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Financial Services and Credit Reform Green Paper
Corporations and Financial Services Division
Treasury
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Per: financialservicesgreenpaper@treasury.gov.au

Dear Sir/Madam

FINANCIAL SERVICES AND CREDIT REFORM GREEN PAPER

Westpac Banking Corporation congratulates the Government on its *Financial Services and Credit Reform* Green Paper, which sets out a number of critical challenges and opportunities facing Australia's financial services and consumer credit landscape.

We believe the appetite among consumers and financial services providers is open to Government making significant but sensible changes to the regulatory framework that can deliver superior consumer and investor protection measures and certainty, efficiency and simplification for the market. There is also an opportunity to learn from Financial Services Reform (FSR) and Uniform Consumer Credit Code (UCCC) experiences.

As a matter of good public policy, we believe an effective transfer of credit regulation to the Commonwealth is as much about getting the policy intentions and design settings right as it is about sensible implementation and outcomes. Accordingly, we welcome the Options set out in the Green Paper, including the proposals around consumer credit, and we submit the following comments.

We also note Westpac is supporting the submission of the Australian Bankers' Association (ABA).

Position summary

National markets should strive for national regulatory solutions and, we agree, it is time for consumer credit to be regulated on a footing to reflect its cross-border nature and its significance for consumers and providers.

Consumer credit is a national market not simply because it has national participants. The need for national treatment is required to ensure all consumers – no matter where they reside or where they transact or with whom they deal – receive the same high standards of regulatory protection.

Similarly, national regulatory treatment is important to ensure competitive neutrality among credit providers and certainty for all providers as well as delivering greater efficiency in terms of regulatory compliance burdens.

We, therefore, support the following Options:

- that the Commonwealth takeover <u>all</u> consumer credit regulation via the re-enactment of the *Uniform Consumer Credit Code* (UCCC) as national legislation, under Australian Securities and Investments Commission (ASIC) jurisdiction as the <u>sole</u> financial services regulator;

- that trustee corporations be covered under APRA supervision to reflect the concern about consistent national regulation;

- that margin loans be included within Chapter 7 of the Corporations Act, although this must be subject to a careful assessment to determine the suitability and applicability of each provision within Chapter 7 to margin lending;

- that debenture regulation is harmonised to deliver further certainty; and

- that active steps are taken to regulate property investment spruikers under a single national regulator. We see little distinction between advice as regulated by the Corporations Act and advice associated with property purchases.

We support these Options for the following reasons:

- *Uniformity* – single national regulation offers enhanced uniformity of policy-setting, decision-making and enforcement. It can prevent forum shopping and deliver greater consistency and certainty for consumers and providers. National regulation can better utilise government funding to more efficiently target consumer detriment and remove the time and cost to change. At the same time, it can avoid adversely impacting already highly-regulated providers;

- *Accountability* – placing consumer credit regulation (for example) within ASIC's jurisdiction offers a more comprehensive and transparent structure that can deliver simplicity and consistency for the regulated community. Working through ASIC also offers a credible and robust regulatory mechanism that is preferable to current arrangements, which can be characterised as opaque and cumbersome;

- *Efficiency and simplification* – multiple layers of regulation, each with its own enforcement regime, can create inefficiencies that increase operational costs that often end up being funded by consumers. Single national regulation offers a model to reduce these costs and burdens; and

- *Neutrality* – consumers are directly disadvantaged by the lack of regulation addressing practices by fringe credit providers and some intermediaries. Applying a single national regulatory model offers consistency of standards across the country. This is an important competitive neutrality concern for providers that are already subject to substantial prudential and corporate regulatory oversight.

Difficulties in consumer credit regulation

The *Uniformity Agreement*, which underpins the template model and the UCCC, was a welcome step. However, significant market developments since the UCCC's inception and an increasing fracturing among State and Territory jurisdictions have rendered the UCCC an inefficient form of national regulation.

The Ministerial Council on Consumer Affairs' (MCCA) role is *…to consider consumer affairs and fair trading matters of national significance and, where possible, develop a consistent approach to those issues*[1] and, relevantly, includes matters relating to the management of the UCCC, which is the primary law regulating consumer credit. However, the *Uniformity Agreement* is not absolute and individual jurisdictions have sought to implement their own measures in their own timeframes.

These measures frequently over-lap or conflict with each other or with other national reform proposals. This can lead to a lack of uniformity across State and Territory jurisdictions, which triggers inconsistencies for consumers and a risk of jurisdiction shopping, poor targeting of regulation, unnecessary scope creep and expensive and duplicative processes for market participants that operate across a national footprint. Further, the uniform model also relies on each State and Territory undertaking its own enforcement action. This means the uniform model is susceptible to local variations that risk differential consumer treatment, and adds to the regulatory burden.

These poor outcomes have fostered a fragmented and opaque consultation process for developing new measures or making changes to the UCCC. This makes it difficult for industry to provide timely and measured feedback, particularly about regulatory burdens and customer impacts. Some examples follow:

- *Supervision* – credit providers can be subject to separate audits on the UCCC from different States or Territories as well as facing ASIC oversight on similar or identical matters. This duplicates time, resource, legal and other costs;

- *Mortgage Brokers* – despite agreement among stakeholders, and numerous contributions to the policy process dating back to 2003, draft regulations have taken many years to produce. Disappointingly, after this long process, the 2007 draft Bill contained provisions that were either not previously subject to consultation or did not explain why earlier feedback had been accepted or rejected;

- *Fringe Credit* – despite general agreement that the fringe market represents a particular subset of the credit provider segment, the unheralded August 2007 proposals sought to introduce a regime disproportionately covering all credit providers (including ADIs) and imposing a new untested and unconsulted regulatory standard for reviewing fees and charges. MCCA has recently agreed to press ahead with this blunt regulatory response, despite significant industry opposition. This has been an unacceptable outcome of the fragmented regulatory regime;

- *Mandatory Comparison Rates (MCR)* – despite mounting evidence that MCRs are ineffectual and the existence of a sunset clause, which industry reasonably expected to be activated when it first fell due, the MCR regime has been extended on two occasions. We consider MCR a flawed tool that has failed to deliver reliable or practical consumer benefit. Relevantly, New Zealand abandoned its equivalent *Annual Finance Rate* in 2002. MCCA recently agreed to repeal elements of the MCR and revise the format and calculation of comparison rates in credit advertisements. In the absence of empirical data to support the MCR, this remains an inappropriate response to a long overdue decision to allow the regime to sunset; and

[1] http://www.consumer.gov.au/html/protection.htm

- *Unfair Contract Terms* – despite a lack of empirical evidence, some jurisdictions are looking to capture consumer credit within broad unfair contract terms proposals. This distorts the picture in relation to consumer credit contracts, where the UCCC and self-regulatory measures already provide a layer of protection and redress opportunities for consumers who have grounds for complaint.

These deficiencies exacerbate frustration about the ability for the regulatory structure to sensibly adapt to consumer needs, product innovation and market behaviour. This malfunctioning UCCC reform model has lead to *significant* inertia in terms of consistent, practical or ongoing consumer credit regulation.

1. MORTGAGES, MORTGAGE BROKING AND NON-DEPOSIT TAKING INSTITUTIONS

We understand the term 'mortgages', and its use in the Green Paper, refers to residential mortgages over real property. Accordingly, we further understand that the discussion about credit reform is limited to consumer credit and does not expand to all forms of credit[2]. Our comments reflect this view.

We strongly support a level playing field in relation to mortgage regulation. Therefore, we agree that mortgage (and other consumer finance) brokers and non-ADI lenders should be included in any transfer of consumer credit to the Commonwealth. Although clarity is required in relation to what this might mean for ADIs who use broker channels. For example if Option 3 is adopted will the Chapter 7 requirements around financial products and services apply to the distribution of mortgages?

In relation to non-ADI regulation, we firmly agree that greater regulation is required. This is critical on neutrality grounds as well as to ensure all consumers can access the same level of protection irrespective of where they source their mortgage or other credit funding.

<u>Option 1</u>

We do not support Option 1, which proposes doing nothing, because it fails to address the well-accepted regulatory gaps, duplications and jurisdictional differences that exist under the State-based approach.

<u>Option 2</u>

We support a complete transfer of <u>all</u> consumer credit regulation from the States and Territories to the Commonwealth as outlined in Option 2. However, while we support Option 2, we do not support compressing consumer credit into the Corporations Act, which is the intention behind Option 3. It would be unfortunate for consumers and credit providers if, in the process of transferring to the Commonwealth, consumer credit received incomplete or inappropriate regulatory treatment.

Further, we disagree with the assertion in the Green Paper that consumers have substantively different needs depending on their geographic location. While this may be the case in relation to specific local microfinance projects, we do not believe this view is sustainable in terms of the substantively larger markets for car and personal loans and credit cards and certainly not between different States or Territories.

The Corporations Act is the principal legislation regulating the formation and operation of Australian companies as well as setting out duties of officers, takeovers and fundraising. The Corporations Act regime has been designed to protect depositors and investors placing their funds into the market. This is a very different function to consumer credit

[2] Although, it remans unclear, for example, whether the proposals would capture residential mortgages for the purpose of investment.

laws, which are designed to give effect to the principle of truth in lending and protect consumers seeking funds from the market. Adding mortgages (and potentially other credit products) into the Corporations Act would cloud this very clear distinction.

Rolling mortgage regulation into Chapter 7 of the Corporations Act would apply all Australian Financial Services (AFS) licence obligations plus product disclosure and financial advice requirements to a mortgage provider. These investor protection measures may not align to protection for consumers of credit. This would also be a significant departure from the already well-understood practices developed under the UCCC and would represent a larger implementation and ongoing compliance cost. It could also potentially introduce a complexity that would make it more difficult for consumers in accessing credit.

Financial Services Reform took many years to implement and refine. There were a range of unintended consequences which resulted in undesirable outcomes for consumers – it required considerable effort by Government and the financial services industry to resolve these issues through legislative and regulatory amendments.

Note: There is further discussion about including mortgages within Chapter 7 of the Corporations Act under Option 3 below.

Option 3

We do not support Option 3, which proposes transferring only mortgage credit (including brokers and non-ADI lenders) to the Commonwealth but would not regulate bank fees or charges and would leave all other forms of consumer credit to the States and Territories. This Option fails to address the identified problem and would create product carve-outs that for car and other personal loans and credit cards will inevitably lead to further uncertainty, duplication and regulatory arbitrage.

We believe that a cherry-picked approach to transferring credit regulation will have a stifling affect on product innovation; such as where mortgage products are linked to credit cards. Option 3 will require separate regulation that will cause confusion for customers and is likely to hold back product development. The Green Paper is also silent about whether current features of the UCCC that apply to mortgages would also be reprised within the proposed Commonwealth framework. These features include advertising restrictions, mandatory comparison rates, enforcement provisions and court powers to reopen contracts.

To the extent that the Green Paper sets out a pathway to federally regulate mortgages, Option 3 also raises a number of questions about disclosure and licensing arrangements.

In relation to disclosure, the UCCC already sets out clear and specific requirements about what information must be disclosed to consumers before they enter into credit contracts, as well as about the contracts themselves. However, Option 3 proposes including mortgages within the general principle-based approach to regulation taken in Chapter 7 of the Corporations Act. For example, AFS licensees are required to issue a Product Disclosure Statement (PDS) for some financial products but the specific content required in a PDS is not set out in Chapter 7 but in various ASIC Policy Statements and Regulatory Guides.

Being able to understand a financial document is critical to consumer and investor protection; and in relation to mortgages, which is typically a consumer's biggest financial commitment, this is particularly the case. So it is timely to remember that the primary criticism levelled at the current PDS obligations under Chapter 7 is that they result in overly lengthy and dense documents. This is a vast difference from the existing disclosure obligations attached to UCCC-regulated credit contracts[3], which include a mandated pre-contractual summary of relevant information and financial data.

The Green Paper's reference to "improved disclosure"[4] as a feature in any transfer of regulatory responsibility also signals an intention that the inclusion of mortgages within Chapter 7 may require new and separate disclosure obligations specifically for mortgage products, including separate policy guidance from ASIC. This reflects the view that, when compared to the regulation of investment and other financial deposit products, mortgages as a lending product do not naturally align.

In these circumstances, we would prefer that any disclosure obligations mirrored the current UCCC requirements as far as possible. However, even if this occurred, placing mortgages within Chapter 7 would still signal an unwelcome expectation that lenders prepare a PDS for each loan product, in addition to Financial Services Guides (FSG) and Statements of Advice (SoA) for consumers in discussions about entering into a home loan. Consequently, instead of streamlining mortgage regulation, Option 3 would appear to create a separate category within the existing law, necessitating additional costs to comply with this regime and potential confusion for customers.

In relation to licensing, the Green Paper indicates that providers would be required to obtain a licence from ASIC for mortgages, in addition to adhering to new disclosure and conduct requirements. It is unclear what would be required, above existing AFS regulation, to satisfy these new licensing requirements. For example, would this require further training at prescribed levels for staff who sell home loans? Would this require further compliance requirements resulting in changes to current systems to harmonise with the broader 'financial product' regulatory environment?

Perhaps the most overwhelming consequence of Option 3 will be the cost of transitioning into the new regulatory system. Departing from the understood UCCC requirements will involve significant legal and other costs associated with the redrafting of credit contracts and preparing newly-required disclosure documents. Additionally, substantial costs will be incurred as providers seek to re-establish or create new loan processing systems to support this new compliance in addition to costs to retrain all employees involved in the provision of mortgage products. This will have a sizeable impact on resources, exacerbated by the requirement to maintain concurrent compliance systems for credit not brought under the proposed Chapter 7 regulatory umbrella.

Importantly, it should also be remembered that both Option 1 and Option 3 would also leave much of the regulation of opportunistic payday and predatory lenders – that typically target the most financially stressed – under ineffective and variable State and Territory regimes. Neither Option 1 nor Option 3 would address the existing failings of the UCCC for all other forms of consumer credit. Both these Options would also mean providers of mortgages and other credit products would be subject to a staggering 9 different regulatory regimes.

Preferred approach

We believe the simplest and most effective transfer of consumer credit to the Commonwealth can be achieved by:

[3] s.14 – 16 of the UCCC sets out the pre-contractual disclosure requirements (s.162 contains legibility requirements) and Regulation 13 sets out the prescribed disclosure information. In 2006 proposals were released to amend these obligations that sought to restrict the pre-contractual disclosure statement to no more than x2 A4 pages.

[4] Green Paper, ***'Financial Services and Credit Reform'*** (June 2008), at 14 and 16.

- re-enacting the UCCC, in materially its current form, as national legislation[5]. This offers a simpler early process, bringing a well-understood regime within the scope of ASIC. It would also reflect the well-understood, simple and single *personal, domestic or household use* test applied under the UCCC. This would be a minimalist approach directed primarily at uniformity and completeness of regulation;

- empowering ASIC as *sole* administrator and enforcer of the new national consumer credit legislation. This would recognise ASIC's established understanding of the financial community and its existing experience as an investor protection regulator with carriage for nationally operating products, providers and markets;

- ensuring any future reform of credit regulation properly accounted for existing prudential and corporations obligations. It is important that any reform recognises the Australian Prudential Regulation Authority's (APRA) supervision of ADIs under the Banking Act and ASIC's regulation of AFS licensees under the Corporations Act vis-à-vis other credit providers;

- enacting stand-alone and targeted mortgage broker regulation under ASIC supervision; and

- establishing new mechanisms for engaging consumer, investor and industry stakeholders in robust and informed policy formulation, consultation and post-implementation review.

2. TRUSTEE CORPORATIONS

A way forward will need to determine whether there is a greater need for consumer protection or for a prudential framework in relation to the practices and treatment of trustee corporations. The concern seems to be more around the lack of consistent legislation than any consumer protection issue. If the concern is primarily that there is a lack of consistent legislation then an alternative option could be for separate legislation.

On that basis, we offer our tentative support for Option 2. However, the current Options lack sufficient specificity and we are unable to assess whether there would be any additional compliance burdens for us as bankers to trustee corporations. For example, it is unclear if any new regime would involve reporting obligations that mirror those for real estate or solicitor trust accounts.

3. MARGIN LENDING

We recognise the incomplete nature of margin lending regulation. The Corporations Act applies where the investment involves a financial product; however, the credit component of the loan transaction is unregulated. We understand the term 'margin lending', and its use in the Green Paper, refers to transactions involving consumers. However, we believe further clarity is required around the definition of margin lending, which may vary depending on the nature of the facility, the purpose of the loan, the relationship to any security and who the provider might be.

We do not support Option 1 as it fails to address the regulatory gaps and leaves consumers exposed to risk. While Option 3 would allow for the development of a tailored response, it would impose an overly complex regulatory solution and may result in significant duplication of the Corporations regime and would not represent the simplest or most efficient response.

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[5] After this initial transfer step is settled, it may be appropriate to revisit certain elements within the UCCC – such as temporary overdraft assistance being limited to 60 days before full disclosure – to consider their continuing operation and their practical impact under the new national framework.

Accordingly, we offer qualified support for Option 2 because it has the potential to clarify ASIC's role in regulating margin lending and may be easier to implement because it would leverage the disclosure features of Chapter 7 of the Corporations Act as well as existing compliance and legal frameworks. We also believe Option 2 has the potential to offer a greater level of protection for (individual) consumers and consistency for product issuers, not offered by the other Options, although additional disclosure and loan documentation costs would be incurred.

Including margin lending within Chapter 7 would add rigour to disclosure practices, including the requirement to be *clear, concise and effective*, as well as the quality of advice provided to retail consumers of these products. However, FSR regulation applies to deposit and investment products but margin lending is neither of these so we urge caution that margin lending does not become over-regulated as a result of a broad application of Chapter 7. Therefore, while we agree margin lending (to individuals) requires a certain level of disclosure, we would be concerned if this involved a detailed assessment of a customer's ability to repay from sources other than the disposal of the shares pledged as security.

The Green paper observes that: *"Some industry players have backed calls for standardising the timing of margin calls and disclosure requirements across the industry. It is argued that this will assist in ensuring the long-term viability of the margin lending industry."* With respect to this comment, while we support a more consistent disclosure regime, we would still wish to retain the ability to make margin calls at our discretion (with accompanying disclosures).

So our support for Option 2 is subject to a thorough review of Chapter 7 to consider whether all or parts of that Chapter – including SoA and PDS provisions – should be applied to these lending products.

4. DEBENTURES

Given that promissory notes are currently regulated differently depending on their characteristics, we believe harmonisation would provide certainty. We agree that promissory notes issued to retail investors should be treated as debentures under he Corporations Act. We also support revision of requirements to ensure all issuers carrying on an investment business that regularly offer securities to retail investors are AFC licensed. This support presumes that regulation will be targeted at relevant misconduct in the market. This reflects our view that it is the behaviour and not the class of product that should be the subject of regulatory attention.

5. PROPERTY SPRUIKERS

We support more active steps to move property investment advice under Commonwealth regulation by creating a regulatory scheme applied consistently by a single regulator. We note the *Parliamentary Joint Committee on Corporations and Financial Services* recommended in 2005 that property investment advice should be included in Chapter 7 of the Corporations Act, but this recommendation has not proceeded any further since then.

We suggest that if spruikers are promoting financial assistance for residential loans then perhaps their activities could be caught under national mortgage broking legislation, particularly if the client is a consumer, rather than regulating advice about a consumer loan product (residential mortgages) under Chapter 7.

6. OTHER CREDIT PRODUCTS

To remove any doubt, we believe credit regulation in this context should remain limited to consumer credit – as currently covered by the UCCC – and not expanded to all forms of credit.

We accept there may be some regional differences in credit requirements in relation to micro-credit offerings, but we do not agree there are State-based differences that justify maintaining differential regulation covering non-mortgage consumer credit. Even where there are local practices causing concern, such as payday and other predatory lenders, we believe more consistent uniform responses are preferable. What remains unclear is what regional differences have to do with either a level playing field for credit providers or ensuring a basic degree of protection for all consumers exposed to these activities regardless of where they reside.

In its recent Inquiry Report, the Productivity Commission[6] recommended (at 5.2) a pathway to a new national credit regime that covered <u>all</u> consumer credit products and all intermediaries providing advice on such products. It also recommended that the UCCC be retained as a self-standing set of requirements within the broader financial services regulatory regime, but allowing for streamlining of these UCCC requirements over time.

Accordingly, we strongly support Option 1 involving the complete transfer of <u>all</u> consumer credit to the Commonwealth. We do not support Option 2, which we believe would only foster increasing cost and compliance difficulties as providers become subject to parallel regulatory regimes at Commonwealth and State and Territory levels. This would be a retrograde step that would relegate consumer credit regulation back to its pre-UCCC position.

<u>*Note*</u>*: See also section 1 above, which outlines Options to transfer mortgage regulation to the Commonwealth.*

Conclusion

We congratulate the Government on its decision to prioritise making sensible changes to the regulation of financial services and consumer credit. There is now a unique opportunity to materially improve the quality and consistency of protection for consumers and investors and to deliver enhanced certainty, efficiency and simplification for the market.

Each of the Options being proposed will cause additional costs for industry in terms of forms and processes, however, alignment across each jurisdiction will reduce complexity, mandate consistency and provide longer term benefits.

We look forward to contributing further to settling the design and implementation features of Australia's national financial services and consumer credit regime.

If you would like to discuss any of the matters in this submission, please contact me on (02) 8253 3139 or at vsomlyay@westpac.com.au.

Yours sincerely

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[6] Productivity Commission, *'Inquiry Report No. 45 – Review of Australia's Consumer Policy Framework'*, 30 April 2008.