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By email: christian.mikula [at] treasury.gov.au

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Dear Christian

Treasury discussion papers: maximum annual cost rate and interest-free disclosure models

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the discussion papers on:

- the operation of the proposed 48% cap on cost of credit in proposed subsection 32A(2) of the National Consumer Credit Protection Act 2009; and
- restricting use of the term 'interest-free' in consumer credit disclosure in proposed regulation 78A of the National Consumer Credit Protection Regulations 2009

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

Maximum annual cost rate: proposed subsection 32A(2) of the *National Consumer Credit Protection Act 2009*

At present proposed section 32A reads:

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32A Credit provider must not enter into a credit contract if the annual cost rate exceeds 48%

(1) A credit provider must not enter into a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48%.

Criminal penalty: 50 penalty units.

(2) A person must not be a credit provider under a credit contract (other than a small amount credit contract) if the annual cost rate of the contract exceeds 48% at any time.

Criminal penalty: 50 penalty units.

The discussion paper lists four possible options with regard to subsection 32A(2):

1. Retain the existing provision at subsection 32A(2);

2. Retain the existing provision at subsection 32A(2) with a modified formula so that only fees that relate to the cost of credit (and not fees that relate to costs incurred by the credit provider in the provision of services) would be included in the calculation of the 48% cap;

3. Amend subsection 32A(2) so that the obligation only requires the lender to have not charged in excess of 48% per annum by the time the contract is discharged; and

4. Amend subsection 32A(2) to address uncertainty it may create with regard to continuing credit contracts.

Regarding Option 1

We recommend option 1, retaining the existing provision. As noted in the discussion paper, the provision will be useful in preventing possible techniques to avoid the price cap, and if Treasury's analysis is correct, it will not impose significant costs on lenders. As Treasury notes, lenders should be able to predict what fees they could charge without breaching the cap when a contract is first entered into. This should remove the need to re-calculate the annual percentage rate being charged each time a new fee is levied.

Regarding Option 2

We do not support option two. This option involves drawing a fairly arbitrary distinction between fees based on uncertain definitions. Ultimately, this option will introduce a great deal of complexity without solving the problem subsection 32A(2) was introduced to address.

In our view, determining which fees belong in which category will be a complex exercise and would probably result in different lenders categorising similar fees differently. This will be highly confusing for consumers and presumably adds costs for credit providers. In addition, we suspect Option 2 will also encourage avoidance by providing an incentive for lenders to dress up a fee as one related to a cost incurred for services, thereby allowing them to charge higher aggregate fees and remain within the cap.

Regarding Option 3

We prefer option three over option two, however it is also an unsatisfactory response as it will be easily evaded. If a lender intentionally breaches the 48% cap by adding unjustified fees (which is exactly the problem the subsection is setting out to address), the lender will not volunteer to repay the additional amount to the customer when the contract is discharged. This kind of breach would be almost impossible to detect or enforce, as most consumers will not even realise the breach has occurred.

If, despite this problem, option three is favoured by Government, the interest rate calculation should include all fees incurred rather than only fees considered to relate to the cost of credit (for the reasons discussed above).

The discussion paper identifies a further avoidance risk, that lenders would include a term in the contract that a loan is not discharged even after the debtor has made all required repayments. This would mean that the obligation to repay any amount paid in excess of the 48% cap is never triggered. However, this could be addressed by including a further provision in section 32A to the effect that a contract is taken to be discharged if the debtor has made all payments due under the contract.

Regarding Option 4

We do not recommend making any amendments to subsection 32A(2) with regard to continuing credit contracts unless a credible problem is identified. As with other credit contracts, a provider of continuing credit could assess in advance the amount of fees that could be levied without breaching the cap.

Interest free disclosure models: proposed regulation 78A of the National Consumer Credit Protection Regulations 2009

This discussion paper concerns regulations to restrict the use of the term 'interest free' by credit card providers so that it is only used in particular circumstances. The draft regulation sets out three scenarios in which phrases including the term 'interest free' may be used:

1. *Interest free* (with no other phrase or term) – interest must not be debited to the outstanding balance (so long as the consumer is meeting their repayment obligations under the credit contract).

2. *Interest free only on amounts you repay in full by each due date* – interest must not be debited if the consumer repays the closing balance in full by the due date; and

3. *Interest free if you make repayments by each due date* – interest must not be debited on amounts the consumer repays by the due date.

Application to longer term interest free promotions

The discussion paper seeks views on whether purchases under scenario 1 that will not accrue interest and will never accrue interest should be exempted from the regulatory scheme altogether. We understand the thrust of this question is that these arrangements are clearly "interest free" and do not need further clarification.

We do not support excluding this scenario from regulation. We understand the purpose of regulation 78A is to ensure that where the term "interest free" is used, it is not used in a misleading way. To exclude particular uses of the term from regulation would add complexity and create a loophole without creating any obvious benefit.

<u>Where product is interest free for only a certain period</u>

The discussion paper also includes draft wording for proposed subregulation 78A(3). The wording of this provision is unclear, though the intent appears to be that where products are interest free for only a certain period, disclosure should make that clear. We support this intent and indeed suggest that this merely confirms prohibitions against misleading or deceptive conduct.

<u>Fees imposed when term "interest-free" is used</u>

We note that many products that are marketed as "interest free" also charge additional fees, which are not necessarily transparent. For example, many "12 or 24 month interest free periods" for in store purchases come with monthly maintenance fees. These fees can be significant and, in some instances, appear to be able to be increased during the term of a contract.

We recommend that when the term "interest free" is used, there should be no cost at all, including fees and charges.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
CONSUMER ACTION LAW CENTRE

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