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Manager, Consumer Policy Unit
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By upload and email

16 April 2020

Dear Rosemary

Enhancements to Unfair Contract Term Protections – Consultation Regulation Impact Statement

Since the Enhancement to Unfair Contract Term Protections Regulation Impact Statement (RIS) was released, there has been significant change to the Australian economy and the finance industry that has been caused by the COVID-19 pandemic.

The Australian Finance Industry Association (AFIA) has worked and continues to work closely with Treasury and the Treasurer to formulate its assistance packages to small business and to individuals impacted by the crisis to support the flow of credit through the economy and to ensure that all Australians and Australian businesses have continued access to credit during and in the aftermath of this pandemic. In this context, we welcome the opportunity to respond to the RIS.

AFIA Background

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia. For more information about AFIA, please see Annexure A to this submission.

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self-regulation through industry codes and to work with the Federal Government, financial regulators and other stakeholders to promote a supportive environment for industry.

Our guiding principles seek to build the settings to:

- Promote simple, convenient, innovative and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering unsuitable credit contracts;
- Foster competition and innovation in Australia's financial services industry, which enables our members to grow, expand and thrive as key participants in lending and other markets; and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy and improve social participation to create financial wellbeing.

To do so, we focus on the key drivers that provide positive customer outcomes, foster competition and innovation within industry, and facilitate financial, economic and social engagement by both customers and industry.

Our Submission

We note that while members have contributed to our submission, the position being put by AFIA may not reflect a particular member's organisationally-specific position on all of the issues. These will get captured through a submission from that organisation.

Key Recommendations

At a macro level, AFIA supports an unfair contract terms regime that protects consumers and small businesses. Our recommendations are built on the following principles:

- that the existing UCT regime is comprehensive and fit for purpose;
- regulatory settings should support continued access to affordable finance for small business, particularly to support the flow of credit during and in the aftermath of this crisis;
- the proposed extension of the regime to introduce financial penalties will negatively impact that access to finance and should be reconsidered and deferred until the outcomes from the pandemic and its impact on customers and financiers are better understood.

We therefore recommend any changes to the UCT regime should be deferred for at least 12 months to allow businesses to focus their resources on supporting their customers and their employees during this crisis and hold a further round of RIS consultation in say January 2021 when we collectively are in a more informed position. In this context, we also make the following interim recommendations:

- the regime should be enhanced to allow the court to have the power to determine appropriate penalties;
- the regime should not be extended to the Australian Securities and Investments Commission (ASIC) to introduce financial penalties for breaches;
- the Government should take this time to align the definition of small business across legislation;
- any update to existing UCT guidance material should include a clear focus on plain English and simple form contracts and include a summary of recent case law on UCTs;
- education campaigns for small business should take place, led by ASIC and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO).

Our detailed responses are at **Annexure B**.

Should you wish to discuss our feedback further, or require additional information, please contact Naveen Ahluwalia, Director, Policy & Regulatory Affairs at naveen@afia.asn.au or 02 9231 5877.

Kind regards

Karl Turner
Chief Operating Officer

Annexure A

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance sector. AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia which includes:

- major, regional and mutual/community owned banks;
- providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers;
- providers of land finance, including residential and commercial mortgages and bridging finance;
- equipment financers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing;
- motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance;
- fleet leasing and car rental providers; and
- providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services;
- commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see here.

Annexure B – Our Submission

We acknowledge that a significant amount of work has been undertaken by the Government and by regulators to establish a robust regime that protects both small businesses and consumers from unfair contract terms, including:

- changes to the Australian Consumer Law to protect small businesses from unfair terms in standard form contracts;
- publication of the Unfair Contract Terms guide by the Australian Competition and Consumer Commission (ACCC), ASIC and state and territory consumer protection agencies (the UCT Guide);
- ASIC Report 565 on 'Unfair contract terms and small business loans' and, as a result of Report 565;
    - the insertion of further UCT protections within the revised Banking Code of Conduct issued by the Australian Banker's Association;
    - the use of ASIC's market supervision powers to recommend changes by financial service providers to consumer and small business contracts to exclude terms that in ASIC's view are UCTs;
- recommendation 4.7 of the report by the Royal Commission into Misconduct in the Banking and Superannuation and Financial Services Industry (Royal Commission) in relation to the extension of the UCT regime to insurance contracts, and the subsequent extension of that regime through proposed amendments to the Insurance Contracts Act; and
- court proceedings commenced by both the ACCC and ASIC against organisations in relation to unfair contract terms, that serve as precedent for businesses in the assessment of contracts with small businesses and consumers.

In addition, AFIA has done a significant amount of work, in consultation with the ASBFEO, with its AFIA Online Small Business Lender members to review standard form contracts and through industry self-regulation compliance requirements, that members continue to comply with unfair contract terms legislation and best practice (expanded below).

Questions

We respond to those questions that are relevant to our members and that we are able to provide constructive and helpful input to this RIS.

Legality and Penalties

Are you aware of any industries in which UCTs (or potential UCTs) are regularly included in standard form contracts? If so, please provide details including which industries, the types of UCTs (or potential UCTs) and the prevalence of UCTs (or potential UCTs).

We are not aware of any industries in which UCTs or potential UCTs are regularly included in standard form contracts. AFIA has, through self-regulation in the AFIA Online Small Business Lenders (AOSBL) Code, undertaken targeted industry-wide initiatives to uplift industry compliance with the UCT regime.

AFIA has taken a leading role in developing codes for two industries, the AOSBL Code and Buy Now Pay Later (BNPL) Code. AOSBL members developed the Online Small Business Lenders Code which is now in its second year of operation. The Code requires that signatories to the Code certify compliance with UCT laws within standard from contracts for their small business customers, and as such, the Code has received strong support from a range of stakeholders including the ASFBEO, Fintech Australia and the bankdoctor.org. You can find a copy of the Code here.

Separately, AFIA announced on 19 December 2019 the development of an industry code for its BNPL members, and an ongoing public consultation on the BNPL Code commenced mid-January 2020. The BNPL Code also reinforces that the pro forma contract documents of code compliant members need to be compliant with laws dealing with unfair contract terms. You can find a copy of the draft Code here.

Do you have any suggestion as to how regulatory guidance and education campaigns could help reduce the use of UCTs? This includes any suggestions on improvements to current guidance or areas where further guidance is required or areas where further guidance is needed.

Guidance

ASIC REP 565 'Unfair contract terms and small business loans', which was a culmination of good work done by ASIC and by the ASBFEO into small business finance contracts offered by the big four banks, has been helpful to non-bank small business financiers as guidance around what constitutes an UCT. Our members rely also on the UCT Guidance published by ASIC and the ACCC.

We understand that the UCT Guidance is regularly updated and recommend, in the next update, that there be a clear focus on plain English and simple form contracts.

We also support and encourage any additional guidance being provided, after appropriate consultation with industry, and that includes a compilation of relevant case law to assist industry with the review of standard form contracts.

Education Campaigns

It would also be helpful for there to be further education available to small businesses to allow consumers and businesses to enter into informed conversations with their financiers during the contract negotiation process. We believe ASIC and the ASBFEO would be best placed to provide these educational campaigns.

Do you consider making UCTs illegal and introducing financial penalties for breaches would strengthen the deterrence for businesses not to use UCTs in standard form contracts? Please provide reasons for your response.

The introduction of a legal regime that introduces financial penalties for breaches is unnecessary for a number of reasons, including:

- the courts are the appropriate forum to provide remedies for UCTs;
- there has already been a significant compliance uplift within the industry to the UCT regime through a combination of regulator action and industry self-regulation; and

- small businesses and consumers have sufficient redress mechanisms through external dispute resolution schemes, thus negating a further regulatory process and intervention.

Courts are best placed to determine and provide remedies for UCTs

As previously noted in this submission, our view is that the current UCT regime is appropriate with respect to the avenues available to enforce the UCT regime – the provisions adequately and appropriately allow for actions to be brought to a court and for a court to declare a term of a standard form contract to be unfair and therefore void.

Courts are best placed to consider issues of contract interpretation, which is a complex area and requires significant and relevant expertise. An example of some of these complexities includes consideration that a particular term, regarded as a UCT in one commercial context, may not regarded as a UCT in a different context and that consideration includes whether a term in the context of a particular standard form contract can be supported as being in the legitimate business interests of the party relying on the term. Circumstances can determine where use of a particular term may be for a reasonable and legitimate business interest.

For instance, the 2016 High Court decision in *Paciocco v ANZ* found the charging of particular bank fees did not constitute unconscionable conduct, unjust transactions or unfair contract terms. In arriving at that decision, the Court took into account a range of factors which provided justification for the fees as being reasonable and in the bank's legitimate business interests.

Industry compliance uplift

Much of the uplift of compliance with the regime has occurred without court action, and has been heavily influenced by:

- the work that ASIC and the ACCC has done with the banking industry including the publication of Report 565;
- industry monitoring and surveillance programs - we continue to encourage the ACCC and ASIC to work with industry to identify and make recommendations to potential subsequent changes to terms in standard form contracts that may be considered UCTs; and
- industry self-regulation, including as described above, subscribing to industry codes that require demonstrated compliance self-assessment with the UCT regime.

External Dispute Resolution access for small business and consumers

Most lenders within the Australian market are members of the Australian Financial Complaints Authority (AFCA) which provides an avenue for the customers of those lenders to make complaints and seek redress including in relation to UCTs.

Specifically, in relation to the small business lending market, the Online Small Business Lenders Code mandates that, to become code compliant, members must ensure that contracts are compliant with unfair contract terms legislation and requires that each code signatory is a member of AFCA.

What do you consider are the additional costs and benefits for each of the proposed options?

We note the imperative, in this current environment, to continue to support the flow of credit through the economy and to ensure that all Australians and Australian businesses have continued access to credit during and in the aftermath of this pandemic.

Government intervention in this area at this time could potentially impact the free contracting between parties, which in turn could restrict access for small businesses to affordable credit. In this context, we make the following comments:

- it is appropriate for, and is the role of, the court to ultimately determine by reference to the law and precedent cases whether a term of contract is unfair. The court should then determine any appropriate remedies where it has found a term of to be unfair. As a result, we support Option 1 (i.e. to maintain the status quo);
- regulators have played and continue to play an integral part in uplifting compliance of the UCT regime which includes monitoring and surveillance activities, targeting court actions and publications of reports and guidance. To this end, the strengthening of regulatory compliance and enforcement activities is a common sense and pragmatic approach. As a result, we support Option 2 (i.e. strengthened compliance and enforcement activities);
- in relation to disputes between contracting parties, the focus should be on compensating for loss and not penalising parties. As a result, we do not support Option 3 (i.e. making UCTs illegal and attaching penalties);
- we would be concerned if the matter of contractual interpretation, which is traditionally the role of the court, is assigned to regulators to determine and outcome. As a result, we do not support Option 4 (i.e. to strengthen the powers for regulators to allow regulators to make determinations on whether a term is a UCT and issue infringement notices).

<u>Flexible remedies</u>

The Final Report of the Royal Commission emphasised the need to ensure that small businesses have access to reasonably affordable and available credit.[1] We believe that the goal of both protecting small businesses and improving access to affordable credit for small businesses is best served by proportionate regulation that is fit-for-purpose.

This requires a considered regulatory approach to small business lending, which takes into account the particular characteristics of small businesses, as compared to consumers. It also requires proportionate responses by regulators, based on:

- the tenure of the lending category
- the lender
- the asset class
- the impact of the conduct being regulated (i.e. in this case, the unfair term) on small businesses; and
- the impact on competition and access to affordable credit for small businesses.

In this context, we provide our responses to the questions below.

[1] Final report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page 95.

If a court determines a term or terms in a standard form small business contract are unfair, should it also be able to determine the appropriate remedy (rather than the term being automatically void?) Please detail reasons for your position, including the possible impact this might have on your business.

We believe that a term that is determined by a court to be unfair should not be *automatically* void. Rather, the court should be able to make orders that would enable the contract to survive, including to vary the contract and enable the contractual arrangement to remain on foot. As noted in the RIS, the effect of the voidance of a term may be that "the contract-issuing business could lose revenue from the contract falling through, while the small business may lose access to critical goods and services". For example, and relevantly to our members, if credit contracts are rendered inoperative and unenforceable, this can have material impact on credit providers. It can also trigger the withdrawal of funding to small businesses.

It is therefore sensible, in such cases, for the court to be able to apply remedies that it determine are the most flexible to the benefit of both parties – including to vary the terms to allow a contract to remain on foot.

Do you consider a regulator should be able to commence court proceedings on behalf of a class of small businesses on the basis that an unfair term has caused or is likely to cause the class of small businesses to suffer loss or damage? Please detail reasons for your position, including the possible impact this might have on your business.

We understand and can see the benefit of having a party, such as a regulator, commence court proceedings on behalf of parties with limited resources to do so themselves. However, we also note a number of already existing avenues through which UCT protections are able to be enforced and where small businesses are able to obtain recourse. These include:

- regulators (i.e. ASIC and the ACCC) have powers to commence proceedings to enforce unfair term protections in small business contracts (for example, the commencement of proceedings by ASIC in the Federal Court of Australia against the Bank of Queensland)[2];
- individual small businesses can commence court proceedings on the basis that a term is potentially unfair;
- small businesses can commence class actions on the basis that a term is unfair; and
- AFCA, in the case where small businesses contract with AFCA, is are able to receive complaints and determine compensation for direct financial loss resulting from unfair contract terms.

As a result, we do not consider it timely or appropriate that ASIC be provided with the power to commence proceedings on behalf of small businesses.

[2] See 19-238MR ASIC sues Bank of Queensland for use of unfair contract terms

Definition of small business

What impact has the current headcount threshold had on your business (or those businesses you represent)? Please include any relevant information including costs, benefits, impact on business practices etc?

The Royal Commission recommended expanding the definition of small business within the Banking Code of Practise i.e. an annual turnover of less than $10million, fewer than 100 staff and less than $3million in total debt. The Australian Bureau of Statistics use the headcount threshold of under 20 employees to define small business, and that definition is widely used while APRA, the ATO, AFCA and the ASBFEO use different definitions – the latter two have supported and adopted the definition of small business within the Banking Code of Practise. Our view is that there should be a consistent definition of small business within legislation and in industry codes and are supportive of any moves to bring consistency to the definition.

If annual turnover was used to determine whether a business should be covered by the UCT protections for small business, what impact might this have on your business.

Some members report practical difficulties with using annual turnover threshold as it can reveal commercially sensitive data to another party. This is particularly the case where both contracting parties are SMEs; other members are of the view that an annual turnover test is an appropriate measure in addition to or as a replacement for the headcount test, however these members suggest the turnover test should be applied to the a corporate group (i.e. aggregated, not entity level). As outlined above, having one aligned multi-regulator, multi-purpose definition would represent significant progress.

Do you consider $10million annual turnover to be an appropriate threshold? Please detail reasons for your position, including the impact this might have on your business.

This aligns to the Royal Commission recommendation in relation to the definition of small business and as noted above, we are supportive of consistent definitions being used.

In terms of determining which businesses should be covered by the UCT protections for small business, how should employee numbers for subsidiaries be counted? Please outline reasons for these views, including the potential impact on your business.

Our members are of the view that including subsidiary employees can be helpful if the entity's controlled interest in the relevant subsidiary is more than say 50%. We believe there may be merit in the UCT laws making the position clear in relation to corporate groups, so that the corporate group is regarded as a whole rather than just that entity.

Value threshold

As a broad comment and as noted above, it would be sound public policy to have one consistent definition of what constitutes a small business. We have previously suggested the use of a tax basis, as an indication of business size, rather than head counts of employees, whether full time, part-time or

casual. The rise of the 'gig' economy, where contractors are substituted for employees, also undermines the head count approach.

We note that the work that our members have done to modify contracts to comply with UCT provisions business contracts was undertaken agnostic of whether the other party would be small business as currently defined or the value threshold.

Are there likely to be any negative impacts on how the current contract value threshold were to be increased to $5million? Please provide details.

We refer to the Royal Commission recommendation in relation to the expansion of the definition of small business. We understand that there is continuing dialogue between ASIC and industry in relation to the contract value threshold for finance contracts. We note ASIC has endorsed an industry-commissioned independent review of the definition of small business and will also collect quarterly data from banks and AFCA who will monitor the extent of the Code's coverage of small business and then assess the appropriateness of an increase to the $5million threshold.

We believe that data is important, useful and informative, and that any proposed changes to the threshold must take into consideration both the industry report and industry data. Any proposed increase of the threshold must consider the impact on competition between large and smaller lenders in relation to lending to the small business sector.

<u>Clarity on standard form contracts</u>

What impact do you consider 'repeat usage' would have on clarity around standard form contracts? Please outline reasons for these views.

We understand that the proposal is to include, in the range of factors that a court must consider in determining whether a contract is a standard form contract, 'repeat usage' and that the term 'repeat usage' is where a contract is repeatedly used with multiple parties.

We note it is common for businesses to offer consumers and businesses the same or a similar contract i.e. standard form contracts to improve efficiency. We are supportive of the current legislative test around what is a standard form contract, including:

- whether one of the parties has all or most of the bargaining power relating to the transaction;
- whether the contract was prepared by one party before the transaction was discussed with the small business;
- whether the small business was required to either accept or reject the terms of the contract in the form in which they were presented;
- whether the small business was given an opportunity to negotiate the terms of the contract; and
- whether the terms of the contract take into account the specific to characteristics of the small business or the particular transaction.

Commercially and legally, our view is that what constitutes a standard form contract is reasonably well understood, in particular that the body of the terms of the contract are not negotiable. While we believe the addition of the 'repeat usage' test will not add anything to providing any clarity around what is a

standard form contracts, we would support Option 2 – the addition of 'repeated usage' as a matter of common sense.

If the law were to be amended to set out the types of actions which do not constitute an 'effective opportunity to negotiate', what impact could this have on your business?

We reiterate our views that negotiation depends on context and what one or the other, or both, of the parties, wish to negotiate, or could be said to negotiate. It could be said that special conditions are an indicator of effective negotiation. If a small business or consumer wishes to agree to the terms of a standard form contract, without objection, it does not diminish the fact it is a binding agreement ordinarily enforceable by the courts.

Do you have any suggestion as to how regulators could better promote and enhance guidance on what constitutes a 'standard form contract'? Please provide details, including any suggestions around improvements to current guidance and areas where further guidance is needed.

Our view is that the use of any terms arrived at through negotiation, such as bespoke covenants, conditions precedent and undertakings, should be considered special conditions and it would be helpful to include this point in any updated guidance.

<u>Minimum standards</u>

If minimum standards under state and territory laws could be challenged as being unfair, what impact is this likely to have on your business (or those businesses you represent)?

While we have no specific comment as it affects AFIA members, we are of the view that, if a contract meets statutory or regulatory standards, it should not be challenged on the basis of it being 'unfair' as it meets legal requirements and nothing more should be expected of or by contracting parties.

Application of any enhanced protections to consumer and insurance contracts

We have previously provided support that the UCT exemption for insurance contracts is removed from the Insurance Contracts Act and note the current legislation before Parliament.

AFIA's position in relation to the application of any enhanced protections is that there should be consistency in regulation and regulatory response. That means that if these enhanced protections are applied to UCTs in small business contracts, these should equally apply to contracts with consumers and insurance contracts.