

BANKING AND CREDIT (GENERAL)

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Legal Briefings - By **Tony Coburn, Amy Ciolek, Julia Massarin, Sky Kim and Kiara Salvia**

The recommendations made in relation to banking and credit more generally were in some regards unsurprising and minor, relative to the [responsible lending recommendations](#) and [credit distribution recommendations](#), both of which went to the crux of Commissioner Hayne's "four observations".

We observed that Commissioner Hayne did not jump to a quick-fix solution of more regulation. For example, Recommendation 1.9 is to not extend the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**) to small business. However, in some regards, recommendations to remove existing regulatory complexity, such as Recommendation 1.7, to remove the "point of sale" (**PoS**) exemption, will involve a material departure from how certain credit industry segments current operate.

POLICY RECOMMENDATIONS

REMOVING THE POINT OF SALE EXEMPTION

The PoS exemption, in Regulation 23 of the *National Consumer Credit Protection Regulations* (**NCCP Regulations**) is commonly used by goods and services vendors, especially by dealers in the auto and equipment finance industry. The exemption allows vendors to introduce borrowers to lenders for regulated credit without needing to hold an Australian Credit Licence (**ACL**), or be authorised as a Credit Representative.

Recommendation 1.7 is that the exemption of retail dealers from the operation of the NCCP Act should be abolished. The removal of the exemption will mean that vendors must hold an ACL, or be appointed as a Credit Representative, and must carry out a responsible lending assessment prior to assisting consumers to apply for a loan

SMALL BUSINESS LENDING

The question of whether or not to extend the NCCP Act to small business credit has been topical for years. It presents a balancing act between protecting small business, allowing them to access affordable credit and avoiding unnecessary additional regulatory cost.

Recommendation 1.9 supports that the NCCP Act should not be amended to extend its operation to lending to small businesses. See our [discussion about responsible lending](#) to small and medium enterprise for further analysis.

AGRICULTURAL LOANS

Numerous case studies presented during the Royal Commission hearings highlighted the unique challenges and vulnerabilities that can exist with agricultural sector borrowers.

Recommendation 1.14 recommends that when dealing with distressed agricultural loans, banks should ensure that those loans are managed by experienced agricultural bankers, only appoint receivers as a remedy of last resort, and cease charging default interest when there is no realistic prospect of recovering the amount charged. In relation to the issue of default interest, the Final Report commentated that “there comes a time, especially in connection with distressed agricultural loans, when charging default interest serves no larger commercial purpose than providing a bargaining chip to be thrown onto the table by the bank even though, when played, it is a chip with no realisable value.”¹ In the same context,

Recommendation 1.13 is that the ABA should amend the 2019 Banking Code of Practice (**Banking Code**) to provide that banks will not charge default interest on loans secured by agricultural land in an area to be affected by drought or other natural disaster.

THE ENFORCEABILITY OF INDUSTRY CODES

Recommendation 1.15 is that some provisions of industry codes be picked up and applied as law, so that breaches of those provisions will constitute a breach of the law. Specifically, the legal amendments suggested include:

- that ASIC's power to approve codes of conduct extends to codes relating to all APRA-regulated institutions and ACL holders;
- that industry codes of conduct approved by ASIC may include ‘enforceable code provisions’;
- that ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as ‘enforceable code provisions’ in determining whether to approve a code;
- for remedies that follow from a breach to be modelled on those currently set out in Part VI of the CCA, for breach of an ‘enforceable code provision’; and
- for the establishment and imposition of mandatory financial services industry codes.

This links closely with **Recommendation 1.16**, that the Australian Banking Association (**ABA**) and ASIC take all necessary steps to have the provisions that govern the terms of the contract between the bank and the customer or guarantor designated as "enforceable code provisions".

RECOMMENDED AMENDMENTS TO THE BANKING CODE

Recommendation 1.10 is to amend the definition in the Banking Code of a "small business" to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than \$5 million. While this does not align the definition with the definitions in other laws,² it is at least more easily ascertainable than the current definition, and applies to a broad population of small business borrowers.

ACCESS TO BANKING SERVICES

Recommendation 1.8 is to amend the Banking Code to improve accessibility of banking services for customers who live in remote areas and those who are not adept in using English. It further recommends that the Banking Code require banks to follow AUSTRAC's guidance on the identification and verification of persons of Aboriginal or Torres Strait Islander heritage, not allow informal overdrafts on basic accounts, and not charge dishonour fees on basic accounts. Broadly, these recommendations are in line with recurrent themes of fostering financial inclusion as demonstrated by initiatives such as the Financial Inclusion Action Plan program. The recommendation will align the Banking Code with similar provisions in other industry codes.

Expected	Unexpected
The NCCP Act should not be extended to credit for small business borrowers	Withdrawing the PoS retailer referrer exemption from the NCCP Act
Banks' should use specialised agri-credit officers to resolve agricultural loans in distress, only appoint receivers as a remedy of last resort, and cease charging default interest when the prospect of recovery is unrealistic.	The ABA should amend the definition of small business in the Banking Code.
The ABA should amend the Banking Code to (1) improve accessibility of banking services for customers who live in remote areas and those who are not adept in using English; (2) require banks to follow AUSTRAC's guidance about the identification and verification of persons of Aboriginal or Torres Strait Islander heritage; (3) not allow informal overdrafts on basic accounts; and (4) not charge dishonour fees on basic accounts.	
Give legal effect to certain provisions in industry codes, so that a breach of the provision will constitute a breach of the law.	

THE BIG PICTURE

REMOVING THE POINT OF SALE EXEMPTION

The PoS exemption has been a topic of review both by Treasury in 2013,³ and by the Productivity Commission in 2018. The 2018 Productivity Commission Inquiry Report into Competition in the Australian Financial System states that it sees "little justification"⁴ for maintaining the PoS exemption, and suggests that consumers should be protected by the NCCP Act when taking up finance from retailers.

Recommendation 1.7 has attempted to resolve PoS related issues through a blanket ban. Commissioner Hayne considers that the PoS exemption promotes three types of conduct that create adverse consumer outcomes, (1) the use of flex commission; (2) lenders relying on dealers to collect accurate information; and (3) lenders capitalising on add-on insurance. In most part, flex commission has been banned under *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780*. The two remaining issues seem somewhat related to lender conduct, monitoring, and regulatory response to curb conduct that could breach a lenders existing section 47(1)(a) and (b) NCCP Act obligations to act fairly, honestly, and without disadvantaging consumers as a result of a conflict of interest.

SMALL BUSINESS LENDING

The recommendation that the NCCP Act should not be amended to extend its operation to lending to small businesses was made partly in recognition of an existing legal and regulatory framework of small business protections. These include:

- prohibition on misleading or deceptive conduct in relation to financial services;⁵
- prohibition on unconscionable conduct in connection with the supply or possible supply of financial services;⁶
- implying particular warranties into contracts of the supply of financial services;⁷
- the unfair contract terms regime;⁸ and
- the standard in the Banking Code that a lender will ‘exercise the care and skill of a diligent and prudent banker’.

AGRICULTURAL LOANS

Despite examples of cases in recent years in which the courts have upheld the validity of default interests that is challenged as unreasonably high,⁹ the recommendations aims to give certainty to a the position that it would be unfair to charge default interest when there is no realistic prospect of recovery, or where the land held as security is affected by natural disaster. We note that this recommendation is only made in the context of “banks”, and we question whether the prohibition would extend to non-bank lenders.

It is possible that this recommendation may be implemented in a similar form to the existing unfair contract terms regime whereby contravening clauses that are found in contracts will be rendered void.

THE ENFORCEABILITY AND APPLICATION OF INDUSTRY CODES

Commissioner Hayne expressed concern in relation to a climate of “highly undesirable” uncertainty that currently exists around which provisions of industry codes can be relied on, and enforced.¹⁰ Instead, parties to contracts should know what terms govern their relationship.

Attention was previously given to how these limitations and difficulties can be met in the December 2017 report by the ASIC Enforcement Review Taskforce. The report includes various recommendations about industry codes in the financial sector. Relevantly, it recommends that entities subscribe to the approved codes relevant to their business activities, and that an individual customer should be able to seek appropriate redress through the subscriber’s internal and external dispute resolution arrangements for non-compliance with an applicable approved code.

Commissioner Hayne considers it necessary to go one step beyond what was proposed by the ASIC Enforcement Review Taskforce, and expressed agreement with Treasury’s statement in its Interim Report Submission “[f]or codes to be meaningful rather than tokenistic, there needs to be reasonably effective mechanisms in place to ensure adherence.”

Commissioner Hayne notes that if breaches of enforceable code provisions can be enforced by the courts, problems arising in the current climate, such as entities disagreeing with conclusions reached by external dispute resolution bodies and persisting in practices that have been criticised are likely to be reduced, even eliminated.

With the government, along with the ABA’s CEO, Anna Bligh, expressing support on behalf of the banking industry for the enforceability of the Banking Code and the proposed amendments to the definition of ‘small business’, it is possible that these recommendations will considerably change the current climate of uncertainty associated with the enforceability of industry codes and will expand the application of the Banking Code to a wider set of small businesses.

ACCESS TO BANKING SERVICES

Anna Bligh, Chief Executive Officer of the ABA, has already confirmed in a press conference that the ABA welcomes the recommendations proposed by the Commission with respect to the Banking Code and that it intends to implement all the recommendations.¹¹ Based on this, it is likely that all signatories to the Banking Code will have to consider ways to improve accessibility of banking services for customers who live in remote areas and those who are not adept in using English. Any basic account products that currently allow for informal overdrafts or charge dishonours fees will have to be changed in light of the recommendations.

GUARANTORS

Surprisingly, despite hearing numerous case studies of the banks taking a hard line in enforcing guarantees, Commissioner Hayne was careful not to disrupt the existing law in relation to guarantees, whether given in support of lending to SMEs or more generally. The reasons cited were mainly that there was a settled body of case law (for example, *Amadio*¹² and *Garcia*¹³) against which individuals and businesses have structured their dealings and there were sufficient additional protections introduced in the Banking Code to protect the guarantors.

INSIGHTS AND TRENDS

REMOVING THE POINT OF SALE EXEMPTION

Irrespective of whether or not banning the PoS exemption is the correct answer, and will create a better consumer outcome than simply banning the sale of the concerning financial products, or whether it will drive a stronger use of interest free products, the recommendation will result in change impacting the entire motor vehicle dealer industry. We expect that many motor vehicle dealers will not want the trouble of having to conduct responsible lending assessments, or licensees will not want the risk of appointing so many Credit Representatives, and an opportunity will arise for data rich, online application solutions. This could present an opportunity for both new market entrants, and exiting licensees looking to reinvent themselves through a digital model.

NOT EXTENDING THE NCCP ACT TO SMALL BUSINESSES

While Recommendation 1.9 is to not extend the to small business, the recent regulatory changes, including the extension of the unfair contract terms (**UCT**) regime to small business, and ASIC's driven focus on enforcing the small business UCT regime (even against other small businesses) indicates that additional care is required when lending to small business (even if not legislated) to meet the regulator's expectations.

AGRI-LENDING

Various jurisdictions have agricultural loan-debt enforcement schemes in place now, so as the new national initiative in Recommendation 1.11 is being planned, lenders will need to try to engage with the policy makers to ensure that they are represented, and will need to incorporate new rules into their lending programs. Agri-lending is full of unique challenges, and it is critical to the Australian economy, to industry innovation and sustainability and, at the end of the day, to the cost and availability of our food supply.

If it is the case that improvements to APRA imposed land valuation standards will consider potential land-related volatility and other risks as proposed under Recommendation 1.12, and lenders have difficulty enforcing agri-loans, or charging default interest (as proposed in Recommendation 1.13), it is possible that lending to the agricultural segment will reduce or become more expensive. Reducing agri-loan volume or accessibility may be Commissioner Hayne's intention to protect farmers, but could have catastrophic results for the Australian economy, unless the government balances the credit crunch with government funding initiatives. The delicate nature of agri-business appears to present a hurdle to implementing credit reform.

WHAT IS OMITTED FROM THE GENERAL CREDIT RECOMMENDATIONS?

While it is interesting to consider the general credit recommendations, it is equally as relevant to consider what was not included, such as:

- comments or recommendations on other NCCP Act exemptions, such as unregulated consumer lending products;
- a reduction in the volume or consolidation and rationalisation of prescribed disclosures to make disclosures easier to consume when borrowers use digital channels; and
- the need to change laws to allow for full electronic delivery and execution of key documents to assist unbanked and remote customers to access credit (in line with Recommendation 1.8)

SO WHAT DOES THIS MEAN FOR THE INDUSTRY?

We look forward to sharing further observations and trends with you, as we work through these ourselves, and with clients, and considering how these recommendations may affect your product design strategy and approach.

ENDNOTES

1. Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report (1 February 2019), Volume 1 (**Final Report**), page 103.
2. For example, the *Corporations Act 2001* (Cth), small business taxation concessions law, or the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).
3. Treasury, Discussion Paper – The exemption of retailers from the *National Consumer Credit Protection Act 2009*, available at https://static.treasury.gov.au/uploads/sites/1/2017/06/POS_Discussion_paper.pdf.
4. Australian Government 2018, Inquiry Report on Competition in the Australian Financial System, Productivity Commission, viewed 5 February 2019, < <https://www.pc.gov.au/inquiries/completed/financial-system/report/financ...>, p.28.
5. ASIC Act ss 12DA, 12DB, 12DC, 12DF.
6. ASIC Act ss12CA, 12CB.

7. ASIC Act s 12ED.
8. ASIC Act Pt 2 Div 2 Sub-div BA.
9. For example, *Arab Bank Australia Ltd v Sayde Developments Pty Ltd* [2016] NSWCA 328.
10. Final Report, page 106.
11. ABA, Transcript of Royal Commission Final Report Media Conference, 4 February 2019, available at <https://www.ausbanking.org.au/media/transcripts/4-feb-19-royal-commission-final-report-media-conference/>.
12. *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447.
13. *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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