AUSTRALIAN **B**ANKERS' **A**SSOCIATION INC.

David Bell
Chief Executive Officer

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

1 July 2008

Financial Services & Credit Reform Green Paper
Corporations & Financial Services Division
Treasury
Langton Crescent
PARKES ACT 2600

Email: financialservicesgreenpaper@treasury.gov.au

Dear Sir/Madam,

Financial Services and Credit Reform Green Paper - June 2008

The Australian Bankers' Association (ABA) commends the Commonwealth Government's decision to release this Green Paper as the first major step in reforming Australia's financial services to bring greater efficiencies to Australia's consumer credit regulatory regime. The ABA also commends the States and Territories through their participation in the Council of Australian Governments (COAG) process for their cooperation and experience in helping to deliver these outcomes.

The ABA is the peak national body representing 24 banks authorised by the Australian Prudential Regulation Authority to carry on banking business in Australia. The majority of the ABA's members make up the overwhelming proportion of consumer credit lending in Australia and are recognised for their high standard of lending in this market in terms of both credit quality and market conduct.

The ABA's primary submission in response to the Green Paper is to strongly support Option 2 in Chapter 1 "Mortgages, Mortgage Broking and Non-deposit Taking Institutions" in the Green Paper in respect of the future regulation of consumer credit (including non-prudentially regulated lenders) and associated finance broker regulation. That is, the whole of the responsibility for the regulation of consumer credit, consumer credit providers and intermediaries providing advice on credit products should be transferred to the Australian Government. Implementation should include the Australian Government taking responsibility for all remaining matters under consideration by the MCCA in

relation to consumer credit and finance broking and for consultation with stakeholders accordingly. The Consumer Credit Code (UCCC) should be re-enacted as a Commonwealth statute and should not be incorporated with Chapter 7 of the Corporations Act (FSR). The Australian Securities and Investments Commission (ASIC) should be the sole responsible regulator.

Without the Australian Government having complete regulatory coverage of these consumer credit related matters, the deficiencies under the current regulatory arrangements where the States and Territories have responsibility will not be overcome and that consumers and the consumer credit industry will not reap the benefits of a streamlined single national regulatory regime. This would be the inevitable result if there were to be split responsibility between the States and Territories and the Australian Government based on credit product type.

The Green Paper canvasses options as high level policy or framework options rather than detailed regulatory proposals. Therefore, it will be essential that an appropriately constituted consultative working party is established that includes consumer credit provider representatives to assist in the development of the regulatory proposals.

The ABA will also make some brief comments on the margin lending and debentures proposals recognising that other industry bodies may lead in their responses on these aspects.

1. Background

On 11 December 2006 the then Treasurer, the Hon Peter Costello, requested the Productivity Commission to undertake an inquiry into Australia's Consumer Policy Framework, including its administration. The Productivity Commission's inquiry was extensive and thorough. This is evidenced by the fact that the Commission's original reporting date was extended twice from December 2006 to February 2008 and again to 30 April 2008.

In its final report, the Productivity Commission drew a distinction between a need for a national generic consumer law applying to all consumer transactions after the event, including financial services, and industry specific consumer regulation including consumer credit and intermediaries providing advice on credit products (finance brokers) where more specific regulation such as pre-contractual disclosure is required

The Commission identified the national regime for consumer credit (including finance brokers) should be delivered through an industry specific regulatory approach.

Key features that the Commission identified for a future national regime for consumer credit included:

- an absence of loopholes that could be exploited by unscrupulous providers;

- striking an appropriate balance between consumers' interests and providing them with efficient access to a wide range of products and services;
- consistency in national regulatory requirements and enforcement across all consumer credit providers and consumer credit products;
- a responsive framework to policymaking and enforcement.

The Commission recommended (Recommendation 5.2) as follows:

"*Responsibility for the regulation of credit providers and intermediaries providing advice on credit products ('finance brokers') should be transferred to the Australian Government, with enforcement to be undertaken by the Australian Securities and Investments Commission (ASIC).*

Amongst other things, the new national credit regime should:

- *cover all consumer credit products and all intermediaries providing advice on such products (including through electronic or other arms-length means);*
- *retain the Uniform Consumer Credit Code (UCCC) as a self standing set of requirements within the broader financial services regulatory regime incorporating changes to the Code that have been agreed to by the Ministerial Council on Consumer Affairs (MCCA), but not yet implemented;*
- *incorporate requirements from state and territory credit legislation outside of the code, where these pass a benefit-cost test;*
- *include a national licensing system for finance brokers, and a licensing or registration system for credit providers that would give consumers guaranteed access to an approved dispute resolution service; and*
- *allow, over time, for the streamlining of the current UCCC in the light of requirements within the broader financial services regime, where net benefits are likely.*

Also, CoAG should give consideration to implementing the new national regime in a phased way, including as initial steps:

- *importing into the Australian Government's jurisdiction the current UCCC modified to reflect changes agreed to by MCCA, but not yet implemented and making ASIC responsible for its enforcement; and*
- *introducing an interim, ASIC enforced, national licensing arrangement for finance brokers, based on the draft proposal developed by MCCA*."

Taken as a general approach to reform of the policy and regulatory framework for the regulation of consumer credit nationally, the ABA supports this recommendation with some qualifications. There will be specific aspects of the recommendation that the ABA and its members will need to examine more closely

if the recommendation is to be implemented according to its terms and when the detail starts to be developed. For instance, the Commission having determined that the current MCCA model for the regulation of consumer credit is wanting and should be replaced, in the ABA's view it follows that all matters currently under the supervision of the MCCA including those matters yet to be implemented should now be taken over by the Australian Government. There is the recent example of the MCCA proposals to regulate fringe credit providers where there are matters of serious concern to the ABA that require a renewed process of consultation of which, to date, the MCCA processes have fallen short.

In its submission to the Productivity Commission on its draft report prior to the Commission's release of its final report, the ABA outlined its preferred model as follows:

(1) The Commonwealth should assume sole responsibility of consumer policy, its implementation and administration and enforcement.

(2) The proposed hybrid model for consumer policy development with the MCCA should not be pursued.

(3) The transfer of responsibility from the MCCA to the Commonwealth should be expedited as a priority.

(4) In the interim, any MCCA consumer policy processes that are yet to be implemented should be transferred to the Commonwealth forthwith for further consultation and decision by the Commonwealth.

(5) The Consumer Credit Code (UCCC) should be re-enacted in its current form as a stand-alone Commonwealth statute and should not be incorporated with the provisions of the FSR.

(6) There should be a separate Commonwealth act for the regulation of finance brokers.

(7) ASIC should become the sole consumer credit and finance broker regulator to be nominated under the relevant corresponding Commonwealth acts.

(8) Substantive consumer policy law reform should be the subject of further detailed consultation after changes to the consumer policy mechanisms have been made.

At its March 2008 meeting the Council of Australian Governments (COAG) agreed in principle to the Australian Government assuming responsibility for the regulation of mortgage credit and advice, mortgage broking, margin lending and lending by non deposit taking financial institutions.

A process followed that meeting whereby COAG's Business Regulation and Competition Working Group (BRCWG) is to identify any other financial services providers that should sit within the Australian Government's responsibility.

In the ABA's further submission that follows the ABA notes that the COAG decision is not consistent with the Productivity Commission's Recommendation 5.2 that covers all consumer credit products, consumer credit providers and finance brokers providing advice on those products. It is further noted that the Productivity Commission in its final report made this observation in considering the features of the new regime:

> *"First and foremost, it should cover all consumer credit products and all intermediaries providing advice on such products (including through electronic or other arms-length means); not just those advising on mortgage products."*

Although not stated in the Report, it is important to note the ongoing protection this will afford consumers where new entrants join the market.

2. Green Paper Options for Consumer Credit – Support for Option 2, Chapter 1.

2.1 The Commonwealth should take over all consumer credit regulation

This submission supports Option 2. Option 1 has been found to be unworkable by the Productivity Commission and by COAG by its March 2008 decision to regulate mortgages, mortgage brokers and advisers.

Option 3 (that in part reflects the March 2008 decision of COAG) does not ensure adequate coverage of the consumer credit market in Australia and would create the substantial risk of national disuniformity in consumer credit regulation that the Productivity Commission has gone to considerable lengths to explain ought to be avoided. It should be understood that some consumer credit products, such as mortgages and credit cards, are often linked in a package of consumer credit facilities. For example, a consumer may be able to access a mortgage facility using their credit card. Dual regulation could adversely impact on product innovation and functionality where, for example, secured and unsecured lending products might operate together as a package. Separate and inconsistent regulation between the Commonwealth and the States for these products also would be likely to result in consumer confusion and higher regulatory compliance costs for industry in having potentially differing regimes for advertising, disclosure, distribution and ongoing provision of information (e.g. statement of accounts) for consumers. Consumers also would have to deal with separate regulators for the one complaint.

It follows that to avoid these complications the same approach to national regulation should be applied to the regulation of finance brokers and not just mortgage brokers. For the Commonwealth to regulate just mortgage brokers and leave the regulation of other finance brokers to the States and Territories would be a serious, sub-optimal outcome for consumers for the same reasons as if consumer credit regulation were to be divided that way along product lines. Mortgage brokers and the broader finance broking industry both participate and compete in the one national market and not necessarily along strict product lines.

They offer services for packages of products for consumers of both a credit and general banking nature.

To the extent that a need is identified for consumer credit regulation to provide for specific "advice and disclosure requirements" (Green Paper p13) this can be done conveniently and with minimal risk that these requirements are inconsistent with the general policy concepts in the primary legislation. The general objective of national consistency in consumer credit regulation that was first agreed by the States and Territories in the 1990s resulted in the enactment of the UCCC. A decision to divide responsibility for dealing with exceptions in the consumer credit product market (for example, specific issues with credit cards) between the Commonwealth and the States and Territories would turn the clock back almost two decades.

In its analysis of credit and mortgages in Australia the Green Paper evaluates the personal credit market by reference to aggregate levels of credit held, noting that within personal credit housing loans make up 86% (by value) of personal credit. The Green Paper concludes that by regulating mortgages, the Australian Government would be taking over the regulation of the vast majority of personal credit.

While this is correct according to aggregate levels of credit held, there is another prism, with respect a more relevant prism, through which this market can be viewed.

If we take numbers of accounts, that is numbers of customers, the following picture emerges: -

- In June 2007 there were about 2.9 million bank loans to owner occupiers and allowing for a percentage of these as split loans (two loan accounts for the one property) the actual number of customers would be significant although less than 2.9 million.
- On the other hand, there are 13.5 million people aged 18-65 in Australia. Of these 13.5 million, about 30% do not have a credit card. Therefore, 9.5 million people do have a credit card. As at March 2008 there were just over 14 million credit cards on issue in Australia which suggests that on average each customer holds 1.5 credit cards.
- As at June 2007 there were about 1.1 million personal loans on the books of banks.

It can be seen that the number of consumers that have non-mortgage consumer finance exceed the number of consumers that have owner occupied mortgage finance.

It follows that if the Australian Government were to regulate only mortgages it would not be taking over the regulation of the vast majority of consumer finance held by consumers in Australia.

2.2 The Commonwealth should re-enact the UCCC as Commonwealth statute

Development of a single Commonwealth regime for the regulation of consumer credit would be potentially complex and costly. It also could mean that consumers would meet a new and unfamiliar disclosure regime.

Therefore, the ABA recommends that the Commonwealth re-enact the UCCC as a Commonwealth statute making any necessary consequential changes for the UCCC to operate in a Commonwealth environment, for example adjusting the roles of courts and tribunals.

This should mean far fewer changes for credit providers in their compliance arrangements including documentation, procedures staff training and IT systems and ultimately less confusion for consumers.

The ABA would be strongly opposed to a proposal to incorporate consumer credit regulation into the FSR that seems to be suggested at page 13 of the Green Paper. Banks and consumers are familiar with the UCCC and its disclosure, statement of account and administrative regime. The UCCC has been operating successfully for nearly 12 years.

There is a fundamental conceptual difference between the FSR with its regulation of investment, risk management and transactional products and services on the basis of client risk and consumer credit where risk of loss is borne by the credit provider. Further, the FSR regime is significantly different in its disclosure and documentary requirements compared with the UCCC.

For banks and other credit providers to transition from a UCCC regime to an FSR model for consumer credit, in practice, would be a repeat of the FSR experience all over again but this time with consumer credit. A repeat of the industry and consumer experiences with the FSR along with the substantial compliance costs for industry should be avoided.

Further, it should be noted that in 1994-96 banks' costs for preparing their compliance programs for the commencement of the UCCC were approximately $200m and $50m recurring annually (1994-96 values). Far greater sums were required in preparing for the commencement of the FSR.

Currently, there are negative licensing systems in force in most Sates and Territories under which the relevant regulators are able to place conditions on the activities of certain credit providers or even prohibit them from trading where the circumstances warrant this.

The ABA sees no reason for banks to be subjected to a licensing regime as is the case under the FSR and to submit banks to additional costs and compliance requirements associated with making licence applications and maintaining licences. Banks were exempt from State and Territory based licensing regimes for constitutional reasons but the ABA has seen nothing to suggest that banks should be subject to a licensing regime simply because the Commonwealth may assume sole responsibility for the regulation of consumer credit.

2.3 ASIC should be the sole regulator responsible for consumer credit.

ASIC should replace the State and Territory regulatory agencies as the sole regulator of consumer credit. This naturally follows from the single national Commonwealth regime. In fact, to the extent that ASIC is the sole regulator for financial services generally this should be addressed under Option 2 in the Green Paper. Industry and consumers should have the benefit of access to the one regulator, policy development by the one regulator and enforcement action being undertaken by the same regulator. This will provide consistency of policy and in approach providing certainty and better, more timely outcomes than has been the case under the current State and Territory arrangements.

2.4 The Commonwealth should take over and consult on all current consumer credit regulation proposals

The ABA remains very concerned about the current proposals developed by the MCCA for the regulation of fringe credit providers. The proposals fail to distinguish fringe credit providers from banks and other mainstream credit providers despite ongoing representations from the ABA and other mainstream credit provider representative associations that they do so. The joint submission to the MCCA by the ABA, the Australian Finance Conference and Abacus Australian Mutuals can be accessed at http://www.creditcode.gov.au/content/downloads/creditcodesubmissions/Fringe_Credit_Industry_Response.pdf.

Also, the ABA and other key industry bodies have significant concerns with a number of the legislative proposals contained in the draft National Finance Broking Bill released for public consultation in November 2007. A copy of the ABA's submission in response to the draft Bill is provided with this submission.

The Productivity Commission concluded that the current consumer policy framework was flawed and was delivering inadequate outcomes and should be replaced with a national model. It is inconsistent with this conclusion for matters currently under consideration by the MCCA to be left with that flawed arrangement.

As part of the adoption of Option 2 in the Green Paper the Commonwealth should assume responsibility for all remaining matters under consideration by the MCCA in relation to consumer credit and finance broking forthwith.

Margin Lending

The Green Paper raises two discrete issues with margin lending.

The ABA notes the statement in the Green Paper that while "the instance of margin calls has been very low" recent concern has been expressed about "retail client's understanding of how their margin product operates."

It is not clear what empirical research has been undertaken to assess the level of this concern and its source. The Green Paper cites media reports as authority for these concerns including ways in which these concerns might be addressed. The

ABA believes that a more scientific approach to these issues and any possible solutions should be undertaken before there is further regulatory intervention.

In the meantime, ASIC has powers under the Australian and Securities Investment Commission Act 2001 to deal with misleading and deceptive and unconscionable conduct in relation to margin lending.

The ABA observes that while recent focus has been on margin lending the central issue is in reality the risk associated with shares investment and trading. Many of the reported issues are not due to the fact that there is margin lending against the shares but is due to the fact that disclosure and investor education about share trading itself needs to be significantly improved. Regulating margin lending will not necessarily protect an investor from an improvident investment in shares.

The second issue is of a corporate governance nature where company directors acquire (or dispose of) shares in their own companies. As the Green Paper points out, there are insider trading and market disclosure obligations that apply in these cases as well as director's duties to act in good faith and in the interests of their companies.

The recent incidents involving margin lending raise questions that may require further examination to assess whether there has been a market failure that current regulation is able or unable to deal with or whether the scale of the market failure warrants further regulation. This would be consistent with best regulation practice.

Debentures

The ABA understands that other industry associations will be making submissions on this aspect.

The ABA makes the observation that the market failures associated with debentures and other financial instruments concerned investments in property development ventures and apparently poor investment advice given in some cases by advisers that lacked independence and who received substantial commissions for their recommendations to investors.

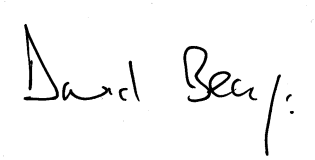
There is a mainstream investment market in debentures offered by reputable companies, for example bank related finance companies, that have provided investors with safe and profitable returns over many decades.

One observation the ABA would make is that the relevant market conduct associated with the financial product rather than the nature of the product itself should be a key focus if regulatory intervention is to be considered.

In closing, the ABA welcomes the positive initiatives by the Australian Government and the governments of the States and Territories in seeking to create further efficiencies and better consumer outcomes in Australia's financial services sector with the objective that Australia can become a key regional financial services centre that will benefit all Australians.

We look forward to further discussions with the Government in due course.

Yours sincerely



_____

David Bell

Encl: ABA submission on National Finance Broking Bill

cc Senator The Hon Nick Sherry, Minister for Superannuation and Corporations
cc The Hon Chris Bowen, Assistant Treasurer and Minister for Consumer Affairs