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National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012

Dear Mr Mikula

ANZ is pleased to provide a submission on:

- The Exposure Draft *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* (EDB), which proposes amendments to the *National Consumer Credit Protection Act 2009* (NCCP Act); and
- The *National Consumer Credit Protection Amendment Regulation 2012 (No.)*, which proposes amendments to the *National Consumer Credit Protection Regulations 2010*.

In our submission, we have addressed the following aspects of the proposed amendments:

- Commencement timeframes;
- Responsible lending obligations for some classes of investment lending;
- The permit regime for small business credit activities; and
- Small business lending – the definition of small business, small business contracts over $5 million, minimum disclosure requirements and responsible lending obligations to address "asset stripping"

ANZ is a member of the Australian Bankers' Association and the Australian Finance Conference. We acknowledge our support of the submissions made by both of these industry associations in relation to the EDB and amending regulation.

We note that the Government has now announced that any reforms to small business finance will be deferred and it will not be seek passage of Schedule 2 of the EDB in the life of the current Parliament.

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Commencement

The EDB currently contemplates a maximum commencement timeframe for the substantive provisions of six months following Royal Assent.

The major practical considerations for implementation of regulatory reform are changes to IT systems, documentation, processes, procedures and policies as well as staff training, communication to and training of intermediaries, e.g. brokers, dealers and mobile lenders.

There are only a limited number of changes ANZ is able to make every year to its IT systems, determined by internal prioritisation of resources and the overall capacity of systems. Exceeding this threshold increases the risk to the stability of IT platforms. To manage this risk, planning for IT system changes is generally undertaken a year in advance. Defining the requirements for all systems impacted can take between three to six months depending on the number of systems impacted by the changes.

In addition, customer demand on our systems also affects the timing of when we are able to make changes. For example, we do not make systems changes during the peak December-January period.

In relation to staff training, ANZ has thousands of frontline staff as well as back office and support staff who will need to be trained in order to appropriately implement these regulatory changes. The design phase of in-house training can only commence once all legislative requirements have been finalised.

In addition, ANZ has relationships with thousands of vehicle dealerships, finance brokers and other intermediaries. At a minimum, we will need to communicate process and policy changes to intermediaries and, in many instances, we will need to provide training to intermediaries.

ANZ submits that there should be a commencement date of not less than 12 months after Royal Assent.

Investment Lending

The proposed provisions will effectively create two types of regulated credit for investment purposes:

1. Residential investment credit which will continue to be regulated under NCCP Act and the NCC in the same way as personal, domestic and household credit; and

2. 'Investment credit contracts', entered into predominantly for investment purposes, excluding residential property, which will be subject to reduced obligations set out in the EDB.

In addition, they will create two types of 'protected investment credit contracts':

1. Regulated product (home secured) investment credit contracts – for the purpose of acquiring a financial product from a person who is not prohibited from providing that product under the *Corporations Act 2001*. The contract is to be secured by the consumer's principal residence.

2. Unregulated product investment credit contracts – for the purpose of either:

(a) Acquiring a financial product from a person who is prohibited from providing that product under the *Corporations Act 2001*; or

(b) Acquiring a product that is not a financial product.

This introduces significant complexity for investment lending. Credit providers will need to ensure that they distinguish between these types of investment purposes when entering a credit contract, as different compliance obligations apply. They will need to put in place systems and processes to meet the obligations in relation to each type of contract. Extensive training will also be required to enable frontline staff to identify different types of investment lending contract and understand the obligations.

In order to determine which compliance obligations will apply, credit providers will need to rely on the consumer to accurately declare the nature of the investment. Credit providers should therefore have the protection of a presumption, similar to the existing 'business purpose declaration', allowing them to rely on the consumer's stated purpose in order to make this distinction between different regulated investment-purpose credit contracts.

Alternatively, the proposed provisions need to be clearer about the level of inquiries credit providers are required to undertake in order to confirm the type of investment purpose.

The provisions should also allow credit providers to have the option of treating investment credit contracts as 'fully regulated' loans, if this suits their business model. As currently drafted, it is not clear that this option is available.

Protected investment credit contracts

Part 3-2E in the EDB creates a new modified responsible lending regime for 'protected investment credit contracts'. The responsible lending obligations will differ according to the type of protected investment credit contract.

For both types of 'protected investment credit contracts, the responsible lending provisions are divided into obligations applying to providers of credit assistance (Division 2) and obligations applying to credit providers (Division 3). It is not explicitly stated that the Division 2 obligations do not apply to credit providers. For the reasons noted earlier in this submission in relation to the corresponding provisions for small business lending, we submit that it should be made clearer that the two sets of requirements are mutually exclusive.

Furthermore, before entering into a 'protected investment credit contract' (of either type) which is secured by the consumer's principal place of residence and is provided for the purpose of acquiring a financial product from a licensed provider, a credit provider must inquire as to whether the consumer is prepared to lose ownership of the principal residence should the consumer be unable to comply with their financial obligations under the contract. A contract will be unsuitable where the consumer is not prepared to lose ownership of the principal residence.

As noted earlier in this submission in relation to small business lending, it could be argued that an owner would never be 'prepared' or willing to lose ownership of their property under any circumstances. In addition, preparedness to lose ownership of the principal place of residence by the consumer at the time of acquisition of the investment product and the formation of the credit contract will inevitably change if the consumer's situation changes for the worse.

In our view, the appropriate standard is whether the owner understands loss of the principal residence is a possible outcome. We submit that proposed s. 133EL should be amended to reflect this.

Regulated product (home secured) investment credit contracts

ANZ is concerned that the responsible lending regime that the EDB introduces for regulated product (home secured) investment credit contracts does not make clear the extent to which a credit provider must make inquiries into the true purpose of a loan. For example, the provisions do not give any certainty as to:

- Whether a credit provider can rely on the consumer's stated purpose of investing in a financial product; and

- Whether a credit provider can rely on the financial product provider's documentation or is required to make inquiries as to whether the provider holds an Australian Financial Services Licence (AFSL).

In ANZ's view, the drafting should be amended to clarify these issues.

Unregulated product investment credit contracts

ANZ would not provide credit if it were aware that the credit was to be used to invest in an illegally offered financial product. However, as noted above in relation to regulated product (home secured) investment credit contracts, the EDB does not make clear the level of inquiries a credit provider is required to make into the provider of the financial product.

Treasury has indicated this category of credit contract will be further restricted so that it only covers contracts where there are commissions or financial arrangements that could cause conflicts, including arrangements between:

- The credit provider and the provider of the product; or

- The provider of the product and a broker or other intermediary.

If such an approach is taken, it is ANZ's view that the credit provider should only have to treat such contracts as unregulated product investment credit contracts where the commission or financial arrangement involves the credit provider. We submit that it is unreasonable to expect a credit provider to inquire into financial arrangements between completely unrelated entities, in classifying the credit contract.

Responsible lending obligations for unregulated product investment credit contracts

'Unregulated product investment credit contracts' will include credit for investment in commercial property and other non-financial products and property, e.g. artwork, irrespective of whether the consumer's home is security for the loan. The responsible lending standards for these contracts are equally as onerous as those applying to 'standard' consumer credit contracts (i.e. those currently regulated under NCCP Act).

While this policy may be understandable in situations where the investment is in a financial product that may be illegal, we consider that it does not make sense to apply such a regime to commercial property investment credit contracts.

Additionally, it is unclear how a credit provider could provide an investment credit contract to a customer where a financial product provider was prohibited from providing

the financial product to the consumer and at the same time avoid the "involvement" contravention in s. 133EM. We consider that it is counter-intuitive for the law to anticipate a credit provider providing credit for a known illegal product.

Permit Regime for Small Business Lending

Proposed amendments to the regulations introduce a requirement for any person engaging in credit activity in relation to a small business credit contract or a small business consumer lease to hold a permit. The permit regime is separate to the existing Australian Credit Licence (ACL) regime.

While the permit regime contemplates a streamlined process for Authorised Deposit-taking Institutions (ADIs), it will result in unnecessary duplication and additional compliance requirements to those already required under an ACL. Existing ACL holders should be required to obtain a variation of their ACL to cover small business credit activities, rather than the introduction of a separate permit regime. Such a variation to the ACL should only subject holders to the limited obligations in respect of small business lending.

In the event that a separate permit regime will apply, we are concerned that the EDB does not appear to make provision for a person to act as a credit representative of a permit holder. As a consequence, ANZ would not be able to authorise an external third party to engage in credit activity in relation to small business credit on its behalf. Instead, that third party would need to obtain its own permit.

We query whether the inability of a permit holder to authorise a representative is an intended consequence of the drafting in the EDB. We recommend that drafting be reconsidered so that permit holders are able to authorise a representative to engage in small business credit activity.

Small Business Lending

ANZ small business lending is already regulated by various bodies and laws including the *Code of Banking Practice*, *the Australian Securities and Investments Commission Act* and the *Corporations Act*. We believe that these provide sufficient customer protections. For example, the *Code of Banking Practice* requires subscribing banks to exercise the care and skill of a diligent and prudent banker in the provision of credit to small business customers. Regulators provide a level of oversight and monitoring of a credit provider's practices.

In addition, our credit standards have been implemented to comply with prudent and diligent lending standards. Our small business customers also have access to external dispute resolution through the Financial Ombudsman Service.

The amendments proposed by the EDB will mean that small business credit contracts will be regulated by the National Consumer Credit Code (NCC) but that the substantive disclosure and conduct provisions will not apply. Providers of small business credit contracts will be subject to modified responsible lending obligations under NCCP Act. Further obligations will apply to "protected small business credit contracts"

Definition of small business

'Small business' is defined in s. 5(1) of the EDB as a business that has:

- Less than 100 employees if a manufacturing business, and otherwise less 20 employees; or

- No employees

We accept that this definition is consistent with the definition in the *Code of Banking Practice* and Corporations Act. However, it is not consistent with how credit providers identify their small business customers, based on customer group turnover or total business lending.

The proposed definition of small business will mean that, for lending purposes, credit providers will be dependent on the small business consumer to accurately declare the nature of the business and the number of employees so that they can determine whether the business falls within this definition.

The characterisation of a business as manufacturing or non-manufacturing and the treatment of part-time or casual staff in determining total staff numbers, is open to interpretation by a customer. Given the penalties that non-compliance may attract, a presumption similar to the existing 'business purpose declaration' should be available so that lenders can rely on the customer's statement of the status of their business.

Notwithstanding that s.5(1A) of the EDB sets out that the NCC will apply to credit provided predominantly for the purposes of a small business, it is possible that lending to medium to large corporates with independent entities having their own employees and meeting the definition of a small business could be caught. It appears to be an unintended consequence of the proposed legislation that such "small business" credit contracts would be regulated.

It should be made clearer in section 5(1A) that credit does not have a small business purposes where it is provided to an entity that meets the definition of small business in s.5(1) but that entity is part of a corporate structure that does not meet the definition.

Small business credit contracts over $5 million

ANZ has a number of concerns with the proposed regulation 58A to exclude small business credit contracts over $5 million from the NCC:

- To support $5 million in lending, a business would need to generate a turnover of potentially $10 million or more. The proposed $5 million threshold will mean that lending to businesses that generally would not be categorised as small could be regulated under the EDB, particularly when coupled with the fact that the proposed definition of small business does not take into account corporate structures.

  In our view, a lending carve out of $1 million would more realistically align with typical small business borrowers. The use of $1 million as a threshold would also align with other lending regulations, such as the Basel regulatory requirements for assessing customer risk/capital adequacy.

- As drafted, the $5 million threshold applies to individual credit contracts rather than to the aggregate value of all lending to a customer. This could have an unintended consequence of capturing a significant proportion of business lending to medium and large corporate entities in Australia, particularly when coupled with the issues identified above in relation to s. 5(1A).

- Proposed regulation 58A will exclude small business credit contracts over $5 million from the NCC. However, under the current drafting of the amending regulations, these contracts will still be subject to the requirement to hold a permit and the

modified responsible lending obligations under the NCCP Act, as they fall within the proposed definition of 'small business credit contract'.

Notwithstanding that we do not consider $5 million to be the appropriate threshold, we note that the purpose of excluding small business credit contracts over $5 million from the NCC only and not the NCCP Act is unclear and appears to be unintended. If the intention is to exclude these contracts from all proposed regulation under the NCC and the NCCP Act, we suggest that it would be clearer to exclude these contracts under proposed s. 5(1A) in the EDB rather than proposed regulation 58A.

Responsible lending - Disclosure

The proposed disclosure model for small business credit contracts is based on the pre-contractual disclosure currently required for regulated credit under the NCCC.

While ANZ agrees disclosure will benefit consumers, the proposed disclosure provisions raise the following concerns:

- The requirement to quote the total amount of repayments is not limited by the term of the loan. In our view, this requirement should be limited to contracts with a term of 7 years or less, as is currently the case for 'standard' consumer contracts under the NCC;

  For small business credit limit increases the proposed disclosure provisions will apply in their entirety. This exceeds the disclosure currently required for limit increases for standard consumer credit contracts. In our view, there is no policy reason to require a higher level of information for small business credit limit increases. The proposed disclosure obligations should be narrowed for limit increases, so that they are limited to those required for standard consumer contracts under the NCC.

  Furthermore, under s. 71(3) of the NCC, disclosure is not required at all for credit limit increases for continuing credit contracts. There should be a consistent treatment of credit limit increases for continuing small business credit contracts and the proposed provisions should be amended to exempt these from disclosure requirements.

Responsible lending – Protected small business credit contracts

The Regulation Impact Statement (RIS) on small business credit prepared by Treasury identifies practices of concern engaged in by lenders and brokers, in relation to small business borrowers who are in financial distress.

The RIS recognises that the lenders and brokers who engage in these practices are generally considered to be 'fringe lenders and brokers'. Given these practices are not evident in mainstream small business lenders, the obligations and prohibitions that are proposed to apply for 'protected small business credit contracts' will impose an unnecessary compliance burden on those lenders who do not engage in these practices.

Accordingly, it is our view that Part 3-2F of the EDB goes further than required in order to address the identified market failure.

Insofar as the technical aspects of Part 3-2F are concerned, we have identified the following issues:

- As in the NCCP Act, the responsible lending provisions for small business credit contracts are divided into obligations applying to providers of credit assistance

(Division 2) and obligations applying to credit providers (Division 3). However, unlike the equivalent part of the NCCP Act, it is not explicitly stated in Division 2 that those provisions do not apply to credit providers.

In order to maintain consistency with the current responsible lending framework and to give clarity to credit providers, it should be made clearer that Division 2 does not apply to credit providers of small business credit contracts.

- Under the NCCP Act, responsible lending obligations for 'standard consumer' credit contracts apply only to licensees, credit providers and, to a lesser extent, credit representatives. Those operating under a licence exemption are not subject to any specific responsible lending obligations.

  Proposed Division 2 of the EDB does not provide an exclusion for those currently exempt from licensing. As a consequence, credit assistance providers operating under a license exemption would be subject to the responsible lending obligations applying under Division 2 of the EDB but not the rest of the NCCP Act. Consequently, they would be subject to more onerous responsible lending obligations in respect of small business lending than they would be for mortgages, personal loans or credit cards.

  This appears to be an unintended consequence and we consider that proposed Division 2 should be amended so it only applies to permit holders who provide credit assistance.

- Before entering into a 'protected small business credit contract', a credit provider is required to inquire as to whether the consumer or owner of the residential property that will be security for the contract, is prepared to lose ownership of that property. This raises two concerns:

  - Where the security is provided by a third party, a credit provider will be required to make enquiries with that third party, who is either not a customer or not a customer for the purposes of the loan; and

  - The requirement that the owner is 'prepared' to lose ownership on default, in order for the contract or credit increase to be suitable, is too high a standard. It could be argued that an owner would never be 'prepared' or willing to lose ownership of the property under any circumstances. In our view, the appropriate standard is whether the owner understands loss of the property is a possible outcome. The proposed s. 133FJ(b) should be amended to reflect this.

- Additional obligations are imposed where a credit provider enters into a new protected small business credit contract which will refinance an existing 'defaulting contract', that is secured by residential property. The new contract will be unsuitable if the consumer or owner of the security property does not think that entering into, or increasing the limit of, the contract will enable a higher sale price for the property to be obtained (proposed s. 133FK(2)(c)).

  We acknowledge that the intent of these obligations is likely aimed at having a customer in stressed circumstances give consideration to whether entering into a new credit contract, or increasing the limit of their existing contract, is in their best interests, However, in our view, it is unclear why, for the contract to be 'not unsuitable', the consumer must think that entering the contract or limit increase will enable them or the property owner to sell the security property for a 'higher price'. We consider that the primary purpose of the contract or increase, in many cases, would be to enable the small business to continue to operate and clear the defaulting

contract; the consumer may not have considered specifically entering the contract to avoid the residential property being lost for a low price. We query why in these circumstances the new contract should be unsuitable.

Furthermore, this provision raises a question as to what the credit provider should do if the consumer does not have a view on whether the contract will enable them, or the property owner, to obtain a higher sale price for the property. It also raises a question as to what is a 'higher price' – relative to what?

ANZ would be pleased to provide any further information on this submission. I can be contacted on (03) 8654 3459 or Michael.Johnston2@anz.com.

Yours sincerely

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