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THE FINANCIERS ASSOCIATION OF AUSTRALIA LIMITED NEWSLETTER
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Welcome to the Autumn 2007 edition ofThe Financiers Association of Australia Limited newsletter.
As usual we try to keep up with any legislative changes in the credit code as well as inserting any interesting general business pieces gleaned from various sources.
A welcome is also extended to new members at this time.

Managing The Cost Of Consumer Credit In Queensland

The Queensland government has released a discussion paper to explore viable options for ensuring that fees and charges relating to the provision of consumer credit are fair and reasonable. Submissions were invited and closed on 15 December 2006.

Under the Uniform Consumer Credit Laws Agreement, the governments of each state and territory established the UCCC. The agreement provides that a state or territory can individually fix maximum interest rates.

The current situation is:
- NSW and the ACT - 48% pa maximum for interest and credit fees and charges
- Victoria - 48% pa for unsecured loans and 30% pa for secured loans. The cap applies to interest only and there is no cap on fees.
- SA - recently introduced legislation (not yet in force) that mirrors NSW.

In 2000, the Queensland Minister for Fair Trading established the Pay-Day Lending Working Party to consider pay-day lending. The PDL Working Party considered that an interest rate cap of 48% pa did not take into account the time, effort, and expense associated with the provision of pay-day lending.

An interest rate cap without a fee cap is of little impact because the lender can exceed the cap through fees. Victoria's recent report on consumer credit recognised that Victoria's legislation could be circumvented in this way, but did not recommend introducing a cap on interest and fees.

Many commentators argue that imposing a cap will have the undesirable consequence of forcing pay-day lending underground. It is reasonably commonly accepted that the cost of establishing a short-term loan (such a s a "pay-day loan") and the risk of making such a loan is not adequately recouped by a return of 48% per annum.

Practical example:
- Bill receives a bill to register his car. In order to pay this bill he obtained a loan of $100 from a fringe credit provider. The loan was repaid by a single payment of $120 at the end of the week. This equated to an interest rate of 1,040% per annum (20% per week).

- If the fringe credit provider which provided Bill's loan was subject to an interest rate cap of 48% per annum which included other fees and charges, the maximum amount that the fringe credit provider could have charged Bill for the loan would have been under $1. This equates to a return of less than 1%.

The Queensland report noted previous research which found that in 2002 the average annual earnings of pay-day lending customers were approximately $24,500 with many customers earning less than $400 per week. Loans were typically used to pay bills or to cover day-to-day living expenses. Low income households also rely on credit to meet emergencies and fund major purchases.

If pay-day loans are prohibited, consumers may suffer an impeded ability to overcome financial difficulties, an increased likelihood of default on loan repayments, and further exclusion from the mainstream market.

Imposing a cap on interest and credit fees and charges might result in excluding some legitimate products from the market and propel consumers away from lenders who attempt to comply with the law and further into the fringe.

The report notes that imposing an interest rate cap creates an incentive for credit providers to develop and promote new products which are not covered by the UCCC. One such structure is promissory note lending. The cap could also result in consumers who are already excluded from the mainstream market, also being excluded from the fringe market. These consumers would be forced to obtain credit from illegal lenders which may place them at even greater risk.

Against this background, the Queensland report makes no recommendations and seeks submissions. The report covers the issue very well and shows a good understanding of the market and the issues.

A full copy of the report can be found on the Queensland Government Fair Trading web site.

Court Sympathy Causes Recovery Rethink

Borrowers who took on more debt than they could afford to repay used to obtain little sympathy from the courts. This has now changed.

Borrowers who can show that the lender knew, or ought to have known, that their home loan could not be serviced are with increasing frequency obtaining relief under the 'unjust contract' provisions of the *Contracts Review Act.* This trend heightens the risk of relief also being afforded to borrowers under the equivalent 'unjust contract' provisions of the *Consumer Credit Code.*

These cases have had some common threads:

- vulnerable borrowers on fixed income
- incomplete or internally inconsistent loan applications that (with the benefit of hindsight) throw doubt on whether the borrowers understood the transaction or loan purpose
- failure to follow lending guidelines
- providers of legal and financial advice not being truly independent of the lender and otherwise failing to provide adequate advice.

By obtaining the court's sympathy, borrowers, in some instances, have not had to repay the loan. In other instances, the courts have required the borrowers to repay principal, normal interest but not higher rate interest.

It can be a costly experience for both borrower and lender to partake in litigation when the end result only effects how much interest is repaid.

The challenge for lenders is to identify at an early stage whether:

- the borrowers in fact could not afford the repayments at the time of the loan
- the borrowers' circumstances are such that they may find sympathy with the courts
- whether there are any third parties such as brokers, financial or legal advisers who may have played a part in facilitating the loan.

Going forward, lenders would be well-advised to ensure that all parties who a borrower maintains were responsible for their excessive debt are present and accounted for, by being joined to the proceedings – especially if a commercial solution to the dispute cannot be found and a final hearing is likely.

WA Finance Brokers Licensing Scheme Finalised

On 5 January 2007 the final part of the Finance Brokers Licensing regime in WA was gazetted removing the last hurdle facing businesses from obtaining a finance brokers licence in WA. Finance broking businesses who conduct business in WA need to take action now to obtain a licence. Finance broking is widely defined and includes aggregators and mortgage managers. A licence is required even if only arranging or managing non-UCCC regulated credit.

What's new? – D class licences

New regulation 16(5a) provides for the issue of D class licences to individuals who do not satisfy the education and experience requirements for an A, B, or C class finance brokers licence in WA.

The new D class licence allows directors/partners of companies and partnerships to obtain a licence (thereby enabling the company or partnership to obtain a licence) when the directors/partners cannot satisfy the education and experience requirements provided the company or partnership has an A or B class licensee in bona fide control of the finance broking operations in WA of the business.

Prior to this amendment, a number of businesses who needed to be licensed in WA were unable to apply for a licence as their directors or partners did not meet the criteria.

Regulation 5A which commenced on 5 May 2006 removed the requirement to be resident in WA to obtain a licence. Applicants now need only to be resident in Australia.

Once the individuals hold the necessary licences, their licences can be attached to a company or partnership.

Code of Conduct

The regulation scheme is administered by the WA Department of Consumer and Employment Protection (**DOCEP**). DOCEP is currently finalising further regulations to replace the existing outdated Code of Conduct. The proposed regulation will deal with the requirement for disclosures to customers including commission disclosure (usually contained in a finance broking contract). These regulations (Code) are expected to be released by March 2007.

Conclusion

It is likely that in the future, national regulation will require finance brokers and mortgage managers to be licensed. The WA licensing regime can be seen as a precursor to a national scheme. Put simply, if you do business in WA or with WA residents and you arrange loans you need to be licensed. The penalty for acting as a finance broker without a licence is $50,000, and an order can be made to prevent you continuing to trade.

A comedy of errors?

JARGON PTY LTD -v- GOOD EARTH GARDEN PRODUCTS PTY LTD [2006] WASC 282 (15 December 2006)

Good Earth Garden Products Pty Ltd supplied Jargon Pty Ltd with goods on credit terms. In May 2006, Good Earth sued Jargon in the WA Magistrates Court for $44,403.73 plus interest for goods supplied between February 2004 and March 2006.

Jargon's director, Mr Van Straalen, lodged a notice of intention to defend. That notice, which is in a standard form, says, among other things, that within 14 days of receipt of the notice the claimant (Good Earth) must file and serve a statement of claim, and within 14 days of receipt of the statement of claim the defendant (Jargon) must file and serve a statement of defence. However, Van Straalen said he wasn't aware of the time limit. When he later asked the Court how long he had in which to file his defence, he was told judgment had since been entered against him by default. Judgment was for $55,802.55.

Van Straalen instructed solicitors and applied to have the judgment set aside. Among other things, he disputed the amount (saying Jargon had paid cash-on-delivery since September 2004), and disputed the right to charge interest (saying he had never seen terms of trade from Good Earth which might allow it). However, at the hearing to set aside the judgment, there was no appearance for Jargon and the matter was dismissed.

A second application was made. At that hearing, in September 2006, the judge said he would set the judgment aside, provided Jargon paid $44,000 into court by 3 October 2006. This didn't happen so the application was dismissed.

In August 2006, Good Earth served statutory demand on Jargon. In the statutory demand, Good Earth said that "the amount of $50,000" is owing to it by Jargon. The debt is described in the schedule to the statutory demand as "Magistrates Court Judgment obtained on 19.07.06 $50,000". In fact, judgment was for $55,802.55. Good Earth's solicitor apparently became confused over the fact that the Magistrates Court has jurisdiction only up to $50,000. He or she therefore decided to reduce the amount demanded. However, the $50,000 limit only applies to the principle sum (here, $44,403.73). According to the judge, the fact that interest and costs took the judgment over $50,000 was not a problem.

Jargon applied to set aside the judgment on three grounds. First, Good Earth's address for service on the statutory demand - their solicitors' offices - was wrong. The correct address was 326 Hay Street. The address on the form was 326 Hill Street. This wasn't enough to make the judge set aside the statutory demand. Clearly, Jargon knew the correct address.

Second, Jargon argued that if a statutory demand is not for the specific sum for which judgment was given, it must be accompanied by a verifying affidavit. However, the judge said this wasn't necessary where the difference was "obvious and plainly unrelated to any issue as to the amount or existence of the debt." The demand was not "defective in any sense that would warrant it being set aside."

And third, Jargon claimed there was a genuine dispute over the debt.

In general, a judgment means that a court has said, in effect, "this money is definitely owed to the creditor." However, a default judgment (where the merits of the case have not been argued, but judgment has been entered on the basis purely that the debtor didn't defend) may not be conclusive evidence that the money is owed. But that doesn't mean that a default judgment is worthless. In this case the judge said, "In the light of the existing judgment and the two failed applications to set it aside ... I do not consider that ... there can be ... any genuine dispute as to the debt."

The application to set aside the statutory demand was dismissed.

Anti Money Laundering Bill Made Law

On 7 December 2006, the Parliament passed the *Anti Money Laundering and Counter Terrorism Financing Act 2006* (Cth) (**Act**). The new Act is the culmination of two public exposure drafts and two Senate Inquiries. The result is a new regime for regulating financial service providers, the gambling industry and bullion dealers that is intended to prevent money laundering (**ML**) and terrorism financing (**TF**).

The Act changes the way that financial service providers interact with clients. It requires reporting entities to identify and verify clients, which means they are likely to need to collect more personal information about clients. The Act also imposes monitoring, reporting and compliance obligations on regulated entities, which will require significant changes to systems and process and training of staff.

Significant unresolved issues

The Parliament passed the Act without change since the last draft of the Bill was released in November. Nor has the Government taken on a number of key recommendations by the Senate Inquiry in its report and issues raised in submissions.

These include:

- **Delaying commencement**: Although the Government will not delay commencement by 3 months as recommended by the Senate, it will extend the 'prosecution free' period by a further three months (ie from 12 to 15 months) for all obligations in the Act
- **Rules**: AUSTRAC's rule making powers will not be restricted to technical matters
- **Civil penalty provisions**: risk-based obligations could still lead to prosecution with a lower burden of proof and high penalty amounts.

What next?

The Government intends to release a policy principles paper which will explain its policy direction in relation to the Act and AUSTRAC's regulatory directives during the 24 month transition period and beyond. The Government also intends to introduce a technical amendments Bill in the first quarter of 2007 to rectify any technical errors already identified by the Senate Committee, including:

- **Stored value cards**: clarifying that gift cards will constitute a stored value card and not a debit card
- **Funds management**: dealing with the problems associated with the capture of selling securities
- **Community banks**: ensuring community bank branches are included in the definition of 'owner-managed branch' in clause 12.

The Government has indicated that this amendment Bill is only intended to deal with technical issues and not significant policy issues that have previously been raised.

However, the Government has accepted the Senate Inquiry's recommendation to include further threshold value limits, to exclude low risk, low value services (eg traveller's cheques and foreign currency transactions). These amendments will be implemented by regulations or by Rules made by AUSTRAC.

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