NATIONAL CONSUMER CREDIT PROTECTION BILL

Submission to Senate Economics Committee Inquiry by Mortgage and Finance Association of Australia (MFAA)

MFAA

The MFAA is a national association of some 13,000 members comprising mainly mortgage and finance brokers, mortgage managers and non bank lenders. Its mortgage broker members comprise an estimated 75% of all mortgage brokers operating in Australia.

Its membership criteria requires minimum education (Certificate IV in Financial Services [Finance and Mortgage Broking]) for mortgage loan writers, plus probity checks, compliance exams, and continuing professional development. Its members are required to belong to an ASIC approved EDR scheme and are subject to the MFAA Code of Practice and Disciplinary Rules, the latter being authorised by ACCC.

The key essentials of the Code are *disclosure of commissions and a requirement that members must only suggest or recommend finance that they genuinely and reasonably believe to be appropriate to the needs of the applicant.* Under the Disciplinary Rules, members may be sanctioned for misconduct and breaches against the Code. Sanctions may involve suspension or expulsion from membership which are publicised by media release and on the MFAA website (www.mfaa.com.au) as well as being advised to ASIC.

MFAA's CEO Phil Naylor is a member of the Working Group established in 2008 by the, then, Minister for Corporate Law and Superannuation, the Hon Nick Sherry, to advise on the content of the National Consumer Credit Protection Bill. MFAA believes this process was beneficial to enabling stakeholders and government to understand the many issues. We believe government has responded well to MFAA concerns in this process.

OBSERVATIONS ON THE BILL

MFAA has been lobbying for national regulation in the broker sector of the credit industry since 2002. Initially this was via a process of convincing state governments, which held the jurisdiction for credit, to enact uniform state-based regulation. We believe that while MFAA's membership criteria and Code provide a robust protection for consumers, it can only impact on its members and therefore a mandated regulatory regime is necessary to provide full consumer protection.

We welcomed the Federal Government's decision to assume, with state and territory government agreement, the jurisdiction for credit and have worked as closely as possible with the government to bring about national credit regulation.

Accordingly we generally support the Bill introduced into Parliament on 25 June 2009.

However we have the following concerns/reservations:

KEY ISSUES:

State and Territory Jurisdiction

It is a major problem that states and territories will still be able to legislate in relation to credit. A key attraction of most stakeholders (certainly MFAA) to federal regulation is that there would only be one national source of legislation (ie Federal Government) and no further jurisdiction would be held or exercised by the states and territories.

Delay of the Operation of the Responsible Lending provisions of the Bill until 1 January 2011

These provisions of the Bill are the heart and soul of the legislation, so a decision to delay their operation is tantamount to a decision to delay consumer credit protection for 12 months. But it is more than that because in those states and territories where there is already operative broker legislation, viz WA, NSW, Victoria and ACT, consumers will be in a worse position than they currently are, as it is proposed state jurisdictions will be 'turned off' on 31 October 2009.

MFAA members are already operating in an association regulatory regime which is at least equivalent, and in some respects superior, to the proposed legislation. There is no desire on their part to delay the legislation.

Disclosure of Credit Provider (Lender) Commissions

The Draft Bill, released for public comment on 27 April 2009, included a requirement that credit providers:

"…give the consumer a document that sets out any commission an employee, director or credit representative of the licensee is likely to receive in relation to the contract…"

The rationale for this provision was that individuals who receive some incentive to sell a particular product, may be influenced by the incentive over a duty not to provide unsuitable finance to the borrower. It has been well accepted by the industry that brokers, which receive commissions for recommending particular lenders' products, should disclose those commissions to the borrower. Brokers argue that if a broker may be influenced by the relative size of a commission to recommend a product, equally a credit provider's employee may be influenced by an incentive payment.

However MFAA's submission in response to the Draft Bill recognised that the above requirement was too wide and proposed instead:

"Commission includes any kind of payment including salary. The clause (or the definition of 'commission') needs amendment to make it clear that only payments in the nature of a success fee or incentive must be disclosed."

The provision, in toto, however has been deleted from the Bill, leaving the inference that an employee of a credit provider (lender) may receive an incentive without any check on whether that incentive has influenced the product provided to the borrower.

Credit Providers Relying on Brokers Verification

A basic premise of the Bill, in ensuring Responsible Lending, is that all parties involved in the provision and distribution of credit play a role in ensuring the credit product recommended or provided to a borrower is not unsuitable for them

The Bill recognises that 'credit assistance providers' (brokers) must carry out a 'preliminary assessment' (Chapter 3, Part 3-1, Division 4) and that 'credit providers' (lenders) carry out an 'assessment', recognising that the lenders have access to more and better information and tools for determining credit suitability as well as their own commercial risk appetite.

However s130(c) seems to indicate that a credit provider in making its assessment is not required to verify information that is obtained by the broker's preliminary assessment. This would mean that, despite a broker's best endeavours to verify information accessible to the broker, it can only ever be a preliminary assessment, but a credit provider can rely on that information. That seems to make a nonsense of the distinction between a preliminary assessment and an assessment.

While it probably opens up the possibility of actions by the lender against the broker for 'incorrect' or 'incomplete' information, that is clearly unfair to the broker who may not have had the tools required to provide information appropriate to a 'final' assessment. It also seems to do little to protect the consumer. Advice from our PI consultants is that underwriters will see a higher risk imposed on the role of brokers and they will increase their PI premiums to cover that unascertainable risk, or in some cases, may cease to provide that cover.

It also seems to allow a lender to abrogate its responsibility to make the ultimate assessment. No licencee should be able to escape their obligations. Lenders should be responsible for lending, servicing, and collections. Brokers should be responsible for broking.No doubt prudent lenders will have their own practices to ensure all information is appropriately verified, but it leaves the door open to poor practices under which predatory lending and broking, which this Bill is clearly focussed on protecting consumers from, can thrive.

So, 130(3) should be deleted, because there should be no case when the lender can escape liability. If it wants to outsource some credit activities to a broker (and more particularly to a mortgage manager or in the case of a trustee to the program manager), the lender's licence applies. This is an outsourcing arrangement, not a change of who is responsible for what.

On the wider issue of outsourcing, items 1(c), 3(c), 4(b), and 5(b) of section 6 should also be deleted. If outsourced service providers are required to obtain their own licence, costs would increase, and there would be a reduction in competition. There would be endless arguments about who was responsible, the principal or the outsourced provider. Rather, the principal must always wear the risk and accept the responsibility.

There is a fundamental confusion about outsourcing which is critical to the operation of the whole regime and needs to be fixed to avoid:

- a huge loophole will exist for the unscrupulous (eg predatory lender choosing to turn a blind eye to information provided by the broker); and
- significant extra cost and loss of competition for consumers when dealing with reputable licensees who will be unable to access the efficiencies caused by outsourcing.

Provision of Information

While s73 provides qualified privilege to ASIC giving information regarding licensees and authorised representatives to licensees, it does not remedy an ongoing problem in the industry, viz protection for those who inform ASIC or others, eg MFAA Disciplinary Rules process, about improper conduct.

This is particularly true of lenders (especially ADIs) who, in the experience of the MFAA Disciplinary Rules process, will not make a report for fear of defamation and other claims. The reluctance to report also arises from the fact that there is often an element of doubt concerning the allegation, especially where fraud is alleged, because of the difficulty of proof.

There should be an express provision in the legislation entitling anybody to provide information to ASIC regarding licensees, credit representatives, and other persons who appear to be breaching this legislation (ie unlicensed people).

It would also be useful if ASIC had the right to inform the MFAA and other industry bodies regarding any concerns.

Referral Fee Disclosure

Often, in return for business referred to them, referral fees are paid by brokers or lenders to persons not covered by this legislation eg real estate agents, accountants. Although there is a requirement for unlicensed persons to disclose benefits they have received, it is unlikely unlicensed referrers will be aware of this obligation and that disclosure may not happen. Accordingly those covered by this legislation should be obliged to disclose fees paid by them for referrals. Such a provision currently exists in the NSW legislation for Finance Brokers.

Exemptions/Omissions from Bill:

A strong principle of all the discussions leading up to the legislation was that no-one would be totally exempt, and we are concerned that exemptions or omissions from the final legislation will weaken its objectives by allowing loopholes through which non 'responsible lending' practices can prosper.

Definition of Credit Assistance – 'Budget Coaching/interest minimisation schemes'

We are concerned that the definition of 'credit assistance' does not capture businesses or individuals that practice 'budget coaching/interest minimisation' unless they assist the borrower to obtain a loan.

Often the most disadvantaged are taken advantage of by unscrupulous advisers who charge excessive fees for what is often an illusory service. These so-called advisers prey on the weak much in the same way as property spruikers. However there are reputable businesses providing services of this nature and they wish this sector of the industry to be regulated.

Such is MFAA's concern about these practices that, after consultation with ASIC, we promulgated guidelines in 2008 as part of the MFAA Code of Practice to regulate the activities of MFAA members which offer such services.

MFAA submits that the definition of 'credit assistance' should be expanded to include 'providing advice on how to manage cash flows in connection with a loan.'

Exemption – point of sale retailers

The Bill does not include coverage of point of sale retailers and the government has indicated these will be exempt while it is decided how they should be regulated over the next 12 months.

Anecdotal evidence from WA where vehicle sales operations have been exempt (notwithstanding the protests of MFAA) is that this sector has been the source of many irresponsible practices.

Mortgage Managers

We reiterate our view from the outset that the legislation should cover all in the credit industry, acknowledging that different operations in the industry may be subject to different provisions from others. One case in point for special treatment is that of disclosure arrangements for mortgage managers. The Bill in its current state, would impose the same obligations re disclosure of commissions to consumers on mortgage managers as it does for 'brokers' yet they are different operations. Section 2BA of the NSW Consumer Credit Administration Regulations known as the exclusive and first choice arrangement exemption, which was included in 2004 after extensive consultation with MFAA and other stakeholders to deal with this specific issue. This has worked successfully in NSW and should be incorporated in the Bill.

A fundamental requirement to qualify is that the mortgage manager must not, either alone or together with any other business, advertise or trade in such a way that there is any possibility that a customer could believe that the mortgage manager may select products from a range of lenders (ie act as a broker).

This provision allows true mortgage managers to lend without having to disclose their interest rate margin, which places mortgage manager/non bank operations on a level playing field with ADIs.

CLARIFICATION MATTERS:

- S87 of the Code – Direct debit payment default notice. It is unclear whether this notice must be sent the first time each debit fails – ie if the debtor fails to pay each month, do you need to send a notice each month? Section (1)(b) needs to refer to a default ***'in payment pursuant to the direct debit'*** otherwise it could apply to any

kind of default. It is inappropriate to send a notice if the default has been rectified. It is wholly inappropriate to have a penalty applying for failure to give this notice. The lender may not want to give the notice as the borrower may regularly pay late and the lender is happy with that, or the lender may be willing for arrears to be capitalised.

- Section 204 of the Code – definition of residential investment property. How does a lender know whether a dwelling will be built? This should be limited to dwellings intended to be constructed by or on behalf of the borrower within one year of the loan being made.

- A provision authorising indemnities similar to s.169A of the UCCC is required to enable trustees, SPVs, and other vehicles used in securitisation to obtain an indemnity for criminal acts under the new Bill. Further, licensees should be able to obtain indemnities from their credit representatives.

- Registration should be permitted until 31/6/10 so as not to exclude new entrants to the markets and so as not to disadvantage existing industry participants who do not register by 31/12/09, or register the wrong entity.

- Section 47(h) - Impractical for small brokers to comply with IDR requirements. The vast majority of brokers are very small and in most cases, one person businesses. While an IDR process is an appropriate measure before external processes are adopted eg EDR or legal action, we cannot see how a one person business can properly operate an IDR process. It has been suggested that such processes could be outsourced but that would seem then to convert the IDR to an external process. It needs to be made clear how an IDR process can work in the broker sector.

- Section 47J - It is unnecessary and unworkable for lenders to have compensation arrangements. Borrowers have at their disposal the ultimate recourse, namely a reduction or a removal of the obligation to repay the loan. Introducing a requirement for a compensation fund or insurance adds another layer of expense which is not necessary. There is doubt as to whether relevant insurance can be obtained for lenders.

- Section 79A – Direct debit payment default notice. It is unclear whether this notice must be sent the first time each debit fails – ie if the debtor fails to pay each month, do you need to send a notice each month? Section (1)(b) needs to refer to a default ***'in payment pursuant to the direct debit'*** otherwise it could apply to any kind of default. It is inappropriate to send a notice if the default has been rectified.

- There are many options to prescribe things by regulation. This right must be exercised with care so that the legislation is not continually changed.

- Section 114 prohibits a licensee from obtain a fee in excess of the amount quoted to the consumer. This should be amended to only prohibit payment from the consumer, as payment may be received from other sources.

- Section 117C - We suggest that the verification should be limited to 'reasonably enquiries **of the borrower'** as that is the extent of enquiry practically available to most brokers.

- Section 120 – Credit assistants are required to give the borrower a copy of the preliminary credit assessment if requested within seven years of the date the quote is given under s.114. This does not apply if credit assistance was not provided. Credit assistance can be given which does not result in a loan being made. The obligation should only exist if a loan is made as a result of the credit assistance. This would correspond to the obligations imposed on lenders.

- Section 132 – Requires lenders to give the borrower a copy of the assessment if requested either before the credit is provided or within seven years after credit is provided. However, the note states that the credit assessment need only be given if credit is provided. That requirement is inconsistent with the requirement to provide an assessment before the credit is provided.

- Section 133(2) – Requires a credit provider not to make or increase a loan if it is unsuitable loan assessed at the time the contract is entered. This is inconsistent with sections 128 and 131 which allow a credit assessment to cover a specified period.

- There should be no civil penalty applicable to credit providers for entering an unsuitable contract. This creates an unacceptable risk for lenders (especially compliance conscious lenders) who would risk committing an offence each time they lend. Rather, the remedy should be re-opening the contract and any security. This provision may operate to make credit unavailable to those the bill is intended to help most.