Submission
No 12

INQUIRY INTO UNFAIR TERMS IN CONSUMER CONTRACTS

Organisation: Australian Bankers' Association Inc

Name: Mr Ian Gilbert

Position: Director

Telephone: 02 8298 0406

Date Received: 11/10/2006

AUSTRALIAN BANKERS' ASSOCIATION INC.

Ian Gilbert
Director

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0406
Facsimile: (02) 8298 0402

11 October 2006

The Hon. Christine Robertson MLC
Chair
Legislative Council Standing Committee on Law and Justice
Parliament House
Macquarie Street
Sydney NSW 2000

Lodged online

Dear Ms Robertson,

The Australian Bankers' Association (ABA) represents 26 banks authorised to carry on the business of banking in Australia. Those member banks have upwards of 15 million customers many with multiple account and banking relationships. The most recent figures from the Reserve Bank of Australia, (July 2006) indicate that banks' resident assets (residential and personal lending) were approximately $655 billion. On the liabilities (deposits) side resident liabilities represented by deposits were approximately $811 billion.

The ABA is pleased to have the opportunity to be consulted and to respond to your Committee's inquiry. We appreciate the additional time provided for the ABA to make its submission.

In this submission to your Committee the ABA has not attempted to deal *seriatim* with each of the specific matters listed in the terms of reference. It is expected that those seeking unfair contracts regulation will seek to provide the Committee with the necessary evidence and examples.

The ABA believes that the types of contractual provisions listed in the terms of reference are unlikely to operate in the banking industry for the reasons set out throughout this submission.

In short, it can be said that in general banking services contracts with consumers are substantially regulated under legislation or codes that ensure that:

(1) consumers receive notice of any unilateral variation in the price or characteristics of banking services;

(2) where there is a breach of contract the party in breach is liable;

(3) in the absence of breach by the customer (for example default in repayment of a loan where interest will continue to accrue until the loan is repaid), the provision of the relevant banking services and payment are mutual obligations; and

(4) the customer retains the right to terminate the contract at will.

1. Summary

The inquiry terms of reference raise a range of questions that the Standing Committee of Officials of Consumer Affairs Unfair Contracts Terms Working Party also has been considering following its release of its Unfair Terms Discussion Paper in January 2004. The ABA made a submission in response to that discussion paper and this submission to your Committee draws largely on the ABA's earlier submission.

Initially there are some key points that the ABA wishes to make most of which will be expanded upon in this submission.

The ABA has taken a pragmatic approach to the question of whether national regulation of unfair contract terms is needed. Given that Victoria has already amended its Fair Trading Act to deal with "unfair" contractual terms, the ABA recognises the risk of national disuniformity if other jurisdictions were to do the same - but not according to a uniform, national model. In these circumstances, the ABA supports a nationally consistent approach to legislation for the regulation of "unfair" contractual terms in consumer contracts only.

If, after appropriate consultation, the Committee is of the view that legislation should be developed to regulate unfair contract terms in consumer contracts, the ABA requests that:

(1) The proposed legislation is based on a nationally uniform model.

(2) A national model should deal with two aspects of unfairness: -

- Procedural unfairness leading to the formation of contracts that are "unjust"; and
- Substantive unfairness with respect to "unfair" terms in the contract.

(3) For the Consumer Credit Code (CCC), which applies to a specific part of the credit market, consumer credit, the unjust contracts provisions in sections 70 and 72 and those provisions of the CCC relevant to the making of unilateral changes to a credit contract are retained in their current form. These provisions are concerned with both procedural and substantive unfairness and in particular sections 70 and 72. The January 2004 discussion paper noted that many of the disputes under section 70 of the CCC in respect of

unfair terms are settled before they reach the Courts. This is a positive indication that these provisions have an effect. Contracts that are regulated under the CCC should not be further regulated under any proposed unfair contracts regime.

(4) The national model should recognise that self-regulatory requirements and expressly permitted terms for contracts are beyond the scope of the regulation. For example the Code of Banking Practice (CBP) provides (clause 2.2) that a bank must act fairly and reasonable towards its customer in a consistent and ethical manner having regard to conduct and the banking contract. The CBP binds the bank contractually.

(5) Due consideration is given to the special need in banking and finance contracts for contractual certainty to satisfy the prudential risk management requirements applying to them and to provide financial stability for a sector central to the national economy

(6) Crucial terms for these purposes are those providing the right to vary terms and conditions on reasonable notice, to vary interest and other rates and fees and charges in accordance with the agreed terms and conditions, to assign credit contracts and the securities for them under securitisation arrangements, to withdrawal of certain forms of credit without notice including overdraft and credit card loan facilities, to combine account balances, and to terminate contracts on reasonable notice or otherwise in accordance with the agreed terms and conditions.

The following additional points on unilateral change clauses and standard form contractual terms are submitted for the Committee's consideration:

Unilateral Change Clauses

- Unilateral change clauses or any other clause of the type described below are not necessarily unfair *per se*. The concept of "unfair" terms needs to be considered with due regard for the operating context of financial services contracts, particularly credit contracts. This is particularly the case given recent comments made in a different context in the High Court of Australia decision in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* [2006] HCA 41. At page 35 of the judgment Gummow, Hayne and Crennan JJ said:

  " ...to ask whether the bargain struck... is "fair" assumes that there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity. Neither assumption is well founded."

Significantly the Contracts Review Act, 1980 did not include the term *'unfair', preferring the term 'unjust'*. The late Professor Peden, who was largely responsible for the drafting of the Act, said that *"this might have been interpreted to include situations in which, although the contract favours one party, there has been no abuse of power or unfair conduct on his part."* (refer *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 621.) The recent decision of the Victorian Civil and Administrative Tribunal in *Director of Consumer Affairs v AAPT Ltd* [2006] VCAT 1493, at page 21 of the decision demonstrates the difficulty in defining an unfair term.

- Unilateral change clauses are applied by banks fairly and reasonably (the CBP requires this) and are necessary for the efficient administration of credit contracts;
- Unilateral change clauses are required to ensure that ongoing contracts are kept up to date to align with market and regulatory developments and the cost of maintaining a banking service. This means, for example, that a bank can ensure the banking services contract continues to comply with applicable laws and codes that might be amended for time to time.
- The FSR contemplates unilateral changes to financial services contracts by a financial services licensee. It imposes a positive obligation upon the person responsible for a product disclosure statement for a financial product to notify the holder of the financial product of any material change to any of the matters specified in the PDS or any significant event that affects matters specified in the PDS. The legislation sets out the time for giving notice of change or event to the holder of the financial product. This is can only be achieved efficiently and consistently where standard form contracts exist.
- The CCC makes specific provision for unilateral variations of consumer credit contracts with appropriate notification requirements.
- Notice of any change informs the consumer of the change in advance, it also affords the consumer the opportunity to terminate the contract and engage another provider before the change becomes effective.
- Inappropriate restrictions imposed on the application of unilateral change clauses in credit contracts could lead to an increase in the cost of credit or reduced credit product flexibility such as short term, fixed price contracts.

Standard Form Contracts

Similarly as in the case of unilateral change clauses:-

- Standard form contracts help to provide consistent protection for customers, and are a critical component of a bank's compliance with relevant legislation - notably the CCC and the financial services reform regime (FSR) in Chapter 7 of the Corporations Act 2001.
- Standard form contracts are also important to ensure there is compliance with applicable codes of conduct, notably the CBP and the Electronic Funds Transfer Code of Conduct (EFT Code).
- Standard form contracts help with staff training and provide consistency for customers who are accustomed to dealing with their bank and for those who advise customers on their banking contracts.
- Standardisation also reduces the risk of bank staff amending the form of a contract that could lead to a breach of a law or code.
- Under the CCC, terms and conditions are supported with financial disclosure (Schumer box/financial table). Terms and conditions must be easily legible, clear and in conformity with prescribed print size.
- Under the FSR, the product disclosure statement has certain mandated disclosures. Documents must be clear concise and effective. Licensees are under an obligation to "do all things necessary to ensure that financial services covered by the(ir) licence are provided efficiently, honestly and fairly" (section 912A (1) (a)).
- Under the CBP, terms and conditions must be effective disclosure, in plain language and distinguishable from marketing material. Under the CBP banks must act fairly and reasonably and in a consistent and ethical manner. This would preclude unfair reliance on a contractual term.
- Under the EFT Code, terms and conditions must be in clear and unambiguous terms.

The views of the Australian Prudential Regulation Authority (APRA) should be sought on the effect national unfair contract terms legislation could have on banks and other prudentially supervised entities; this is because banks are prudentially supervised by APRA and have a legal responsibility not to put at risk their depositors' funds.

2. Contractual terms that permit unilateral changes or are in standard form must be considered in their proper context

The ABA submits that the mere presence of standard form contracts for banking services or unilateral change clauses in banking services contracts does not

necessarily lead to the issues of unfairness described in the Committee's terms of reference ((a) – i) to iv) and (b)).

Contractual terms which on their face may appear "unfair" must be considered in their proper context. Otherwise, it becomes an abstract exercise to examine whether a term of a contract is "unfair" if the context is ignored and the reason why certain terms exist.

The Reserve Bank of Australia data referred to above is relevant in understanding the context. This context is one of significantly large numbers (millions) of bank customers and extremely high levels of bank assets and liabilities all of which must be managed efficiently and effectively, with prudence and safety.

It follows that contractual terms for banking services contracts cannot in any practical sense be individually negotiated. Simply put, it would be impracticable (a near impossibility) and be cost prohibitive (and therefore for customers) for banking services contracts to be individually negotiated. The same impracticability applies if all contractual variations had to be individually negotiated.

Principles of efficiency and efficacy already mentioned coupled with the need for contractual certainty to prudently and safely manage extremely large portfolios of assets (loans) necessitates a high level of standardisation of contractual terms and terms that can accommodate economic and regulatory changes over the life of a loan.

As already mentioned, unilateral change clauses in banking contracts are important in ensuring that banking services contracts remain relevant and compliant with regulation and self-regulation. These reasons are as important for bank customers as they are for banks themselves. For example, the CBP and the EFT Code are reviewed every three years. Changes to these Codes inevitably lead to amendments to existing customer contractual terms.

The ABA believes that its members' approach to the use of standard contractual terms and to the exercise of the right to vary banking services contract unilaterally are responsible, reasonable and fair.

This is supported in the CBP where member banks of the ABA subscribe to the CBP. The CBP binds the bank contractually to its terms. Clause 2.2 of the CBP provides:

> *"We will act fairly and reasonably towards you in a consistent and ethical manner. In doing so we will consider your conduct, our conduct and the contract between us."*

In his Final Report on the review of the CBP (Review of the Code of Banking Practice Final Report October 2001) Mr Richard Viney, the independent reviewer of the Code and who recommended that a fairness principle be incorporated in the CBP, said that the inclusion of the fairness principle in the CBP would:

"represent, when implemented, a considerable advance in customers' rights" (Final Report p7)

The ABA believes that clauses in banking services contracts provide a good balance between the responsible application of contractual conditions, the interests of the community in having a prudentially sound and safe banking system and the interests of the customer in understanding contractual terms.

The UK experience where, so far, more than 5000 contractual terms have been identified as potentially unfair appears to be an unnecessarily complex and inefficient approach to the issue. The search for unfair terms would seemingly go on forever and to what outcome?

At a Consumer Affairs Victoria seminar in November 2003, Mr Chris Field, the then chief executive of the Consumer Law Centre Victoria and a leading consumer advocate observed that "making terms in contracts unlawful must be examined in terms of compliance costs, and its impact upon competitive markets, however businesses must compete fairly". The ABA submits that the matters raised by Mr Field should be taken into consideration by the Committee.

There will be compliance and related consequential costs for industry arising out of national unfair contractual terms legislation as indicated earlier in this letter. The combination of industry specific legislation covering the provision of financial services, ready availability of free alternative dispute resolution services for retail customers, the contractually binding nature of the CBP are all designed to facilitate a competitive environment of fair and informed participation by consumers.

3. Judicial reluctance to interfere with commercial contracts

Courts have been reluctant to intervene in the exercise of a financier's expertise and judgment on the terms and conditions for the financier's standardised financing contracts and for good reason. In *Citibank Savings Bank Ltd v. Vago*, an unreported decision of Cole J in the Supreme Court of NSW (1 May 1992) His Honour observed that the court should judge the foreseeability of future events and the need to make provision in financing contracts for those events against the historical background of cyclically collapsing values. The court should be reluctant to assume that the commercial judgment of experienced financiers is unreasonably in error in requiring a particular level of security for a loan.

This principle is equally applicable in the formation generally of contractual terms in financial services. It is not and should not be the role of regulators or the courts to usurp the experience and commercial judgment of a banker in determining appropriate contractual terms.

In *Esanda Finance Corp Ltd v Murphy* (1989) ASC 55-703, Hunt J pointed out when he considered the equivalent provisions of section 9(2) (c) of the Contracts Review Act 1980 (NSW) as they appeared in the Credit Act 1984 (NSW), that it flies in the face of reality to expect that a borrower would expect to negotiate the terms of loan contract with a bank or finance company.

Whilst some advocates for unfair contracts terms legislation point to such cases as warranting legislative intervention, this ignores the very salient messages the courts are sending where experience and risk management must be respected in the setting of contractual terms.

4. Prudential supervision and risk management

The Basel Committee on Banking Supervision published its Principles for the Management of Credit Risk in September 2000 (No. 75) which apply to banks (see www.bis.org/bcbs/publ.htm) The Principles contemplate that for a bank to properly and adequately manage credit risk it must have the ability to amend, renew and re-finance existing credits, administer credit risk bearing portfolios, take account of future changes in economic conditions, assess credit risk exposures under stressful conditions and respond and have in place a system for early remedial action on deteriorating credits, managing problem credits and similar workout situations. To meet these prudential principles banks must have the ability to vary contracts unilaterally. Standard form contracts must have relevant non-negotiable terms and conditions for these purposes.

5. What evidence is available of actual disadvantage from contractual terms considered to be unfair?

To the ABA's knowledge there has been no systematic collection of data on the incidence of the use of unfair contract terms or their impact on consumers. Reliance in the past has been placed on an Australian Consumers' Association (ACA) submission to the Dawson inquiry into the competition provisions of the Trade Practices Act as providing evidence of disadvantage.

While examples provided by the ACA are limited, one example of a unilateral change clause cited by the ACA in Annex 11 to its submission to the Dawson review concerns a clause in a consumer banking contract that permits the bank to change amounts of interest and fees and the methods for calculating them and concluding with the words (and) "change any other terms and conditions". The literal interpretation of this clause without regard to the context could convey the impression of unfairness. However, such a clause would almost certainly be read down by a court to apply to terms and conditions that had some relationship with the preceding clauses where unilateral changes by the bank could be made. No additional comment was made by the ACA to qualify the potential impact of the clause nor was any evidence provided as to whether the clause might have been relied upon and, if so, in what circumstances and to what, if any, resulting detriment to the customer. The test that should be applied to such a clause is "*Was the unilateral power to vary the contract exercised fairly?*"

A further example described in the ACA submission as a "tendentious" example involved a commonly understood provision in lending contracts usually described as a "cross default" clause applying to other facilities and securities of the borrower. Such clauses are essential in lending contracts for banks to prudently manage credit risk. Under Basel Principles banks must aggregate credit exposures

on an individual client basis across their banking book and to manage those exposures accordingly. The ability to call in exposures of the bank to the client and to combine accounts is central to sound credit risk management. Such clauses are also important in securities where bankruptcy intervenes. The ABA considers that in the area of banking and management of credit risk terms and conditions providing wide discretions to the bank particularly where lending exposures are high and risks accentuated (for example a substantial deterioration in economic conditions) is essential to sound prudential risk management.

Unlike other contracts on other industries, contracts for banking services are, in general, terminable at the option of the customer. The customer can close their account and withdraw their money and deposit it somewhere else, refinance their loan, change credit card providers and so on. The financial institution cannot impose what might be considered unfair terms on the customer and then force the customer to be held into the contract bound by those terms indefinitely without the customer having the choice to go elsewhere.

Arguments that the enforcement of rights under legislation by litigation is not effective because litigation is slow, costly and binds only the parties to the proceeding ignore the virtual universality of alternative dispute resolution (ADR) in the financial services industry. A financial institutions regulated under the FSR must be a member on an ADR scheme approved by the Australian Securities and Investments Commission (ASIC).

With the advent of alternative ADR schemes in financial services and the increase in the number of schemes due to the FSR covering both consumer and small business disputes, access to free and independent dispute resolution is available in ways that avoid the disadvantages of litigation. Also, ASIC has made it a condition of its approval of ADR schemes for the purposes of the FSR that the schemes must monitor general trends and issues and report to ASIC systemic issues and serious misconduct for investigation (see ASIC Policy Statement 139 at 139.35). The Financial Services Ombudsman scheme in determining disputes may have regard to the law, *fairness* and good banking practice (emphasis added).

The examples of purportedly unfair contract terms advanced by the ACA and in the January 2004 discussion paper for regulation of unfair contracts terms seem to be more concerned with the apprehension of disadvantage rather than any real, materialised disadvantage or consumer detriment. The absence of substantial research showing actual disadvantage suggests a cautious approach to the regulation of "unfair" contractual terms would be prudent.

Legislative recognition of the right to unilaterally vary a contract is also a recognition that the circumstances under which a contract was originally created might change. This could be due to regulatory changes, economic circumstances or the customer's own financial situation.

The ABA submits that these factors should be taken in to consideration and reflected in the development of any nationally uniform unfair terms legislative model.

6. Relevant CCC provisions

Looking at the relevant CCC provisions more closely helps to bear out the point that the terms of the CCC should be left intact. A brief summary of the relevant provisions of the CCC follows. The summary is not intended to be a precise re-statement of the law but is intended to be sufficient to reflect how the CCC's provisions operate.

Unilateral changes in consumer credit contracts, mortgages or guarantees are regulated by Part IV of the CCC (sections 58 through to and including 74). Excluded from this regime by Section 58 (2) are:

(1) changes, ascertainable from the contract, to annual percentage rates;

(2) changes to repayment amounts if automatic;

(3) increases in the term of a credit contract if it occurs because a change in the annual rate, and

(4) a change made under Division 3 (one made on the grounds of hardship).

Section 59 requires written notice of changes in annual percentage rates to be given not later than the day on which the change takes place. Such a change can be published in the newspaper but notice generally needs to be given again when a new statement or account is provided to the debtor. Under Section 59 (4) at least 20 days notice must be given of a change in the manner in which interest is calculated or applied under a credit contract.

A similar notification provision applies in Section 60 in the context of instalments or minimum repayments under a credit contract, and Section 61 extends the same notification requirement to changes in amounts of credit fees or charges or frequency or time for payment of a credit fee or charge.

Under Section 62 if a credit provider decides not to provide any further credit under a continuing credit contract, the contract continues in force in respect of existing credit but the credit provider needs to advise the debtor of its decision not to provide any further credit or to reduce the credit limit unless the debtor is in default. The credit provider can only increase the credit limit (62(3)) at the request or with the written consent of the debtor.

Section 63 requires not less than 20 days notice of the exercise of a power under a credit contract, mortgage or guarantee to unilaterally change terms. Reductions in the debtor's obligation or extensions of the time for payment do not require prior notice but, in that case, the change must be given on or before the next statement of account.

Section 64 inhibits unilateral changes by the credit provider in contracts where the annual percentage rate is fixed if the effect is to increase or change the method of calculation, or the fee or charge payable on early termination of the credit contract or payable on pre-payment (subject to regulations).

Under Section 66 a debtor who is unable, for reasonable cause, to meet his/her obligations under a credit contract but reasonably expects to discharge his/her obligations if the terms of the contract was varied, may apply to the credit provider for such a change.

Under Section 67 if agreement is reached with the credit provider, the credit provider must, within 30 days, give the debtor particulars of the agreed change.

Under Section 68 if the credit provider does not agree to the debtor's request for a change, the debtor can apply to the Court.

Under 68 (2) after hearing the parties, including any guarantor, the Court can order a change to the credit contract in one of the ways permitted by Section 66 (2) which are:

(1) extending the term and reducing the amount of each payment;

(2) postponing the dates on which payments are due under a contract during a specified period; and

(3) extending the period of the contract and postponing the dates on which payments are due (etc).

Under Section 70, the court can reopen unjust transactions, if it is satisfied, on the application of a debtor, mortgagor or a guarantor that, in the circumstances, at the time when the contract was entered into or varied, the agreement was unjust. The matters the Court is able to consider are listed in Section 72 and include:

(1) relative bargaining power;

(2) whether there was negotiation;

(3) whether having negotiations was reasonably practicable;

(4) whether conditions are unreasonably difficult to comply with or not reasonably necessary for the protection and legitimate interest of a party;

(5) the capacity of the debtor, having regard to age, physical and mental condition;

(6) the form of the contract;

(7) the intelligibility of the language;

(8) whether or not independent legal advice was obtained;

(9) the extent of explanations provided;

(10) the presence or absence of unfair pressure;

(11) the steps the credit provider took to explain the nature and implication of the transaction to the parties;

(12) whether the credit provider knew, or could have known by reasonable inquiry, that the debtor could not pay without substantial hardship or not in accordance with the terms;

(13) whether the terms of the transaction by the credit provider is justified in light of the risks undertaken by it;

(14) the terms of other comparable transactions involving other credit providers, and

(15) any other relevant factor.

In Section 71 the powers of the Court, following a reopening of a transaction, are set out.

They include powers:

(1) to re-open an account already taken between the parties;

(2) to relieve the debtor of payments in excess of those reasonable with regard to the circumstances, including the risk;

(3) to set aside part or revise or alter an agreement;

(4) to order the mortgagee to take steps necessary to discharge the mortgage;

(5) to give judgment for a party with such relief that the Court thinks fit to grant;

(6) to give judgment for delivery of goods and make ancillary or consequential orders.

Under Section 72 the Court may review unconscionable interest and other charges. Examples of unconscionability in the context of changes to the annual percentage rate are limited to:

- changing annual percentage rates in a manner that is unreasonable, having regard to advertised rates or other representations made by the credit provider before or at the time the contract was entered into,
- the period of time since the contract was entered into, and
- other considerations the Court considers relevant.
- Or the change discriminates unjustifiably against the debtor when compared with other debtors of the credit provider under similar contracts.

There is a two-year cut-off period for applications under this Section.

Accordingly, applying Part IV to unilateral change clauses in consumer credit contracts, there are, in fact, existing wide powers in the Court to make adjustments and to relieve most injustices.

The ABA submits there are strong grounds based on the relevant unilateral change and "unjust contracts" provisions in the CCC in their current form to exclude consumer credit contracts that are regulated under the CCC form any unfair contract terms legislation.

7. Possible improvements to the Victorian Unfair Contract Terms Model

The Victorian Fair Trading Act amendments dealing with unfair terms in contracts are likely to become the starting point for dealing with the substantive aspect of unfair contractual terms.

The ABA believes it would assist the Committee if there is comment on aspects of the Victorian legislation.

Section 32W

In the Victorian Fair Trading Act the test of what is an unfair term appears in section 32W.

Basically there are four elements of the test: -

(1) Good Faith;

(2) The particular circumstances;

(3) The creation of a significant imbalance in parties' rights and obligations; and

(4) Consumer detriment.

There appears to be an important element missing from the definition in section 32W. The missing element for banks is business efficacy and depositor protection.

The terms of a contract by a business with its customer are for the proper conduct of the business and to comply with the law. There are contractual terms where negotiation cannot be entertained for these reasons. Also, there is legislation, for example the CCC, which prohibits parties contracting out of the requirements of the legislation.

In structuring contractual terms, a business must have regard to principles of efficiency and efficacy. These principles are particularly relevant and important in banking services contracts due to the unique position that banks occupy in the financial services sector and the Australian economy.

Banks are prudentially supervised institutions and have a legal responsibility not to put depositors' funds at risk. Banks need to ensure that there is contractual certainty in the obligations their customers owe to the bank and vice versa. This

is particularly the case in relation to credit contracts. The customer has the benefit of the contract to lend money and a prudent bank must be certain it is able to recover the loan.

The reference in section 32W to "in all the circumstances" should specifically include a recognition that a business (in the ABA's case a bank) has a legitimate interest in conducting its business efficiently, properly, efficaciously, in accordance with the law and with certainty. This is also a public interest criterion.

Section 32V (b)

Section 32V (b) of the Victorian legislation does not provide for contractual terms that are required or expressly permitted by codes. It should because both the CBP and the EFT Code require that the terms of those codes are to be reflected in consumer contracts.

There should be recognition of self-regulatory requirements and expressly permitted terms for contracts should be beyond the scope of the legislation.

Section 32Y (5)

Section 32Y (5) of the Victorian legislation applies retrospectively in the case of standard form contracts.

Typically, contracts for financial services endure for periods of years. Currently, there are millions of financial services contracts in existence. The financial services provided under these contracts have been priced on the basis of the terms and conditions agreed at the relevant time and bolstered by pre-contractual disclosures. The assessment of credit risk, which is a determinant of the price and availability of credit, will have been agreed, in part, on the basis of the contractual terms contained in standard form. Section 32Y (5) will affect these contracts retrospectively. If existing terms and conditions are required to be changed a further assessment of credit risk could be necessary with resulting pricing and finance availability implications. There would be substantial compliance costs to the industry because only relatively recently it has settled contractual terms and conditions for products and services regulated by the FSR and the revised CBP.

It would be helpful to industry and to regulators for the legislation to provide some criteria as a guide to relevant circumstances that would be taken into for the purposes of 32W or its national uniform model replacement.

For example, many banking contracts are either settled for long terms (a housing loan contract can be repayable over a fixed term 25 or 30 years) or are open ended (credit card facilities, deposit and transaction accounts). It is submitted that the term of a banking services contract is a relevant consideration in determining whether a particular term of the contract is to be regarded as unfair. A provision in a short term contract that appears to permit the organisation to change any of the terms of the contract unilaterally should be viewed differently to the same clause in a long term or open ended contract where important

circumstances are more likely to occur over time that warrant the wider ability to make changes.

As mentioned above, restrictions on the inclusion of unilateral change clauses in contracts could drive provisions that permit the provider to terminate the contract or shorter terms contracts which would be to the disadvantage of consumers.

Unilateral change clauses are necessary to take account of innovation in providing banking services. What is today a convenient way of making payments under a contract may give way to alternative means of making payments tomorrow. Some contracts actually specify the means by which payments must be made for the debtor to obtain a valid discharge. Consumers would benefit if alternative payment options are able to be added to a contract at some later date. Practically speaking, it is not possible to predict what these changes might be or how they would be applied. A general variation clause in a contract provides the option to make relevant changes accordingly.

Yet, without understanding this possible future need, there is the risk that the clause could be seen as inherently unfair.

Section 32X

The criteria referred to in section 32X of the Victorian legislation that a court or tribunal might take in to account in determining whether a term of a consumer contract is unfair includes whether the "term was individually negotiated". Again, the notion of individual negotiation of banking services contracts requires a proper consideration of the context and the principles of business efficacy and efficiencies.

Section 32X (j)

Under section 32X (j) there is the potential restriction on the assignment of the benefit of a party's rights under a contract to the other party's detriment unless the other party consents. Apart from the common law right to assign it can be necessary to make explicit provision for assignment in the contract. For example, under a loan securitisation program, a credit provider's portfolio of loans needs to be readily assignable into the securitisation vehicle. Having to seek consent would seriously complicate securitisation programs.

Similarly, the ability of a creditor to sell outstanding assets in the form of debts, particularly debts where the creditor believes there is little prospect of recovery for a discounted return is an appropriate part of managing a debtors portfolio.

An example of an assignment clause is:

> *"The **Bank** may assign or otherwise deal with its rights or beneficial interests under this agreement in any way the **Bank** considers appropriate. **You** agree that the **Bank** may disclose any information or document the **Bank** considers necessary to help the **Bank** exercise this right.*

***Your** rights are personal to **you** and may not be assigned."*

Clearly, in the case of a loan a bank would not permit the borrower to assign the benefit of the loan without the bank's consent. The bank has made its credit risk assessment of the borrower that is central to its decision to lend. It should not become exposed to an unknown assignee. To ensure that an assignee receives the benefit of the assignment the debtor's authority for the bank to provide information is necessary. Without the consent of the customer, the bank's duty of confidentiality would prevent disclosure to the assignee. These provisions are based on reasonable considerations of business and commercial efficacy.

Sections 32ZA, ZC and ZD

Sections 32ZA, ZC and ZD provide that the Victorian Administrative and Civil Tribunal (VCAT), has an important role in adjudicating on whether a term of a contract is "unfair". VCAT may use injunctive or declaratory powers evidenced by its recent decision in *Director of Consumer Affairs v AAPT,* and it is empowered to provide an advisory opinion to the Director of Consumer Affairs in respect of specific contractual terms.

Also, there is power under the legislation for contractual terms to be prescribed as unfair.

Where VCAT exercises its jurisdiction in a proceeding there are appropriate procedures in place to ensure that the respondent has ample opportunity to present its case and inform VCAT about the purpose, application, and context of the particular contractual terms.

Where VCAT is exercising its advisory jurisdiction or where the government proposes to prescribe a contractual term as unfair the ABA is concerned to see that provision is made in the legislation to ensure that organisations have an adequate opportunity to respond to an allegation that a type of clause or a particular clause in use by them is unfair. This procedure should be administrative and should precede any formal application to the VCAT or prescription by regulation. This is to ensure that the full range of views and information is available to assist in VCAT or the government in forming opinions about particular contractual clauses. Opinions formed without the opportunity for industry explanation and information on context could be seriously impaired.

Ideally, there would a prescribed procedure to facilitate this consultation that includes:

- A written statement given to the organisation setting out the reasons for believing that a particular contractual terms is unfair;
- Giving the organisation an opportunity to make a submission; and
- Providing a consultative forum with representation from a range of interested persons and bodies to consider and evaluate the relevant clause or clauses; and

- Taking account of the practicalities of effecting necessary changes to contracts in a timely and orderly manner.

The point on timing of changes to contracts necessitated by a clause being deemed unfair is important. It would be quite unrealistic that following a decision that particular clause has been deemed to be unfair for a business to immediately discontinue use of the term in what could be a vast number of contracts.

8. Business to business contracts should not be included

The ABA notes that the terms of reference for this inquiry relate to "consumer contracts" and the ABA has proceeded on the assumption that the inquiry will not delve into business to business contracts. Neither the UK legislation nor the Victorian legislation includes business to business contracts.

The ABA submitted in some detail in its April 2004 submission in response to the January 2004 discussion paper why Australian nationally uniform unfair contracts terms legislation should not apply to business to business contracts which is unnecessary to repeated in this submission.

9. Insurance and Managed Investment Schemes controlled by Bank related entities

Similar comments apply to contracts of this nature

The ABA would be happy to assist the Committee further in this inquiry

Yours sincerely

Ian Gilbert