian Finance Direct
Australian Integrated Finance
Automotive Financial Services
Australian Motor Finance
Bank of Queensland
BankWest
Baycorp Advantage
Bidgee Finance
BMW Australia Finance
Capital Finance Australia
Caterpillar Finance Australia
CBFC
CIT Financial
Citigroup
Collection House
Credit Corp Group
DaimlerChrysler Financial Services
De Lage Landen
Dun & Bradstreet
Elderslie Finance Corporation
Esanda Finance Corporation
Focus Capital Group
Ford Credit Australia
FundCorp
GE Commercial
GE Money
General Motors Acceptance Corp
Heritage Building Society
HP Financial Services
Indigenous Business Australia
Integrated Asset Management
International Acceptance
John Deere Credit
Key Equipment Finance
Komatsu Corporate Finance
Liberty Financial
Lombard Finance
Mackay Permanent Building Society
Macquarie Equipment Rentals
Macquarie Leasing
Members Equity Bank
MotorOne Group
ORIX Australia Corporation
PACCAR
Pioneer Permanent Building Society
Profinance
RABO Equipment Finance
RAC Finance
RACV Finance
Retail Ease
Ricoh Finance
SME Commercial Finance
Suttons Motors Finance
Sharp Finance
St. Andrews Finance
St. George Bank
Suncorp
The Rock Building Society
Toyota Financial Services
Volkswagen Financial Services
Volvo Finance
Westlawn Finance
Westpac
Wide Bay Australia
Yamaha Finance

<u>Professional Associate Members</u>:
Allens Arthur Robinson
Bartier Perry
Corrs Westgarth
FCS Online
Finzsoft Solutions
Henry Davis York
Horwath Technologies

06/06

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4 April 2006

Ms Pamella Criddle
National Project Manager
Uniform Consumer Credit Code Management Committee
Department of Consumer and Employment Protection
Locked Bag 14
Cloisters Square WA 6850

Email: credit@docep.wa.gov.au

Dear Ms Criddle,

Precontractual Disclosure and the Uniform Consumer Credit Code Consultation Package

The Australian Finance Conference (AFC) appreciates your invitation to examine the consultation package and to provide this response. It comprises two parts. The first is our policy response; the second is an analysis of the amendments proposed in the consultation package.

The AFC has long been associated with reform of consumer credit in Australia, dating back to development of the "uniform" hire-purchase legislation of the late 1950s and early 1960s. The AFC's 60 plus membership today covers a broad church of those involved in providing finance to consumers and business; other AFC members include service providers and advisors to the finance industry.

AFC disclosure policy

The AFC regards contractual disclosure as the cornerstone of commercial contracts, whether customers are consumers or business or government. The AFC has long sought, as part of its contribution to the development of public policy in the field of consumer credit, effective, targeted and streamlined disclosure of key information to credit consumers. We were especially active in the development of the Consumer Credit Code to achieve this. However, the prevailing view of legislators and consumer advocates at the time was that quantity, rather than quality, of information was what disclosure was about. When the Code's Post Implementation Review was undertaken, the AFC strongly advocated for better disclosure rules, providing suggestions and encouraging collaboration between industry, consumers and policy makers, as well as research. Eight years on from that Review, better disclosure still eludes consumer credit policy.

AFC position

To make our position on the consultation package reform proposals clear upfront, we oppose them. We do so, not out of a rejection of disclosure, but out of a disappointment that the reform proposals amount to more disclosure, more paper, more process, more compliance and more operating costs, rather than a substantiated improved customer/consumer outcome. We assess the proposals to be another layer to existing disclosure that will be costly to implement but with no obvious benefit to either credit consumers or credit providers. We do not see value in the reforms; quite the contrary. It is also particularly disappointing that the consultation package makes it clear 'there are no plans to test the new scheme by simulation or survey prior to its implementation'. While this candour is welcome, we regard the underlying position as contrary to principles of good regulatory policy development. It is all the more frustrating in light of the current review of the mandatory comparison rate by Hawkless Consulting, which on our reading, articulates well the value of undertaking appropriate research into significant disclosure policy reform before it is legislated, not after. The same can be said of the Commonwealth's financial services reform package, which is now undergoing refinement of its disclosure requirements, after significant compliance expense has been incurred wastefully.

AFC key recommendation

However, we believe the package can provide a springboard for meaningful disclosure reform. That springboard is research. We recommend this, not as a means of forestalling change, but as a means of getting the settings right. To date, consumers have been largely left out of the development of disclosure rules. Some research was commissioned to accompany the Code's Post Implementation Review, but that is now, in our view, quite dated and not sufficiently on point, with considerable changes in competition, market, product, technological and national economic circumstances since 1998/1999.

Cognitive research of the kind undertaken by Paul O'Shea at Griffith University, which has been made available to you, provides the opportunity for the current consultation process to provide a basis for improved disclosure, balancing value/benefit and costs.

For our part, the AFC would more than welcome detailed and robust research of this nature. We would recommend a collaborative approach involving key stakeholders to ensure confidence with, and credibility of, the outcome.

AFC comments on package reforms

In April 2004 the AFC provided detailed comment and alternative reform approaches on the initial discussion paper on the reforms under consideration. Two years on, little of substance has changed in the reform proposals. As we have not been made aware of the reasoning behind the rejection of our recommended alternatives, our submission dated 29 April 2004 remains pertinent and applicable, especially in examining the value of revising the current precontractual statement requirements rather than jettisoning them and adding further documents and processes.

The consultation package provided questions to focus submission responses. Following are our responses to those questions. In addition, Appendix A to this submission sets out an analysis of the proposed amending provisions to the Consumer Credit Code and its Regulation.

As a general observation before providing individual responses, we observe that the questions appear to be targeted at identifying/improving the effectiveness and value of the proposed

reforms. Given 'there are no plans to test the new scheme by simulation or survey prior to its implementation', the answers to the questions can at best be opinion or given in the abstract. Proper research and engagement direct with credit users are likely to give more reliable answers.

1. *Will the proposed amendments improve the consumer's ability to understand the key features of the credit contract? If not, what improvements could be made?*
A clear and objective answer cannot be given. However, members report a lack of feedback from customers that they are unhappy or confused with the credit contract being used as the precontractual disclosure statement. Preliminary cognitive research, examining the consumer perspective, suggests the answer would be 'no'. As we have recommended, more research of this nature is essential; then an answer may be available to this question.

The provision of consumer credit must be seen in context; it typically does not happen as an isolated event, as least so far as loans are concerned. Depending on circumstances, consumers may be guided by lending staff, brokers, lawyers, retailers, dealers, etc. There is a considerable amount of regulatory and contractual intervention during the acquisition and finance of a thing (e.g. service, goods, land), ranging from privacy consents, sale contracts, insurance policies, tax invoices, provider warranty documents (statutory and otherwise), cooling-off period advices, registration documents, product disclosure statements, financial services guides, personal identification documents and procedures, etc. In these contexts, it is difficult to see how the proposed amendments will improve the consumer's ability to understand the key features of the credit contract. The additional documentation required by the amendments is, at one level, another piece of disclosure amongst many.

2. *Will the financial summary table provide the right 'snapshot' of the credit product? Are there any matters that should be included in the table or not included?*
In our view, the new precontractual statement is likely to confuse consumers, as they now have to cross-reference. Any duplication will add to the complication creating the potential for the consumer making decisions based on the information contained in the precontractual statement rather than that in the contract

3. *Will the summary of other information be useful for consumers? If not, in what way can it be improved?*
Refer our response to Question 1. But, specifically on this proposed document, we see this providing a real potential for confusing consumers. It represents a layering of disclosure across different documents. We imagine that the complete picture would be difficult to discern for consumers.

4. *Are the definitions of 'ongoing credit fees and charges' and 'upfront credit fees and charges' sufficiently concise to enable credit fees and charges to be allocated between these categories?*
Yes.

5. *Are the proposals sufficiently flexible to cope with the innovations in credit products? If not, what changes need to be made to ensure flexibility?*
At this stage, this is unknown, due to the complexity of any proposed/potential products and the adaptability of computer systems. This can then lead to budgetary and time constraints,

which could potentially impact on a credit provider's attempt to meet market and other regulatory demands. Some of these demands can be driven by government, e.g. first home owner's grant, which are public policy developments.

6. *Does the implementation of the proposed amendments have unforeseen consequences for consumers or credit providers?*

We are concerned that there is nothing in the proposed amendments that deals with credit provider obligations should there be a change in disclosed information between the issue of the precontractual statement and the credit contract entered.

We would envisage it likely that, in practice, the precontractual statement will accompany the credit contract in order to manage this. In fact, the amendments indirectly mandate this because of cross-referencing requirements between the precontractual statement and the contract. Otherwise, the precontractual statement provides the potential for an increase in consumer confusion and the provision of incomplete information.

The space limitation of two A4 sides of paper (or electronic equivalent) for both parts of the precontractual statement we envisage would be difficult to comply with for some credit products with various payment, interest rate and fee options. We also see no justification for the format of the precontractual statement being constrained to A4 paper. Many credit products, for example, print part or the entire contract document in a small stamped booklet; at the other extreme, these documents can be produced on A3 paper. The mandated A4 seems to be putting form over substance, with no regard to the variety of credit products and the options.

Implementation issues

The proposed amendments will require credit providers to incur substantial costs in reviewing and amending documents and systems in order to comply. These are unable to quantify with precision at the moment, but it is obvious that a significant investment will need to be made by credit providers.

Should the proposed amendments become law, we believe a lead time of 2 years is justified for credit providers to seek professional and technical advice and to embed changes into their computer systems and supporting peripheral processes.

In the context of credit provider compliance, systems and resource demands, credit providers will also be implementing the proposed anti money laundering legislation within the likely time-frame. This legislation is extraordinarily demanding and intrusive. Other compliance demands on credit providers at the moment and into the foreseeable future include Basel II (on prudential controls), unfair contract terms, electronic conveyancing, further refinements to financial services regulation and electronic commerce changes to the Consumer Credit Code. We believe it reasonable for the Ministerial Council on Consumer Affairs to also factor these into implementation of the proposed amendments.

Conclusion
Many Australian Governments are currently concerned with the extent of "red tape", and are considering ways to ensure regulatory imposts are effective and beneficial. At this stage, we see the consultation package reforms are being contrary to this.

As we said at the beginning of this submission, we support disclosure in the provision of credit products to consumers. Any measure that improves and benefits the process of disclosure has our support. However, the proposed amendments to the precontractual statement are not an improvement, nor do we believe they will benefit consumers.

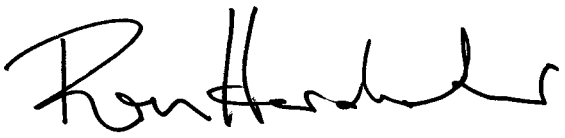
We believe the consultation package can however provide a springboard for a more stakeholder collaborative approach to working through improvements to the Code's disclosure mechanisms. We would recommend that the Ministerial Council undertake a rethink of its proposals and commission appropriate research. That research can also examine our alternatives placed forward for consideration 2 years ago and during the Code's post implementation review in the late 1990s.

Based on the concerns we have expressed in this submission, and our recommended way forward, the AFC will be discussing with kindred bodies a practical means of engaging all stakeholders in a better way to advance policy development of the Code.

In the meantime, if you require further assistance, please do not hesitate to contact AFC's Legal and Market Consultant, Steve Edwards (telephone: 0414 232 562 | email: steve@afc.asn.au), or me.

Kind Regards,

Yours truly,



Ron Hardaker
Executive Director

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Appendix A

AFC Comments on Draft Bill & Regulation

Consumer Credit Amendment Bill 2005

Provision of Bill	Comment	Recommendation
2	Agree that a significant implementation period is required, given changes involved to documentation, systems, training of staff and intermediaries, etc.	Allow a 2 year implementation period
4 – new s14(5)	The physical separation of the proposed contract from the related precontractual statement imposes additional procedures and loses the link with contract. This imposes a new piece of paper in the name of disclosure of some, but not all, information that is contained in the contract document in accordance with s15. The disclosures contained in the precontractual statement will be repeated in the contract document.	Do not proceed with new s14(5)

Consumer Credit Amendment Regulation (No.) 2005

Provision of Regulation	Comment	Recommendation
4 – new s13(1)	There are concerns that the stipulated disclosures and information will not always be able to limited to 2 A4 pages	Flexibility should be permitted to document length necessary to comply with s13A.
4 – new s13(2)	Duplicates s162 – it is unnecessary	Do not proceed with new s13(2)
4 – new s13(3)	What is meant by "credit facility"? Does it embrace split loans?	Concept needs definition for certainty
4 – new s13A	Should there not be a mirror-reverse statement to that required by s13(B)(1) included in the financial table, directing readers to the "summary of other information", the information statement and the credit contract?	Consider
4 – new s13A(4)(b)	Needs to address situation where the interest rate changes between precontractual disclosure and credit being advanced.	Require inclusion of a statement that the rate can change until credit advanced, if that is the case
4 – new s13(A)(4)(c)	This is not required by s15. It seems more focused on marketing features than meaningful disclosure. Many contracts, especially home loans, give borrowers the	Do not proceed with new s13A(4)(c)

	choice to change applicable rates between variable and fixed. We are unclear why this is regarded as a key disclosure.	
4 – new s13A(5)(b),(c)	In the context of an interest free product, these paragraphs seem to be stating the obvious, rather than a meaningful disclosure	Do no proceed with new s13A(5)(b) and (c)
4 – new s13A(6)	This provides for confusion for readers of the summary table. Ongoing fees can be linked to payments or periods, not necessarily annual. The references to government charges in curious, especially duty on the transfer of land. The trigger for the imposition of transfer duty is not the provision of finance. Why should credit providers who finance the purchase of land include detail about transfer duty? That is the responsibility of the purchaser's advisors.	Remove the requirement to show ongoing credit fees as an annual amount or change so that ongoing fees can be shown at a frequency consistent with the contract. Government fees/duties are part of the costs of credit and should be included in disclosure, except land transfer duty.
4 – new s13A(7)	The disclosure of the amount of minimum repayment based on a fully drawn credit limit will not bear a relationship to the amount that will actually be paid. Many do not fully draw down. In terms of para (b), in many instances the amount required to pay within a interest free period will be depend on the outstanding balance, i.e. that balance is to paid in full by the due payment date. Also, the value to consumers of this disclosure is questionable, as is the policy objective in stating the amount of the minimum payment based on full draw down.	Require statement of minimum amount calculation, instead of statements proposed
4 – new s13A(8)	To provide a reasonable estimate of the maximum repayment amount if the actual amount is not ascertainable, is difficult if not misleading. For instance, construction loans frequently provide for an interest only period while a house is being constructed, with interest only payments due, based on progressive drawn downs. This can vary each month. If the maximum estimate is to assume full drawn down, it bears no correlation to the amount borrowers will actually be paying, as when a construction loan achieves full draw down it becomes principal and interest with a known repayment amount.	Do not proceed with para (b)
4 – new s13A(9)	The requirement to point out credit contract provisions dealing with cancellation is puzzling and ambiguous, particularly in the	Do not proceed with this subsection, or at least do not proceed with the requirement

	context of a summary that is meant to deal only with key financial information. It is unclear whether it extends to the right to payout a loan early. Also, disclosure of the term of a credit contract is even a current requirement of s15 of the Code.	to cross-reference contract provisions dealing with cancellation rights.
4 – new s13A(10)	This is less than ideal drafting, and can lead to error in understanding the Code's requirements. The content of this subsection should be transfered to subsection (6), which the subject-matter dealt with.	Move content to s13A(6).
4 – new s13A(11)		Agree
4 – new s13B(1)	The substance of this is already addressed elsewhere during the precontractual processes under ss14 and 15, including the Forms 3A and 3B warning boxes.	Reconsider in the interests of utility and space
4 – new s13B(2)	Separating disclosures about the APR, with some dealt under s13A and others under s13B, and the rest in the contract is, in our view, likely to be unhelpful, if not confusing to the borrowers. Para (a) requires details of how a change in the APR is to occur – it is unclear as to what is required to satisfy this requirement, e.g. is it the method by which a change will be advised, or is it a method of calculation, etc? Also, is a default rate to be regarded as a change in the APR? Para (b) disclosure of fees relating to a change of rate type can depend on whether a borrower is breaking a fixed rate period. Likely fees can include switch fees and break costs fees. The degree of disclosure militates against the brevity required by the proposed summaries.	Consider in light of comments
4 – new s13B(3)	The layered disclosure of information, in this instance, concerning interest free periods and their management, we believe to be of little value. The summary table tells some of the disclosure, the summary of other information tells some more of it, and then it is all repeated in the credit contract.	Reconsider in light of comments
4 – new s13B(4)	Again, disclosures of information are layered. And, in this instance in particular, appear to lack merit. Para (a) lacks substance that is not already addressed in summary table Para (b) is an inappropriate disclosure,	Reconsider in light of comments

	requiring credit providers financing land to provide a statement of duty and fees payable for buying land. Land purchasers are typically advised by lawyers or conveyancers who address this with their clients. It should not be an imposition on the likes of home lenders. If the policy intention is to only apply this disclosure to land sold on credit, then the drafting of the provision needs to be reconsidered. Paras (c) and (d) could result in expansive disclosures, especially flowing from the credit contract cross-referencing requirement. Most contracts have a table of fees, plus provisions dealing with the circumstances of charging, debiting and recovery of those fees. Para (e) overlaps with para (d). Para (f) deals with an issue that is generally not dealt with in credit contracts. Waiver of fees is largely discretionary, not a matter of contractual right. The point of this disclosure requirement eludes us.	
4 – new s13B(5)	Again, disclosure is divided, and its purpose is unclear.	In the interests of relevance, value and brevity, do not proceed with s13(5)
4 – new s13B(6)	Para (a) is inconsistent with s15(L) of the Code. At the time of entering a credit contract, the precise details of the secured property may not be known – s15(L) reflects that. What is important is that the mortgage identifies the property in accordance with the Code. Para (b) mentions "mortgage insurance". This would appear to be inconsistent with s133(1) of the Code which refers to mortgage indemnity insurance. Or make all references in the Code consistent to "lenders mortgage insurance" or the like. Mortgage insurance is a term that can in fact be used for insurance taken out by mortgagor as a type of consumer credit insurance.	Do not proceed with para(a) or at least draft consistent with the Code. Consider para (b)in light of comments
4 – new s13B(7)	As long as this requirement of para (a) is intended to be discretionary to the credit provider, we offer no comment. However, if it is intended that "special features" be identified and cross-referenced to the credit contract, then we ask for more detailed information about what constitutes "special features".	Consider in light of comments