Consumer Credit Code Amendment Bill 2007

and

Consumer Credit Amendment Regulations 2007

Consultation Package

Submission to the Ministerial Council of Consumer Affairs

October 2007

INTRODUCTION

Australia and New Zealand Banking Group Limited (ANZ) is pleased to provide a submission to the Ministerial Council of Consumer Affairs (MCCA) Consultation Package on the *Consumer Credit Code Amendment Bill 2007* and the *Consumer Credit Amendment Regulation 2007* (Consultation Package).

At the outset, ANZ would like to express its concern at the lack of transparency and public consultation on this issue. While the process has been going on for a number of years now, its focus has always been purely on the fringe credit market. Now however, the draft legislation extends the proposed regulatory coverage to the mainstream credit market with the consultation paper only allowing a short consultation period of four weeks.

The *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, endorsed by the Australian Government, recommended that:

> "*There needs to be effective consultation with regulated parties at all stages of the regulatory cycle. It is important that stakeholders are consulted both at an early stage when policy options and approaches are being considered, and later when the detailed design features are being bedded down.*"[1]

In this case it is clear that effective consultation with the potential regulated parties, which now includes all mainstream credit providers, has not occurred until the design phase, and this consultation has been severely restricted.

---

[1] Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, January 2006, p 147

1. THE FINANCIALLY EXCLUDED AND THE FRINGE LENDING MARKET

In 2004 ANZ commissioned research, conducted by Chant Link and Associates, into the level of financial exclusion[2] in Australia. The research found that around six per cent of adults have minimal financial access, owning only a transaction account, while around 120,000 people, or 0.8 per cent of the population, could be considered totally excluded with no ownership of financial products.

The research also suggested that the concern for those on low incomes was not so much access to credit, but that the credit they can access is generally at a very high cost, which is more likely to lead to unmanageable debt. Mainstream lenders are required to deliver commercially acceptable returns and to conduct their business in a way that is seen as socially responsible. This has led to the establishment of minimum amounts of credit and loan sizes and lending criteria that require a borrower to have a sound credit history and to demonstrate a regular income, commensurate with the credit or loan they wish to obtain. This has effectively excluded some lower income (and therefore less profitable) customers from the mainstream.

This has contributed to exposing this segment of the market to unethical, predatory and 'unsafe' lending practices in the form of high cost 'payday' loans and pawnbroking. Loans for this segment are often priced in excess of the risk posed by this group of consumers, who are, contrary to popular belief, largely good money managers.

ANZ acknowledges that the lack of competition between existing participants, combined with excessive pricing, represents a clear market failure that has the potential to disadvantage some of the most vulnerable consumers in the credit market.

2. TARGETING MARKET FAILURE

ANZ supports, in principle, regulatory intervention to create a 'safety net' for disadvantaged consumers. However, it appears that the proposed intervention will impose regulation over the pricing of all credit, not just where the demonstrated market failure exists.

The *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* made a recommendation, which was endorsed by the Australian Government, on the principles of good regulatory process. The first of

[2] Financial exclusion refers to a lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers, where a lack of access can cause a level of harm to the consumer.

those principles was that "Governments should not act to address "problems" until a case for action has been clearly established".[3]

While the MCCA has clearly identified that a problem exists in the fringe market, a similar problem has not been established in the mainstream market for credit.

Indeed, the mainstream credit market, unlike the fringe lending market, functions in a competitive manner which places a natural constraint on prices. Competition in the consumer finance market over the last few years, especially from the new non-bank entrants, has applied significant pressure on mainstream credit providers to compete on price.

In the credit card market, this pressure is reflected in the significant expansion of low interest credit card products, nil-annual fee card offers and low interest rates on balance transfers. It is also widely acknowledged that increased competition in the home loan market has tightened significantly the interest rate margins of mortgage providers.

Disclosure of fees and charges is also generally considered good in the mainstream credit market. For example, for credit products regulated under the Uniform Consumer Credit Code (UCCC), when advertising an interest rate, lenders are required to state the mandatory comparison rate which takes into account the interest rate plus relevant fees and charges. Further, all credit fees and charges for UCCC regulated credit must be disclosed in a financial table before the debtor accepts the contract.

While its focus was on lending standards in the mortgage market, the House of Representatives Economics Committee Home Loan Lending Report stated that:

> "*It is widely acknowledged that ADIs [Authorised Deposit-taking Institutions], in particular, are not involved in inappropriate lending practices. Heidi Richards of APRA stated:*
>
> > *That is not something we see in our ADIs and we do quite extensive on-site visits of their lending practices.*"[4]

Good regulatory practice suggests that intervention in a market should be limited to the minimum necessary to achieve its objective, and should be directly targeted at that objective. It is unclear that the broad proposal, as put forward by the MCCA, is consistent with this as it will capture far more activity than warranted.

---

3 Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, January 2006, p 147

4 House of Representatives Standing Committee on Economics Finance and Public Administration, *Home Loan Lending: Inquiry into home lending practices and the processes used to deal with people in financial difficulty*, September 2007, p 23

ANZ notes that as the proposed legislation is retrospective in its consideration of fees and charges (i.e. it considers the reasonableness of fees and charges only after they have been introduced or changed) there would be significant uncertainty for all financial institutions.

An example of this uncertainty could occur in the case of the proposed Section 72(2) where financial institutions pass on increases in the official cash rate. This section suggests that a change in interest rates is unreasonable if the change was made in a manner having regard to:

> "*Any advertised rate or other representations made by the credit provider before or at the time the contract was entered into; and…the period of time since the contract was entered into…*"

While it may seem patently reasonable for financial institutions to pass on increases in interest rate costs, as it stands, the proposed regulation would allow such an increase to be challenged in court, potentially consuming significant resources defending baseless claims.

This uncertainty arises not only as a result of the fact that any person can bring an action against a financial institution, but also because what is 'reasonable' in terms of included costs is unknown. One only has to look at the differing views between merchants and financial institutions on eligible costs for credit card interchange fees to realise that a reasonable estimate of costs will be a very subjective matter.

In addition, the evolution of modern banking systems means that many credit-related decisions are now made in a highly computerised environment, with regard to portfolio dynamics (as opposed to one-off credit decisions made under the previous and more costly "branch-centric" model). This means that identifying the specific costs of an individual transaction can require complex cost allocation modelling and assumptions, which are necessarily fraught with difficulty.

Further, financial institutions cannot rely on precedents where a court has found in favour of another financial institution, as these decisions are not binding on any other debtor.

The uncertainty is further compounded by the fact that the proposed legislation appears to contain no allowance for profit or return on capital. Section 72(6)[5] states that:

---

[5] Section 72(3) also states "*An establishment fee or charge is unreasonable only if it appears to the Court that the fee or charge is more than the credit provider's reasonable cost of—*

> *(a) deciding an application for credit; and*
>
> *(b) the initial administrative costs of providing the credit.*"

> *"Any other credit fee or charge is unreasonable only if it appears to the Court that the fee or charge is more than the credit provider's reasonable underlying costs or losses that gave rise to the fee or charge."*

As fees and charges must be based on a reasonable estimate of costs, profit will have to be derived purely from interest on credit. However, Section 72(8) states that:

> *"Also, if it is alleged that the combination of the annual percentage rate and any credit fee or charge is unreasonable because of excessive interest charges, the Court may have regard to the annual percentage rate or rates payable under comparable contracts."*

This casts doubt over the ability of a financial institution to recoup a commercial return on its credit products and return a profit to its shareholders.

ANZ, like many other lenders, makes a return for its shareholders through revenue from both fees and interest charges. The proposed legislation creates uncertainty for financial institutions because a court could effectively be able to set prices in a competitively functioning market. In a competitive market it is appropriate that fees and charges be set by the market, with competition providing the discipline on levels. The proposed legislation however, would mean that a fee could be considered unreasonable if it is more than the credit provider's reasonable underlying costs or losses, potentially meaning profit would need to be derived purely from interest charges, or in an extreme case not at all.

3. THE WAY FORWARD

ANZ believes that the most appropriate legislative response to address this market failure in the short-term is to implement a mechanism similar to that developed by the New South Wales Government. In that State there is an effective interest rate cap, factoring in both interest charges and fees, of 48 per cent per annum.[6]

This cap has been effective at regulating clearly egregious lending practices while at the same time providing for a legislative 'safety net' as the fringe credit market develops. The legislative intervention was put in place where the market failure is present and not across the entire mainstream credit sector.

In the longer term, ANZ believes that the market failure could potentially be corrected through the combination of targeted regulation, more competition in the

[6] ANZ notes that the Queensland Government also plans to introduce a 48 per cent interest rate cap with the Honourable Kerry Shrine, Queensland Attorney-General, stating in relation to the introduction of a cap that "This work is a priority. I hope to finalise a package of measures by the end of the year." (Daryl Passmore, "Pay-day loan law attacked, Sunday Mail, 23 September 2007")

fringe market, especially from mainstream lenders, and consumer education through improved financial literacy. As such, it is important to ensure that any regulation put in place includes a sunset clause so that it can be regularly reviewed to ascertain that it remains effective and appropriate.

ANZ has already implemented a number of initiatives which are aimed at helping low income earners in accessing mainstream credit and in building their financial literacy.

Accessing Mainstream Credit—Progress Loans

In May 2006, ANZ and the Brotherhood of St Laurence launched Progress Loans, a pilot program which provides small affordable loans of between $500 and $3000 to people on low incomes for essential household items such as whitegoods, furniture, computers, cars, car repairs and hot water systems.

Progress Loans was developed in response to ANZ's research into financial exclusion. This program helps people on low incomes access essential services and avoid high cost and unsafe alternatives such as 'payday' lenders and loan sharks which may lead to unmanageable debt.

Progress Loans aims to provide both an affordable and sustainable loans program and charges a fixed interest rate of 12.95 per cent (comparable to rates on most personal loans) and an application fee of $40. The pricing of Progress Loans is consistent with the objectives of:

- Linking participants with the mainstream—a borrower is more likely to establish a positive repayment history with a mainstream lender where they can demonstrate repayment of a loan with a standard interest rate; and

- Ensuring the program is sustainable in the long term—many small loans programs struggle to survive because they are expensive to run, rely on discretionary philanthropic funding and have insufficient scale to generate sufficient interest and fee revenue.

ANZ has just finished its pilot which ran over a 12-month period where it issued 140 loans with an average size of $1549 and an average term of 24 months. There were no loan defaults or loans in arrears at the end of the pilot and this positive performance has continued.

ANZ and the Brotherhood of St Laurence are currently conducting a full evaluation of the pilot, including a study into the social impact of the program with a report due to be published by the end of 2007. In the meantime, the program continues to operate at Melbourne sites (Fitzroy and Frankston) and will be expanded to a new Melbourne site in Craigieburn.

Building Financial Literacy—MoneyMinded and Saver Plus

ANZ supported the development of MoneyMinded, a comprehensive financial education program, to improve financial literacy and help people make better and more informed decisions about their finances.

ANZ has initiated the development of two MoneyMinded programs. Firstly, workshops delivered by community educators and financial counselors working with people facing financial hardship to help them develop their money management skills and capabilities. And more recently, the introduction of an online program available to anyone interested in improving their money management skills.

The development of MoneyMinded was initiated and funded by ANZ with essential contributions from community sector and education experts, including the national financial counseling peak body, the Australian Financial Counselling and Credit Reform Association.

An important feature of MoneyMinded is that it provides unbiased consumer education and does not contain any ANZ branding or promotion of our financial products and services.

An evaluation by RMIT University found that 15,279 people participated in MoneyMinded for the year to 30 September 2006 (exceeding ANZ's target for 2006). For 2007, ANZ has set a target of 20,000 people. Focus group research showed that the most significant impact of MoneyMinded was increased confidence in dealing with financial issues, including creditors and banks.

ANZ also developed Saver Plus in partnership with the Brotherhood of St Laurence (later extended through partnerships with Berry Street Victoria, the Smith Family, the Benevolent Society and the Victorian State Government—Department for Victorian Communities). Saver Plus combines a matched savings program with financial literacy through the MoneyMinded program. As well as the financial education program, Saver Plus matches every dollar saved with an additional $1 (up to $1000 in matched funds) towards primary, secondary and adult vocational education costs.

More than 660 families participated in the Saver Plus pilot program between 2003 and 2005, together saving more than $617,000 and were rewarded with matched savings totaling $1.1 million by ANZ. With new funding (ANZ has pledged $3 million to match participants' savings) ANZ and its community partners have set a target to deliver Saver Plus to 5400 individuals and families on low incomes by 2009. The Victorian Government will contribute $1.35 million over the three years to extend Saver Plus to a further 1800 Victorians on low incomes.

4. CONCLUDING COMMENTS

ANZ acknowledges the significance of the problems in the fringe market and agrees that these must be addressed. Indeed, ANZ has taken steps itself to assist those on low incomes to access the mainstream credit market and to improve their financial literacy.

ANZ's actions are aimed at making a contribution towards correcting the market failure, however, ANZ understands that in the short-term, regulatory intervention is necessary to protect vulnerable consumers. For this to be effective, however, intervention should be targeted directly at the market failure.

While some may argue that any legislative safety net should be applied to fees and charges levied by all credit providers, good regulatory practice dictates that intervention be limited to instances of clear market failure.

ANZ would be pleased to provide any further information about this submission as required, and can be contacted as follows:

Ms Jane Nash
Head of Government & Regulatory Affairs
ANZ
Level 22, 100 Queen Street
Melbourne VIC 3000
(03) 9273 6323
nashj@anz.com