

## Banking & Finance Alert

August 2009

### **'TRUTH IN LENDING': THE NATIONAL CONSUMER CREDIT PROTECTION REFORM PACKAGE**

In June 2009, the Federal Government introduced the National Consumer Credit Protection Reform Package into the House of Representatives. Its objective is "strong consumer protection through 'truth in lending'".

It is hoped the reforms will reduce the number of distressed borrowers having to repay unsuitable loans by imposing responsible lending requirements on most licensees.

Currently, regulated credit providers operating throughout Australia face differing rules and regulations. The proposed legislation is aimed at creating a uniform set of rules and regulations and to capture certain parties not currently regulated.

Depending on the jurisdiction, certain parties involved in consumer credit transactions are not regulated. For example, only Victoria, New South Wales, Western Australia, and the Australian Capital Territory regulate finance brokers. The forms of regulation differ widely; only Western Australia requires licensing. With the passage of the Federal legislation, parties previously not subject to regulation will fall under the National Credit Code (NCC).

#### **Who will be affected**

The scope of the NCC is broader than that of the Uniform Consumer Credit Code (UCCC), the State and Territory legislation it supersedes.

Businesses unregulated by the UCCC but subject to the NCC may face significant transitional costs.

- As a credit provider or finance broker, you may be regulated by the UCCC. Licensed deposit-taking institutions and finance brokers will be streamlined to the new regime without needing to submit detailed applications to the Australian Securities and Investment Commission (ASIC).
- If you are a new or unlicensed credit provider, finance broker or intermediary, you must meet stringent criteria in order to qualify for a license.
- If you are a provider of credit or advice relating to residential investment property loans, you will be subject to the requirements of the NCC.
- If you are a point-of-sale retailer, for example, a car dealer or retail outlet, or a State/Territory licensed debt collector, you may be exempt from the Code pending further consultation over the next 12 months.

ASIC may, at its discretion, exempt credit-related activities or classes of activity from licensing.

#### **The licensing requirements**

Any person or business providing regulated credit or assisting a borrower to obtain regulated credit, must apply for an Australian Credit Licence (ACL) by 30 June 2011. ASIC has been appointed as the sole regulator, with enhanced powers. In order to obtain an ACL, applicants must prove that they:

- are fit and proper;
- meet the legal obligations of a licence holder; and
- are members of an ASIC approved External Dispute Resolution (EDR) scheme <sup>1</sup>

<sup>1</sup> In 2008, several ASIC approved EDR schemes merged to create the Financial Ombudsman Service (FOS). On 1 January 2010, the same date as the commencement of the ACL licensing process, a single set of rules will come into effect and the old schemes will be wound down.

ACL holders will be permitted to lend money under a credit contract and collect the repayments as they fall due. They are prohibited from conducting business with unlicensed persons, such as, unlicensed brokers or similar intermediaries.

ASIC has recently released a consultation paper indicating an intention to include the NCC legislation in its regulatory guide dealing with the general conduct obligations of existing Australian Financial Services (AFS) licensees. In some cases, the requirements will be different. For example, credit licensees will be obligated to ensure borrowers are “not disadvantaged” by any conflict that may arise. This is more onerous than the requirement of AFS licensees to have “adequate arrangements in place for managing conflicts of interest”.

### **Are there any additional requirements?**

The reforms impose responsible lending requirements on licensed brokers and lenders. They are anchored in two core principles:

- Unsuitable loans should not be provided to borrowers; and
- Borrowers should not be provided with loans that they lack the capacity to repay.

In such instances, if a borrower must sell their primary residence to repay the loan, it may be deemed unsuitable.

The responsible lending provisions will not come into force until 1 January 2011, allowing for employee training and the development of compliance systems.

The NCC provides further protections, for example:

- Lenders are prohibited from using essential household items as security;
- Credit assistance providers, such as finance brokers and intermediaries, will be prohibited from lodging a caveat over the borrower’s land in order to secure payment; and
- The threshold under which consumers can apply for the variation of their loan terms on the grounds of hardship rises to \$500,000.

The NCC provides limited protection against ‘unjust contracts’. This will be complemented by the National Unfair Contract Terms Law, another federal bill. Under the legislation, action can be taken against unfair terms in standard form contracts (which will include most mortgage and loan agreements). A term will be considered unfair if:

- It causes a significant imbalance in the parties’ rights and obligations arising under the contract; and
- It is not reasonably necessary to protect the legitimate interests of the supplier.

### **What are the new compliance requirements?**

- Licensees must submit an annual compliance certificate to ASIC.
- Licensees must retain financial records for 7 years.
- ASIC will have the power to cancel licenses in cases where there are breaches of the ACL

### **What are the penalties?**

- Under the bill, ASIC can issue infringement notices and civil proceedings. Civil penalties are set at a maximum of \$220,000 for individuals and \$1.1 million for corporations.
- Criminal penalties of up to two years in jail and 100 penalty units are available for serious breaches.

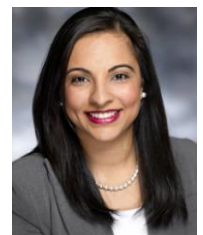
If the Reform Package becomes law, we will provide a further update outlining the implications for you and your business.

In the meantime, contact Sebastian Saccuzzo or Kaajal Fox should you have any queries.

We would like to acknowledge the contribution of Stephanie Gold, Seasonal Clerk, in the production of this article.



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### **DISCLAIMER**

The information contained in this alert is intended as general commentary and should not be regarded as legal advice. Should you require specific advice on this topic, please contact the author/s directly.

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| <b>Key Dates</b>                     |  |
| <b>September 2009</b>                | <b>Anticipated passage of the Reform Package</b>   |
| <b>1 November – 31 December 2009</b> | <b>Entities engaging in Credit Activity must register with ASIC in order to continue operating</b> |
| <b>1 January – 30 June 2011</b>      | <b>Registered persons must apply for an ACL</b>  |
|                                      | <b>Entities commencing activity after 1 January 2010 must apply for an ACL before operating</b>    |
| <b>Mid 2010</b>                      | <b>Anticipated implementation of Phase Two legislation</b>   |
| <b>1 January 2011</b>                | <b>Responsible Lending requirements come into effect</b>   |

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