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The Manager
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The Treasury PARKES ACT 2600

Exposure Draft: National Consumer Credit Regime

I would like to make the following comments on the proposed National Consumer Credit Regime, which is to be implemented through the *National Consumer Credit Protection Bill 2009* (the Bill).

The most important point I wish to make is to strongly support the overall thrust of the proposed regime. The Bill, once enacted, will facilitate Commonwealth regulation of consumer credit through the licensing of credit providers and finance brokers, and the imposition of certain minimum standards of conduct on licensees and their representatives. While there may be room for legitimate debate about certain specific aspects of the Bill, the proposed regime should help overcome many of the key problems which arise out of the current state and territory-based regulation of consumer credit, including the following:

a. there is currently a lack of uniformity in the law relating to consumer credit (including the administration of the law). This leads to unnecessarily high compliance costs for credit providers and finance brokers operating in more than

one jurisdiction. It may also allow unscrupulous practices to emerge in jurisdictions with lower (and inadequate) levels of regulation;

b. the current law does not adequately address inappropriate conduct by credit providers and brokers, such as irresponsible lending;

c. compliance with the Uniform Consumer Credit Code (UCCC) can be avoided too easily (for example, it does not apply where the consumer signs a Business Purpose Declaration);

d. some credit products (such as loans used for investment purposes) are not regulated by the (UCCC) at all;

e. the current law does not require adequate complaints resolution processes to exist for consumers;

f. achieving necessary law reform is extremely difficult because of the need to achieve consensus amongst States and Territories.

In the limited time available to consider and comment on the Bill, I have identified the following issues which may require consideration:

The meaning of 'credit activity' – credit providers

The meaning of 'credit activity' is critical since it helps define when a person requires a licence, and also helps define the scope of certain ongoing obligations which are imposed on licensees, such as the obligation to 'do all things necessary to ensure that the *credit activities* authorised by the licence are engaged in efficiently, honestly and fairly' (LIC 170(1)(a)). Unfortunately, the scope of the concept 'credit activity' is not clear in relation to credit providers. Clause DEF 5 of the Bill states, *inter alia*, that a person engages in credit activity if 'the person is a credit provider under a credit contract'. However, this definition does not clarify which activities of a credit provider are to be regarded as 'credit activity'. Presumably the definition of 'credit activity' is intended to be broad, and encompass all conduct relating to the provision of credit, including marketing, disclosure and the handling of consumer inquiries and complaints. In any event, I suggest that the scope of the concept 'credit activity' needs to be clarified.

When a licence may be granted

In determining whether to grant a licence, LIC 155 requires ASIC to have regard to certain matters (such as banning orders previously made in relation to the licence applicant) regardless of when those matters occurred (see LIC 155(2)(b)). However, criminal convictions must be considered by ASIC only if they are no more than 10 years old (LIC 155(2)(g)). It is not clear why banning orders which may have been made more than 10 years ago are regarded as relevant, whereas criminal convictions more than 10 years old are not regarded as relevant, particularly criminal convictions for serious fraud. The spent convictions scheme does not account for this apparent anomaly, since LIC 155(2) in its entirety is already expressed to be subject to Part VIIC of the *Crimes Act 1914*. As a result, under the Bill, a conviction for serious fraud, whether covered by the spent convictions scheme or not, does not need to be considered by ASIC if it is more than 10 years old. In my view, subject to the spent convictions scheme, all convictions should be disclosed, irrespective of their age, especially convictions for serious fraud. (I

recognise that LIC 155 largely reflects s913B of the *Corporations Act 2001*, and therefore my observations apply equally to s913B).

ASIC's power to make a banning order

I strongly support LIC 315(1)(e)(ii), which provides that ASIC may make a banning order against a person if ASIC has reason to believe that the person is likely to 'be involved in a contravention of a provision of any credit legislation by another person'. This provision will allow banning orders to be made against representatives whose conduct leads to a contravention of the law by the licensee for whom they act. For example, if the conduct of a credit representative results in their authorising licensee breaching the 'efficiently' honestly and fairly' obligation, then appropriate administrative action can be brought against the representative as well as the licensee. A similar provision should be introduced into the financial services licensing provisions under the *Corporations Act 2001* in due course. This would allow, for example, banning orders to be made against authorised representatives whose conduct results in their authorising licensee breaching relevant laws relating to the provision of financial product advice, such as the reasonable basis for advice rule (s945A).

Responsible lending

I strongly support the principle that credit should only be provided to those who can afford to repay the loan without substantial hardship. Nevertheless, the responsibility to ensure that consumers enter into suitable credit contracts should be regarded as a joint responsibility – that is, not only should credit providers and brokers have an obligation to lend responsibly, but consumers should be encouraged to borrow responsibly. To ensure that consumers can do this, greater resources will inevitably need to be expended on consumer education and improving disclosure documents.

Striking the appropriate balance in this area is difficult. For example, under the Bill, in making an assessment about the suitability of a credit contract, the licensee must, *inter alia*, 'make reasonable inquiries about the consumer's financial situation' and 'take reasonable steps to verify the consumer's financial situation' (see R160 and R260).[1] An issue which arises in this regard is whether the dual obligation to inquire *and* verify consumer information in all cases places too great an onus on credit providers and brokers, and places insufficient responsibility on consumers to provide full and accurate information in the first place. Of course, licensees may seek to verify consumer information as a matter of good business practice. But in my view the aim of the Bill should not be to codify good business practice, but to set out minimum acceptable standards of responsible lending. In my view, the law should provide greater flexibility to credit providers and brokers in determining a consumer's ability to repay a loan.

Unsuitable credit contracts – offence provision

Suggesting or entering into an unsuitable credit contract with a consumer is an offence (see R190, R192 and R290). The maximum penalty is 200 penalty units or imprisonment for 5 years (or both). In this respect, these provisions are consistent with the reasonable

[1] This may be contrasted with s945A of the *Corporations Act 2001* which requires only that reasonable inquiries be made in relation to the client's relevant personal circumstances. Section 945A does not impose a separate obligation to verify the information received about the client.

basis for advice rule in s945A of the *Corporations Act 2001* which, in turn, is *inconsistent* with the position which existed prior to the enactment of the *Financial Services Reform Act 2001* (see s851 of the *Corporations Law*). As noted by Mr Doug Clark 'the policy reason for making [s945A] a criminal offence carrying the same penalty as the serious offence of market manipulation has never been adequately explained.'[2]

I am not convinced that either s945A of the *Corporations Act 2001*, or the equivalent provisions under the Bill, should be offence provisions for which imprisonment is a penalty. The Australian Law Reform Commission has stated that 'a key characteristic of crime, as opposed to other forms of prohibited behaviour, is the repugnance attached to the act, which invokes social censure and shame.'[3] Further, the Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers observes that:

> certain conduct should be almost invariably classified as criminal…For example, conduct that results in physical or psychological harm to other people…or conduct involving dishonest or fraudulent conduct…In addition, criminal offences should be used where the relevant conduct involves considerable harm to society…or Australia's national interests…[4]

Applying these considerations, it is difficult to see why s945A or the equivalent provisions under the Bill should be criminal offence provisions. Accordingly, it is suggested that consideration should be given to de-criminalising these provisions. To do so would not alter the fact that a breach of these provisions could lead to other results, such as the imposition of administrative sanctions. Alternatively, consideration could be given to implementing the suggestion made by the Association of Superannuation Funds of Australia (ASFA) that a 'due diligence' defence should be introduced.[5]

Credit guides

I note that the failure to provide a credit guide is a strict liability offence, not an ordinary offence (see R130, R230, R330 and R430). This may be contrasted with s952C(3) of the *Corporations Act 2001*, which deals with the failure to provide a disclosure document such as a Financial Services Guide (FSG), which provides for a maximum penalty of 100 penalty units or imprisonment for 2 years (or both). Consistency between these provisions should be ensured. For the reason discussed above, it would seem inappropriate for the mere failure to provide a disclosure document to constitute an offence for which imprisonment is a penalty.

Attributing the conduct of agents and employees to their principal

The Bill does not seem to include any provision which replicates s769B of the *Corporations Act 2001* which provides that, for the purposes of Chapter 7 of the Act, people are generally responsible for the conduct of their agents and employees. While

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[2] Doug Clark 'FSR & the Stockbroking Industry' Presentation to Monash University FSR Forum 14 July 2006.

[3] Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, Report No 95 (2002) [2.10].

[4] Minister for Justice and Customs, *A Guide to Framing Commonwealth Offences, Civil Penalties and Enforcement Powers* (2004), 12.

[5] Association of Superannuation Funds of Australia, *Submission to the Financial Services Working Group* (2008), 9.

Part 2.5 of the *Criminal Code* would apply in relation to offences under the Bill, the Code deals only with corporate criminal responsibility, not with the broader issue of attributing the conduct of representatives to the licensee for whom they act for all purposes, including for the purpose of bringing civil penalty proceedings against the licensee.

Product Disclosure

One critical issue which the Bill does not address is product disclosure. The UCCC imposes complex disclosure obligations on credit providers. These requirements are costly for credit providers to comply with and do not always lead to disclosure documents which consumers can readily comprehend. It is difficult to expect consumers to accept responsibility for their credit-related decisions if they do not receive disclosure documents which they can understand. Hopefully the Commonwealth Government will address the need to improve the comprehensibility of consumer credit disclosure documents in due course.

Please contact me if you wish to discuss these comments. My email address is Andrew.Serpell@buseco.monash.edu.au.

Yours faithfully

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