AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

**Manager, Consumer Policy Unit**
The Treasury
Langton Crescent
Parkes ACT 2600

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**By email:** uctprotections@treasury.gov.au

Dear Sir/Madam

**Enhancements to Unfair Contract Term Protections**

Thank you for the opportunity to provide a submission in response to the consultation regulatory impact statement in relation to the Enhancements to Unfair Contract Term Provisions ('consultation RIS').

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include Australia's leading banks, credit unions, finance companies, fintechs, and credit reporting bodies. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

Our comments on the consultation RIS are made in relation to financial products and services regulated under the ASIC Act and, in particular, to *consumer* credit regulated by the *National Consumer Credit Protection Act*.

The comments focus on the key questions:

> *6. Do you consider making UCT's illegal and introducing financial penalties for breaches would strengthen the deterrence for businesses not to use UCT in standard form contract? Please provide reasons for your response.*
>
> *27. What would be the impact of applying any of the options around illegality, penalties and flexible remedies to consumer and insurance contracts?*[1]

[1] We have not commented on issues relating to flexible remedies and insurance contracts.

We strongly disagree with *Option 3 – making UCTs illegal and attaching penalties* and, by extension, *Option 4a – infringement notices*.

The above response is made specifically in relation to financial products and services (although some of our comments below would also apply to non-financial products and services).

If the policy decision is made to implement a form of Option 3 (i.e. making UCTs illegal and subject to penalties), we suggest that this be done in respect of identifiable and clearly described UCTs which are indisputably unfair. That is, merely because a term is ultimately deemed to be 'unfair' would not mean the issuer has acted illegally; they would only have acted illegally if they had include a term that was prescribed as being 'indisputably unfair'.

Further, as the types of UCTs that are indisputably unfair will differ between industry sectors and contract types, the legislation should provide that such terms may be deemed as unfair by legislative instrument (rather than set out in the legislation itself) – where that legislative instrument would be subject to consultation and adequately tailored to the industry sector and contract-type. We note that the Product Intervention Power recently granted to ASIC may play an equivalent role and so, for financial products and services, no further regulatory change may be required.

As an example to illustrate the above, the consultation RIS identifies (on page 8) that terms that have been found to be unfair included "terms that allow an issuing business to unilaterally increase its price or alter the terms and conditions of the contract". However, an ability for a credit provider to vary the price and terms and conditions of a credit contract – which may run for decades or indefinitely – is a fundamental element of the contract; where the power to vary the price and terms is expressly recognised, and regulated, by the *National Credit Code*.

Rather than being considered outright unfair, the right to vary the price and terms and conditions should be subject to proportional limitations which, depending on the circumstances, could include requiring appropriate notice periods for any change and an ability for the receiving party to terminate the agreement following a material change. In the context of credit contracts, a unilateral right to change the price and terms and conditions may be deemed unfair and illegal by legislative instrument if it lacked those proportional limitations.

In contrast, a stricter approach to unilateral variation terms may be appropriate in some sectors; either treated as outright unfair or requiring even stronger limitations and protections.

Reasons:

i. **Making UCTs illegal will increase compliance risk and increase cost to consumers**

   Financial products and services are often more complex than non-financial products and services. The complexity and nature of the market for financial products and services was recognised by ASIC in its submission to the *Productivity Commission Inquiry into competition in the Australian financial system* and was noted as a reason

for the higher level of regulation in that sector[2]. Likewise, financial products and services are typically provided at a scale that is almost unmatched in the Australian economy.[3]

As a result, financial products and services require a finely balanced mix of contractual terms that establish the foundations of the product or service, provide for efficient enforceability by the issuer and allow enough flexibility to respond to changing circumstances for products that may run for decades (e.g. home loans) or indefinitely (e.g. credit cards) – while also providing sufficient consumer protections. Further, in establishing that balance, the issuer may be subject to competing regulatory expectations. For example, an authorised deposit-taking institution is required to ensure that its credit products support its continued prudential strength (which requires strong enforceability and flexibility provisions), while also ensuring that it meets its consumer protection obligations under the NCCP and ASIC Act.

It is relevant to note that the proposal to make UCT illegal is based on the view that a business may continue to use terms that are "*very* likely to be unfair" [our emphasis]. However, the UCT legislation does not currently have the concept of a 'scale of unfairness'; a term is either unfair or it is not. There will almost certainly be marginal cases where people, acting reasonably, may have a different view on whether a term is 'unfair'. The consultation RIS itself recognises (and is arguably the result of) the significant uncertainty that is inherent in the UCT laws (which is unlikely to be completely removed regardless of the enhancements that are ultimately made).

As such, for business that are trying to avoid including UCTs in the contract, designing those contracts already requires taking a 'conservative' approach to drafting the contractual terms. As noted in section 4.5 of the consultation RIS, a contract involves the allocation of risk between the parties, where that balancing will directly impact the pricing of the product or service. For the reasons described above, this is particularly evident in relation to the provision of financial products and services, i.e. a small move in that balance may have significant pricing implications. Making the UCTs illegal and attaching penalties is likely, in respect of financial products and services, to have an outsized impact on that allocation of risk and pricing. That is, the product issuer will take more of the risk, and pass more of the cost onto the consumer.

However, the impact will go beyond the rebalancing of existing risk. Given the inherent uncertainty in the operation of the UCT regime, it will introduce new risk – that is, the additional compliance risk of breaching the UCT and engaging in illegal conduct – that will need to be priced into the contract. This will introduce further inefficiencies and increase the costs to consumers of those products and services.[4]

We also dispute the assertion that there would be no further compliance costs under Option 3. As noted above, the question of whether a term of a contract is unfair is not a black and white issue and the contract reviews undertaken by financial service

[2] See paragraph 6.
[3] Only a small number of other products are provided at similar scale, including telecommunications and utilities (which are also subject to specific regulatory regimes).
[4] The increased compliance risk will also apply to non-financial products and services although, depending on the nature of those contracts, may not be as significant.

providers when the UCT regulations first came in - 2011 for consumer contracts and 2016 for small business contracts - will have been done considering the risk profile of the legislation at that time. Making UCTs illegal will materially change that risk profile; by both increasing the potential direct financial impact (i.e. penalties) but also through increased associated risks, such as reputational risks. This will require businesses to review the decisions made during the original contract reviews and is likely to result in, at least, marginal changes to the approach adopted – which will result in significant additional compliance costs (e.g. for systems upgrades, documentation changes, policy and process changes etc). Of course, this is not to say that the changes to the business' approach are the result of terms previously being "unfair"; rather it is the result of the business taking a more conservative – arguably less efficient – approach to the increased compliance risk.

ii. **Voidable UCTs <u>are</u> a real deterrent in contracts for financial products and services**

We note that the consultation RIS references ASBFEO's earlier submission statement that "large banks have low motivation to comply with the UCT protections, noting that voidable terms are legal until found otherwise through the courts". Unfortunately, the relevant ASBFEO submission does not provide further background to this statement. We question whether this assertion is true or, at least, continues to be true given subsequent developments in the financial services sector (such as the reforms and increased regulatory focus resulting from the Banking Royal Commission).

Firstly, in relation to financial products and services (particularly credit contracts), the voiding of a term – and potentially the voiding of the entire agreement – is not something that can be taken lightly. For example, a credit provider relies on the existence of the credit contract in order to govern its *ongoing* ability to charge interest and fees and to enforce non-payment. A finding that a term of the agreement, or the agreement itself, is void would be disastrous for that credit provider. While the credit provider may be able to recover the principle loan amount on a non-contractual basis, its ability to charge interest or fees could be lost and the process for recovering that principle could be made significantly more complex and costly (where much of that cost may not be able to be recovered).

Secondly, holders of Australian Credit Licences and Australian Financial Services Licences are subject to the general conduct obligation to ensure that its services are engaged in efficiently, honestly and fairly. We would expect that a licensee being reckless as to whether their contracts contained UCTs would not be consistent with this obligation.[5]

Finally, we note that complaints relating to UCTs of a licensee would be subject to the overview of the Australian Financial Complaints Authority. If AFCA considered that a contract contained a UCT we expect that would result in a systemic issue report to

[5] We note also that recent or upcoming regulatory changes will provide additional tools to ASIC to deal with contracts of concern, including the Product Intervention Powers and the proposed Directions Power.

ASIC (which could then take relevant action, including under the general conduct obligations).

If you have any questions about this submission, please feel free to contact me on 0414 446 240 or at mlaing@arca.asn.au, or Michael Blyth on 0409 435 830 or at mblyth@arca.asn.au.

Yours sincerely,

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