AUSTRALIAN BANKERS' ASSOCIATION INC.

David Bell
Chief Executive Officer

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0401
Facsimile: (02) 8298 0447

24 July 2009

The Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Committee Secretary,

Inquiry into the National Consumer Credit Protection Bill 2009 and Related Bills

The Australian Bankers' Association (ABA) is the peak national representative body for 23 banks authorised by the Australian Prudential Regulation Authority to conduct banking business in Australia.

The focus of this submission is on the proposed consumer credit legislation under the National Consumer Credit Protection Bill 2009 (NCCP) and National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009.

With respect to the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 the ABA supports the submission that the Australian Financial Markets Association has made in relation to the regulation of margin lending.

The ABA strongly supports the Commonwealth Government assuming sole responsibility for the national regulation of consumer credit. A single, nationally consistent regime for the regulation of consumer credit will be an important contribution to the Australian economy. It recognises that consumer credit is a national market for greater efficiency and consumer certainty requires national regulation. The critical factor in achieving sound economic outcomes and consumer benefit is to ensure that the regulation achieves the right balance.

Unnecessary and excessive regulation coupled with disproportionate penalties, including criminal and civil consequences, will tip the balance away from sound economic and consumer outcomes particularly as consumer credit conditions in Australia do not demonstrate a need for this type of regulatory response.

Unlike the situation in a number of other countries, the Australian banking system has remained strong, stable, secure and profitable in these difficult economic times. This has been an important factor in helping to preserve the strength of the Australian economy and the resulting flow on benefits to Australians.

Australian banks' consumer credit lending standards are of a very high standard compared with some other countries and this is clearly reflected in monthly lending statistics published by the Reserve Bank of Australia.

The latest Reserve Bank of Australia credit card data as at May 2009 is instructive. A summary of gross aggregates for May 2009 follows.

(1) On an annual basis, repayments have exceeded the value of transactions for 50 of the past 51 months, with repayments now exceeding the new transactions by $4.74 billion – a record amount.

(2) The gross balance outstanding was $44.3 billion, an increase of 2.0% ($870 million) over the past year, the slowest growth rate since December 1991.

(3) The gross amount accruing interest was $31.9 billion, increasing by $744 million (2.4%) over the past year. This is the slowest growth on record. The amount accruing interest has fallen by a large $819 million over the last two months.

(4) The gross credit limit was $124.2 billion, increasing by $5.9 billion (5.0%) over the past year. This is the slowest rate of growth since February 1995.

(5) Over the 12 months to the end of May 2009, there were 1.46 billion credit card transactions, 43.1 million (3.0%) more transactions than for the previous year. This is the slowest annual rate of growth on record. There were 32.5 million cash advances, 3.2 million or 9.0% less than for the previous year, the largest fall on record.

(6) There are 14.3 million accounts, with growth of 354,000 (2.5%) over the past year.

This is reliable evidence that Australian households are managing their credit commitments well and have the capacity to adjust their spending budgets according to current economic circumstances. Australian households are demonstrating that despite difficult economic times, the overwhelming majority of households cannot be said to be unable to manage their credit commitments.

Housing

As at March 2009, 90+ days arrears for banks' housing loans were 0.49%. For owner-occupiers it was slightly less at 0.48% while for investors the rate was 0.53%.

Credit Cards

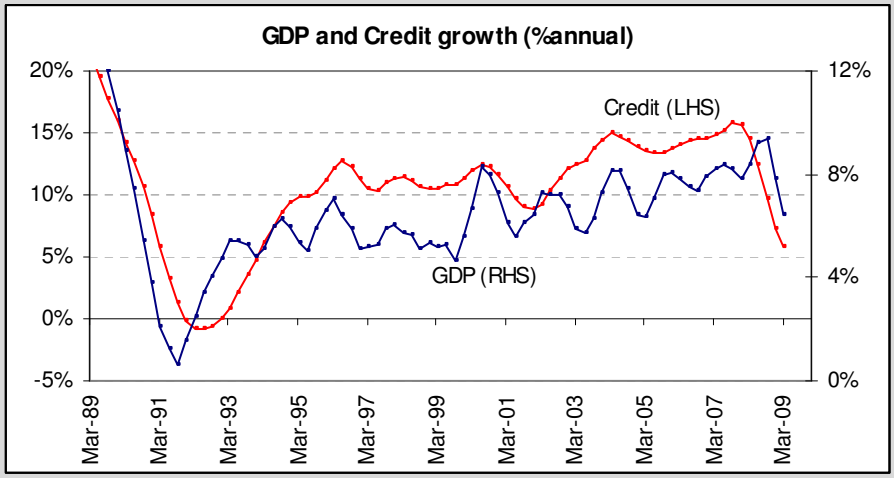
As at March 2009, the 90+ days arrears rate for banks' credit card lending was 1.30%

Where bank customers are experiencing financial difficulty with their credit facilities due to changed circumstances, banks have in place a range of safety net arrangements to carry those customers through a period of financial hardship where, for example, unemployment has occurred and a temporary period of relief is made available until employment returns.

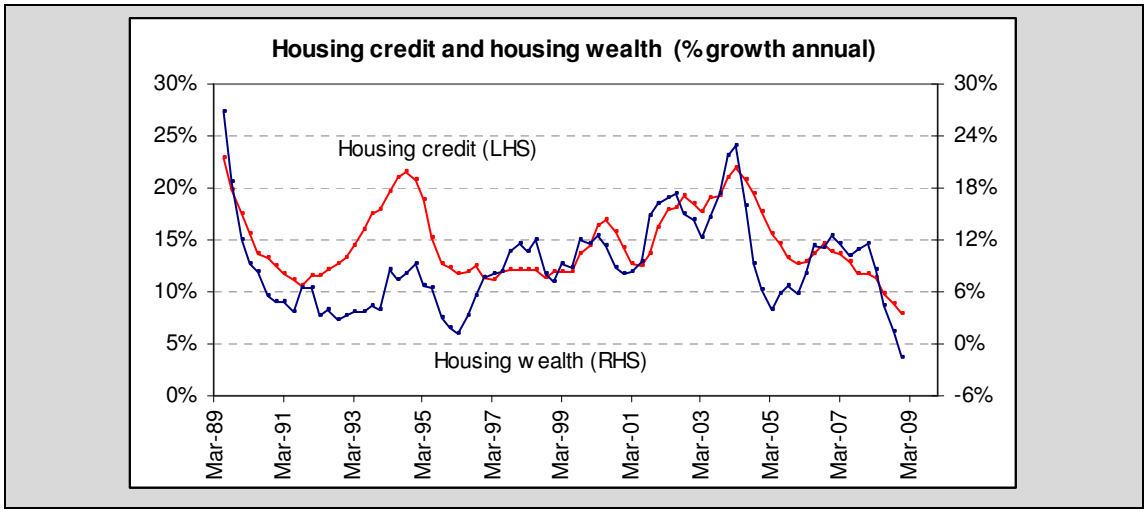
For decades, these types of arrangements have been a feature of banks' lending support for customers, which distinguish banks from other credit providers.

There is a strong correlation between the availability of credit and Gross National Product and a similar association between housing credit and housing wealth. These outcomes are evidenced by the following charts.

The chart below shows strong correlation between nominal GDP growth and credit growth. Changes in credit growth will reflect in changes in economic activity.



The value of the stock of dwellings (including land) in Australia is $3.7 trillion. Housing is the most important source of wealth for Australian households making up 60% of household assets and nearly 75% of household net worth. Growth in the value of people's homes is strongly linked to the growth in the availability in housing credit.



While the original proposal was for the transfer of the States and Territories legislated uniform Consumer Credit Code (UCCC) to the Commonwealth, additional regulatory obligations have been included in the NCCP. This additional regulation makes provision for registration and licensing of credit providers and credit intermediaries such as finance brokers, responsible lending obligations, serious criminal and civil sanctions and a number of enhancements to the provisions of the UCCC that will form the National Credit Code (NCC) replacing the UCCC.

In the ABA's view some of these additional regulatory requirements could be clarified while at the same time taking into account the connection between the responsible flow of consumer credit to the community and the economic and community need for the provision of consumer credit not to be unduly restricted.

The ABA believes that the NCCP is close to striking the right balance.

1. National Uniformity

The ABA is concerned that the NCCP provides that the States and Territories will retain the ability to legislate in relation to consumer credit and displace the related Commonwealth law.

This leaves the single national model for consumer credit regulation vulnerable to the re-emergence of a patchwork approach by States and Territories which has occurred under the UCCC regime and is a key reason for the decision for the Commonwealth to assume sole responsibility for the national regulation of consumer credit.

The ABA submits that this risk of the emergence of national disuniformity should be removed.

2. Finance Brokers

The ABA welcomes the proposed national regulation of finance brokers that the ABA has supported for a considerable period of time. National regulation will remove the piecemeal regulatory approach by the States that has characterised finance broker regulation until now.

Finance brokers constitute an important national information resource for consumers in the consumer credit chain between the consumer and the credit provider. With credit assistance and responsible lending obligations to be imposed on finance brokers, backed up by a national licensing regime, credit providers should be able to receive referrals of credit business from finance brokers with confidence.

The NCCP needs to strike the correct balance for credit assessments and verifications commensurate with the participant's role in the credit chain. The ABA recommends that consideration is given to removing unnecessary duplication between the 'preliminary assessment' required of credit assistants and the more comprehensive credit assessment requirements undertaken by credit providers. Otherwise this will result in prolonged credit approvals for customers and increase the cost of credit applications.

The obligation on the credit assistant in the 'preliminary assessment' should reflect the "know your customer" type test that seeks to match customer objectives with stated financial capacity and provide the credit provider with accurate information about the customer. In this context, the 'credit assistant' should be required to:

- collect relevant identification information;
- complete the loan application information accurately;
- collect relevant information relating to employment details, sighting originals and;
- verify the authenticity of these documents against originals.

Based on this information they would then make an assessment as to product suitability for which they would retain responsibility. In line with this assessment, the customer would be referred to the credit provider, who could rely on the authenticity of the application, but who would perform the checks and verifications required for the responsible lending decision.

The NCCP is to provide for the separation of the roles of the finance broker or intermediary from the credit assessment role of the credit provider. The ABA strongly supports this model because this will avoid duplication, increased costs, delays in handling consumer credit proposals and consumer dissatisfaction if the two roles were to overlap. Given the fundamental nature of this separation of roles in the NCCP, this issue also should be addressed in the NCCP, rather than be dealt with by subordinate regulation.

In addition, to clarify the scope of regulation for intermediaries, the definition of 'credit assistance' should be amended to apply where an adviser 'recommends' or 'negotiates' consumer credit with a consumer rather than where an adviser merely 'suggests' or 'assists' with credit as this extends to broadly too simple spot referral type arrangements.

3. Credit Representatives

3.1 Branch banking

Some ABA member banks operate branch networks on a contractual basis where a branch is a separate corporate entity, operated by a third party as an agent of the bank, employing its own staff and dealing only in the products and services that the bank itself provides.

To all outward appearances, this branch structure is in name and function the same as the more traditional branch of a bank where the branch staff are employed by the bank and the bank provides banking services direct to its customers rather than through an agency arrangement.

As currently drafted the credit representatives provisions of the NCCP will require the bank to appoint its agency branches as credit representatives but may not do so unless the agency branch also belongs to a complying EDR scheme (see section 64).

Further, it appears that under section 65 any natural person appointed by the agency branch operator who acts on behalf of the bank (licensee) also must belong to a complying EDR scheme.

It would be simpler and equally effective if the NCCP were to recognise these structural differences as functional equivalents in the case of a bank and for the bank to accept that its EDR scheme will be available to handle disputes arising from the activities of its agency branches and their employees.

A further complication arises under the credit guide requirements in the NCCP. For banks adopting these third party branch structures there is the potential for up to three credit guides to be required to be given to customers where credit assistance is provided and it becomes likely the bank will enter a credit contract with the customer.

In such arrangements where the credit representative is operating functionally and in name as "the bank", credit assistance that is provided by the bank or its credit representative branch should require only the one credit guide for the credit assistance provider i.e. the bank or its agency, and where a credit contract is likely to be entered into, a credit guide of the credit provider, i.e. the bank.

For consistency, there should be an amendment to the liability provision for credit representatives so that it only applies to actions within their authority consistent with the position at common law. While licensees will actively monitor, train and conduct due diligence of their appointed agents, extended liability for licensees for conduct of credit representatives acting beyond their authority will significantly constrict engagement of credit representatives.

3.2 Credit guide

A similar issue arose for banks with such arrangements under Chapter 7 of the Corporations Act (FSR) in relation to financial services where multiple financial services guides (FSGs) were required under the original legislation. That

legislation was amended in several stages so that now a single FSG suffices. The NCCP should adopt the same approach.

Further, with two fairly similar disclosure documents (the Credit Guide and the FSG) , where a customer is seeking consumer credit and FSR regulated financial services at the one time, the opportunity should be taken for banks to combine the two disclosures into a single guide. This is cost effective and reduces the number of documents a customer is to receive.

3.3 Mere referrals

Draft regulations released by the Government in April 2009 indicated certain exemptions from the credit assistance regime would be available to a range of persons including lawyers, tax agents and others who are acting as a clerk or cashier in activities that a clerk or cashier would ordinarily engage in. A similar exemption exists under the FSR which the ABA believes has worked satisfactorily.

The need for certain exemptions stems from the very wide definition of "credit assistance" in section 8 of the NCCP and "intermediary" in section 9. Under section 8 the mere suggestion of assistance provided by a person to a possible credit applicant who may wish to apply for a credit facility from a nominated credit provider will attract the registration and subsequent licensing requirements or the requirement for the person to be appointed a credit representative of the credit provider. Acting as an "intermediary" is equally broad as the acting need not necessarily be in the course of an intermediary business.

The ABA submits that for the avoidance of doubt certain persons who do no more than point another person in the direction of a credit provider and may possibly merely hand out information that may have been prepared by a credit provider should be exempt from the registration, licensing and credit representative regime. Typically, these situations involve community groups and other non-commercial bodies who in return for the referral may receive a nominal amount similar to a donation from the credit provider.

4. Responsible Lending

The ABA supports a national standard for responsible lending. The standard should provide the right balance between the value to the economy and the community of the ready availability of credit on the one hand and, on the other hand, the need to regulate irresponsible credit providers that engage, for example, in equity stripping of vulnerable consumers where these activities are to the detriment of the economy and consumers.

4.1 Credit assessment

The NCCP will introduce a positive obligation on credit providers to lend responsibly. The key outcome of this obligation is for a credit provider to provide a credit facility to a customer that is not unsuitable.

Simply put, a credit facility will not satisfy this test if it is likely that:

(1) the customer could not comply with the financial obligations under the contract or limit increase or only comply with substantial hardship; or

(2) the contract or limit increase will not meet the customer's requirements or objectives.

The regulations may prescribe further elements of unsuitability.

However, in addition, the NCCP should incorporate a safe harbour for credit assessment inquiries and verification to clarify that these are satisfied where they meet a benchmark standard to act as a diligent and prudent credit provider or credit adviser.

The Australian Securities and Investments Commission (ASIC) is expected to prepare and publish guidance to the industry on responsible lending practices. ASIC will adopt a fully consultative approach in developing this guidance.

Current technology provides banks with a unique view of a customer's performance under their existing credit contract(s) and other account relationships with their bank and a predictive evaluation of the customer's future performance. This allows a bank to make better decisions about a customer's future credit needs and to manage the relationship of the bank with the customer.

A new customer is largely an unknown credit risk for a bank when lending to the customer for the first time. As the account relationship matures, the bank obtains more knowledge about the customer and the degree of risk the customer poses to the bank.

The ABA submits that the responsible lending regime should be flexible enough for banks to continue to rely upon this technology to assess existing customers' suitability for further credit facilities.

4.2 Proportionality in compliance

The responsible lending regime places the whole of the legal responsibility for the lending decision on the credit provider. A credit provider's officers or employees are liable to a jail term of up to 2 years and a fine of up to $10,000 if the credit contract is entered into with the customer and subsequently the contract is found to be unsuitable (as defined) for the customer.

As is the case with the penalty regime, there is no proportionality or tolerance in the credit decision-making process about which information a bank must verify and which it may accept as factual. Section 130 provides for "reasonable inquiries" about a customer's requirements and objectives and their financial situation and "reasonable steps to verify" the customer's financial situation, but this applies to the entire range of information.

There should be a tolerance or "safe harbour" that where the bank has acted as a diligent and prudent banker, as it must under the Code of Banking Practice, it ought reasonably to be excused. This is a common approach under other legislation imposing serious criminal and civil penalties.

4.3 Comprehensive credit reporting

The absence of a more comprehensive credit reporting system in Australia is an impediment in the credit assessment process. The Australian Law Reform Commission recommended that the credit reporting system in Australia should be extended to include more comprehensive credit information about consumer credit applicants including:

- the type of credit account opened,
- the date each credit account was opened,
- the current limit of each credit account, and
- the date on which a credit account was closed.

The Commission further recommended that the prior 24 months repayment performance history of an individual should be available once an adequate responsible lending framework is in place in Australia.

The Commission considered a more comprehensive credit reporting system to be a compelling argument because it would assist credit providers to practise responsible lending.

The ABA submits that the Commission's recommendations in this regard should be implemented in line with the commencement of the responsible lending regime.

5. Credit facility "not unsuitable"

Section 133(2) of the NCCP appears it may apply inconsistently with related section 129(b).

When conducting the proposed unsuitability assessment the credit provider may conduct its assessment for a prospective period of 90 days before being required to repeat the assessment (section 129(b)).

Section 133(2) applies the unsuitability requirement without reference to the 90 days prospective assessment period.

Section 133(2) should be amended to be consistent with section 129(b).

Further, it is unclear how the 90 days prospective assessment period will affect a customer who has agreed to purchase a residence on 120 day settlement terms and who approached their bank for an early loan approval which could take only 14 days to approve. It should not be necessary for the bank and not cause the customer the inconvenience of having to repeat the process 90 days later in this sort of situation.

There is scope for the regulations to stipulate a longer period to accommodate these situations.

6. Lending for residential property investment

Banks do not oppose regulating lending to consumers for residential property investment. However, the legislation does not distinguish between those individuals who are professional investors or property investors and those who are consumers. All forms of lending to individuals for residential property investment will be regulated under the NCCP.

Banks in their lending distinguish between business borrowers and consumer and individual borrowers. There are a number of reasons for this including the types of products required by different borrowers with different levels of commercial and business sophistication, the different risks faced (for example between a developer of a multi unit development at one end and a "mum and dad" purchaser of an established rental property at the other end) and the extent of supervision and review required of the borrower's business and their needs.

By categorising all individuals/borrowers the same (where the purpose of credit is residential property investment) the forms of credit available will be limited to products which fall within the current consumer credit code regulated products. Both the time available to make system changes and the likely costs of making changes to commercial lending products so that they will comply with the requirements of the NCC will mean that those commercial or business products may not continue to be offered to even the most sophisticated individual property developer.

The ABA recommends that consideration is given to providing an exemption for lending to individuals for residential property development for the purpose of sale on completion.

Multi unit developments should be considered commercial in nature irrespective of whether an individual is a borrower. The definition of 'investment in residential property' could be amended to limit the number of dwellings financed or to apply a dollar threshold above which the NCCP would not apply. Loans excluded could then be considered under Phase Two of the Government's proposed regulatory program.

7. Commencement and Licensing

7.1 Staged commencement

The Government has announced that the responsible lending obligations under the NCCP will commence on 1 January 2011.

This is a welcome decision and a realistic decision by the Government that will give all credit providers, not simply banks, sufficient time to prepare their systems and people for the changes to the existing law. Banks already lend responsibly. However, the NCCP will impose a number of new obligations that banks need to understand, develop procedures and IT systems, new documentation and train their employees and credit agents to ensure they are fully compliant.

There are severe civil and criminal penalties for non-compliance with the responsible lending regime and certain other provisions of the NCCP.

The final terms of the NCCP will not be known until October at the earliest. ASIC has yet to provide its regulatory guidance on responsible lending and the proposed regulations for the NCCP are not available.

Implementation of compliance procedures, practices, documentary and staff training requirements cannot really begin efficiently and effectively in an integrated way until all of these details are known and settled.

Further, typically between the months of mid-November and mid-January this period for banks is characterised by high volumes and high value of banking transactions. It is also a period where employees take holiday leave.

Consequently, this period is highly unsuited to a bank making major systems and other changes, particularly IT systems changes that may involve additional human resources to do this. Operationally, for these reasons banks will generally impose a system freeze whereby no changes are permitted to production systems. This is to ensure systems are fully equipped to handle the high volumes of transactional activity experienced during this time of year.

The responsible lending regime will benefit from additional preparation time being made available to banks and other credit providers and this will ultimately be of benefit to consumers.

Other parts of the NCCP regime are to commence on 1 January 2010, in particular the NCC that will contain at least six new forms or procedures on top of the existing UCCC forms and procedures.

For the same reasons sufficient time will be needed by credit providers to make the necessary changes. At least six months to 30 June 2010 should be allowed for this to occur before provisions commence.

The provisions are:

- Section 13 (formerly section 11) - business purpose declaration;
- Section 87 (new) - one-off direct debit dishonour notice;
- Section 88 (formerly section 80) - default notice;
- Section 5(1)(b)(ii) and (iii) - extension of the NCC to provision of credit for residential property investment;
- Section 72 (3) (new) - credit provider notice about agreement or otherwise to application for hardship relief; and
- Section 94 (2) (new) - credit provider's notice about postponement of enforcement proceedings.

7.2 Licensing

Under the FSR an applicant for an Australian Financial Services Licence is able to nominate in the application the date within the mandatory licence application period the applicant's licensee obligations will commence.

This meant that the inconvenience to ASIC of a flood of last minute applications was avoided and that applicants were confident that once their licence obligations commenced the licensee would be compliant.

The ABA submits that the same approach should be adopted for licence applicants under the NCCP.

8. Pre-contractual Disclosures by Credit Providers

The UCCC enables credit providers to provide a single set of disclosures to a prospective customer that contains key financial information about the proposed credit facility, the terms of the proposed contract and certain mandatory information about the nature of credit contracts and, where applicable, mortgages.

The NCCP will require an additional disclosure in the form of a credit guide in compliance with section 126 to be given by the bank to a prospective customer "*as soon as practicable"* after it becomes apparent to the bank that the person is likely to enter a credit contract with the bank.

Non-compliance attracts a civil penalty of 2,000 penalty units ($200,000).

It should be made clear that the credit guide may be given with the customary UCCC pre-contractual disclosures that are to be continued under the NCC as satisfying the "*as soon as practicable"* requirement.

9. Extra-territorial Reach of NCC

The NCC differs materially from the UCCC in its jurisdictional reach.

The UCCC is a State and Territory based model enacted by each State and Territory to apply in their respective State or Territory jurisdictions. The State or Territory law applies to a debtor who is a resident of the relevant State or Territory.

In transposing this to the NCC as a single national Commonwealth law the requirement for the debtor's residence in Australia is missing. This could mean a tourist or a person resident in an overseas country could claim the protection of the NCC if an Australian credit provider provided consumer credit to these persons.

Section 14 of the NCCP also is silent on residency in defining whether a business is carried on in "this jurisdiction" (i.e. Australia) and provides relevantly that in the course of carrying on the business the person engages in conduct that is: -

> *"(a) intended to induce people in this jurisdiction to use the goods or services the person provides; or*
>
> *(b) is likely to have that effect;*
>
> *whether or not the conduct is intended, or likely, to have that effect in other places as well"*

The ABA submits that the requirement of a debtor's residence being in Australia should be included in section 5(1)(a) of the NCC.

10. Sanctions and Penalties

The ABA is concerned that the imposition of criminal penalties, particularly imprisonment of employees, for certain breaches of the NCCP is disproportionate to the event.

Penalties of this nature will cultivate a culture of over-caution and conservatism when banks are making their decisions about whether to approve a credit facility and the amount of credit that may be made available.

This is not to argue that a culture of compliance with the law is not important. The ABA has a strong belief in the value of a compliance culture among its member banks, which banks have demonstrated over many years in making their consumer credit decisions. However, a compliance culture should not be replaced with a fear of non-compliance. There will be difficult situations arising under the new law where decisions will have to be made balancing a consumer's objectives and requirements in seeking a credit facility and the desire of the bank to provide a credit facility responsibly and in accordance with the law. It is not clear whether the new law will mean that banks must radically change their practices and procedures to comply, while it is clear from past practice that banks have responsibly accommodated consumers' credit needs.

The ABA submits that ASIC should publish guidance on its approach and priorities to enforcement, including its view on when it would consider a criminal prosecution for non-compliance should result in imprisonment of the offender.

11. Transitional Provisions

The transitional provisions in the National Consumer Credit Protection (Transitional and Consequential Provisions) Bill 2009 are difficult to understand and are in need of clarification.

Structurally, the provisions differ from the transitional rules that in relation to Credit Acts regime that preceded the UCCC.

The relevant provisions are found mainly in Schedule 1 – Part 2 Division 2 "Treatment of contracts and other instruments made before commencement".

The ABA will be seeking clarification from Treasury and would welcome the Committee's support in this respect.

12. Phase Two

The NCCP constitutes Phase One of the Government's consumer credit reforms.

Under Phase Two the Government is to examine other areas of possible regulation including the promotion of offers of credit limit increases on credit cards, credit for small business and investment (other than margin lending) that is being addressed under Phase One.

The reform process under Phase One has been ambitious and has been conducted over a relatively short period of time with certain confidentiality requirements. Together, these factors have given rise to a need late in the piece to fine tune many of the provisions of the NCCP.

The NCCP will subject all consumer credit providers to implementing significant changes to their practices, IT systems, documents and relationships with third parties.

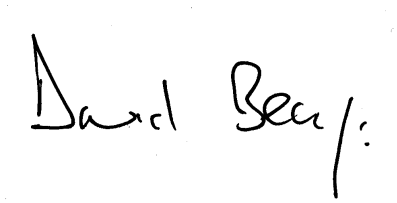
The ABA submits that Phase Two should not commence until all of the necessary changes for banks to implement the NCCP (and margin lending reforms) are completed and the new laws have commenced.

Further, Phase Two differs significantly from Phase One in that Phase One has been largely a product of the Council of Australian Governments where a number of policy settings had been pre-set.

With Phase Two the Government should approach the new areas with an open mind ensuring that any regulatory response is established on the basis of research, identification of market failures and consideration of all alternative options to regulatory intervention. This is consistent with established principles of good regulation practice.

The ABA trusts this submission is of assistance to the Committee and appreciates the opportunity to provide its views to the Committee.

Yours sincerely



David Bell