

Using the product intervention power: continuing credit contracts

Submission in response to ASIC's consultation paper 330

Australian Financial Complaints Authority

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Introduction

The Australian Financial Complaints Authority (AFCA) is the independent external dispute resolution (EDR) scheme for the financial sector.

AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. It does this not only by providing fair dispute resolution services, but also by working with financial firms to improve their processes and drive up industry standards of service, thereby minimising disputes.

In addition to providing solutions for financial disputes, AFCA has responsibilities¹ to identify, resolve and report on systemic issues and to notify the Australian Securities and Investments Commission (ASIC), and other regulators, of serious contraventions of the law. More broadly, AFCA plays a key role in restoring trust in the financial services sector.

AFCA welcomes the opportunity to provide a submission² in response to ASIC's proposed use of its product intervention powers to address significant consumer detriment arising from continuing credit contracts issued to retail clients.

Key points

In response to the consultation paper³, the key points in our submission are:

- AFCA strongly welcomes and supports ASIC's proposal to make a product intervention order by legislative instrument that would prohibit credit providers and their associates from issuing continuing credit contracts, except in accordance with a condition that limits the total fees that can be charged.
- Similar to short term credit contracts, continuing credit contracts can have significant adverse effects on individuals, their families and communities, as well as the broader financial services system.
- Due to their business structure, continuing credit contract providers (and their associate firms) may not require an Australian Credit Licence (ACL), in which case they are generally not required to be a member of AFCA. This significantly limits a consumer's ability to access cost-effective and independent dispute resolution when they have a complaint that can't be resolved directly with the credit provider.

¹ Refer to Part C, Reporting Requirements, of [ASIC Regulatory Guide 267](#): *Oversight of the Australian Financial Complaints Authority*.

² This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

³ [ASIC Consultation Paper 330](#), *Using the product intervention power: Continuing Credit Contract*.

AFCA's previous submission – Short term credit

We understand that the continuing credit contracts model that is the subject of consultation paper 330 appears to have been introduced into the market following ASIC's product intervention order regarding short term credit made on 12 September 2019.

ASIC's September 2019 product intervention order was made to address significant detriment caused by the short-term lending model that, by design, directs consumers to use a fast track process offered by an associated 'collateral service' provider. The provision of credit and the associated collateral service are structured in a way to attract the operation of an exemption under the National Credit Code (NCC), even though the combined costs of these facilities exceed the NCC exemption.

ASIC identified that this model had been used by several credit providers and associated collateral service providers, including Cigno Pty Ltd (Cigno). ASIC has named Cigno as an entity that currently offers services under the continuing credit model.

AFCA's current submission should be read in conjunction with our previous submission on short-term credit, as the issues are interrelated.

1 Overview

ASIC is consulting on its proposal to exercise its product intervention power to address significant consumer detriment caused by the continuing credit contract model.

What is the continuing credit contract model?

The continuing credit contract model that ASIC has identified is a form of lending which involves the provision of credit⁴ to consumers, structured in a way that purports to rely on the exemption for continuing credit contracts under the NCC.

Under this model, the credit provider provides credit under a continuing credit contract. The credit provider can charge a fixed fee for each advance of funds under the contract, up to a specified maximum in the initial 12-month period and a reduced maximum in any further 12-month period.

Separate to this contract, an associate of the continuing credit provider, enters into a services agreement with retail clients, and charges various fees, including for fast-track processing to obtain the loan and the transfer of funds to the client on the same or next day. This associated collateral service is provided under a separate service

⁴ Continuing credit contracts are exempt from regulation under the *National Credit Code* if the only charge that is or may be made for providing the credit is a periodic or other fixed charge that does not vary according to the amount of credit provided and these fees and charges do not exceed the maximum prescribed charge permitted under the exemption.

agreement, and the combined fees can significantly exceed the total amount of credit provided.

The continuing credit contract model raises similar concerns to the conduct that led to ASIC making a product intervention order regarding short-term credit in September 2019. That is, continuing credit providers and associated service providers are structuring services in a way that:

- 1 purports to satisfy the exemption requirement under subsection 6(5) of the NCC, even though the combined costs associated with the credit facility (provided by the credit provider) and the associated collateral service delivery (provided by the associate), significantly exceed NCC exemption limits, and
- 2 circumvents the consumer protections afforded under the NCC.
- 3 significantly limits consumers access to EDR.

Identified conduct

ASIC has identified that this model has been used by BHF Solutions Pty Ltd (BHFS) (credit provider) and Cigno (associate service provider). Neither BHFS nor Cigno holds an Australian Credit Licence (credit licence) nor is a member of AFCA.

Facility types

ASIC has noted that the loans advertised on Cigno's website appear to refer to the continuing credit contracts offered by BHFS and made available to retail clients. These facilities are variously described as:

- Payday Loans
- Centrelink Loans
- Bad-Credit Loans
- No-Credit Loans
- Loans for Unemployed People
- Emergency Loans
- Fast Cash Loans

2 Detriment

- D1Q1 Do you consider that continuing credit contracts, when issued to retail clients in the way described in paragraphs 16–22, have resulted in, or will or are likely to result in, significant detriment to retail clients? If so, please provide any relevant evidence which supports your views.

Continuing credit contract model will result in significant consumer detriment

AFCA agrees with ASIC’s assessment of the potential identified harm the continuing credit contract model can cause. The consumer detriment that can result from these kind of continuing credit contracts arises because they:

- are often used by or are targeted to vulnerable consumers, generally experiencing financial stress.
- incentivise consumers into choosing a high-cost ‘fast-track’ option, as the standard direct application process does not supply the funds quickly
- have significantly higher up-front costs than other regulated products
- involve fees that are extremely high,
- have uncapped default fees
- require payments via direct debit, which may result in overdraft fees if accounts have insufficient funds.

AFCA is concerned that these features mean that the product is likely to exacerbate financial stress and financial hardship for low-income and vulnerable Australians.

Small amount lending, whether it is structured as short-term credit or a continuing credit contract, is often targeted to and used by vulnerable consumers. While these facilities amount for only a small proportion of overall consumer credit debt in Australia, they have been assessed as having a disproportionately ‘corrosive and harmful’ impact on the financial and general wellbeing of the most vulnerable borrowers.⁵

These consumers, typically on low incomes, are already experiencing signs of financial stress, have very basic levels of financial literacy and will generally require access to money quickly, often at the last minute. They are mostly excluded from mainstream banking and credit providers, due to their financial circumstances.

⁵ Melbourne Law School, Melbourne Legal Studies Research Paper No. 696, The Politics of Payday Lending Regulation in Australia. Date written 31 December 2013, last revised 24 February 2015.

It is therefore critical that all products of this kind are subject to appropriate and consistent regulation in order to prevent significant consumer detriment.

We strongly welcome and support ASIC's proposal to exercise its product intervention power in this instance.

We are especially concerned about any product model that appears to have been structured in a manner so as to avoid regulation under credit legislation and the important consumer protection that legislation provides to consumers.

3 Other harm

D1Q2 Do you consider that the continuing credit contract model does or might cause detriment other than that identified by ASIC, or to a greater or lesser extent? If additional or greater, how should the proposed product intervention order be expanded to address this significant detriment?

AFCA considers that the continuing credit contract model does cause other detriment to consumers.

Inability to access external dispute resolution

For consumers and small businesses, AFCA provides a simple and free alternative to going to court. As an EDR scheme, AFCA's role is to assist parties to reach agreement about how to resolve a complaint. We are impartial and do not act for either party to advocate their position. If the complaint is not resolved between the parties, we will decide a fair outcome.

Financial firms that hold an ACL or an Australian Financial Services Licence (AFSL), are required to maintain membership of AFCA. Consumers with complaints against these licence holders (members of AFCA) can access AFCA's EDR services for free.

Some businesses, such as providers of buy now pay later services, have chosen to join AFCA voluntarily. However, other unlicensed businesses, including Cigno and BHFS, have not done so.

This leaves customers of these providers with little option other than to pursue complaints they may have with these firms through the court system. AFCA considers that the court system is usually not the most accessible forum for resolving complaints that consumers have with their financial firm.

The Australian Government final report about its review of the financial system EDR complaints framework in April 2017⁶, confirmed that:

“The traditional court system, which relies on lawyers, the rules of evidence and specific processes and procedures can be complex and intimidating for consumers. In this regard, a benefit of ombudsman schemes is that they provide claimants with a relatively simple process, led by the ombudsman, negating the need for formal legal representation. Furthermore, ombudsman services are not restricted to resolving legal issues; rather, they have scope to consider a broader range of factors.”

The resources required to pursue legal action through the court system are significant, and there will generally be an uneven playing field between a consumer and the financial firm. This is due to a number of factors, including:

- the amount of money and resources available to a financial firm
- the quality of legal representation a financial firm has access to
- the effects of a protracted court process, which are generally not as significant for a financial firm.

In our view, consumers of these services may not understand or appreciate that they are dealing with an unlicensed business that is exempt from regulation, given the services provided relate to credit.

In these circumstances, AFCA believes consumers should not have to rely on a business voluntarily deciding to join AFCA, especially when the decision to do so (and to subsequently cease being a member) rests with the business rather than the consumer.

For consumers entering into credit contracts to not have access to EDR would be an undesirable outcome. As the continuing credit model appears to target some of the most vulnerable consumers, it is essential they have the benefit of appropriate consumer protections, including access to EDR.

Financial difficulty

AFCA deals with many complaints where a financial firm has started debt recovery proceedings against its customer and the proceedings are in the early stages. When a complaint is lodged with AFCA, the financial firm is required to stop all legal and other recovery action. AFCA is often able to resolve these complaints by negotiation.

⁶ The Australian Government the Treasury: FINAL REPORT Review of the financial system external dispute resolution and complaints framework April 2017

In the 2019/2020 financial year, AFCA resolved approximately 92% of all consumer credit complaints involving financial difficulty, without issuing a preliminary view or a final decision.

While a financial firm may be exercising their legal rights when they commence proceedings against a customer in default, we strongly encourage financial firms to work together with their customers to try and resolve financial difficulty issues before they escalate. It is in the interests of all parties to resolve differences without court proceedings as these result in additional costs and may have far reaching consequences for consumers and small businesses.

AFCA's experience demonstrates the significant benefits, including reduced overall costs and avoidance of protracted proceedings, that consumers and financial firms obtain by resolving matters through facilitated agreements rather than pursuing matters through the courts.

The Australian Government looked at the approach to be taken to short term, small amount lending, as part of the National Consumer Credit Protection reforms. The key findings in the Australian Government's Regulation Impact Statement (RIS)⁷ were:

- The majority of consumers accessing short term credit have low incomes, with possibly up to 25% of borrowers having incomes below the Henderson Poverty Line.
- Borrowers largely have no access to other forms of credit (with some surveys finding that this is the situation of over 70% of borrowers).
- The most common uses of the funds advanced under short-term loans are to meet living expenses, such as bills (including utilities), food, rent, and car repairs and registration. There is minimal or negligible use of short term loans for discretionary spending purposes.
- Research consistently demonstrated that borrowers who use short-term loans rarely select a lender on the basis of price. Factors such as the speed of provision of loan have a greater influence, and this is reflected in the advertising used by these lenders.

We again highlight that vulnerable consumers seeking credit through unregulated credit providers and their associates are not afforded the same opportunity to reach a

⁷ The Regulation of Short Term, Small Amount Finance Regulation Impact Statement June 2011

facilitated agreement, as these credit providers are not required to be AFCA members.

If a consumer falls into default under their credit contract and is unable to approach AFCA, they may lose the opportunity to resolve their financial difficulty through an agreed outcome. The resulting costs arising from a default can often amount to multiples of the initial loan.

The significant additional costs borne by vulnerable customers at this stage may be even greater than the harm caused by their initial financial difficulty.

COVID-19 implications

Given the economic restrictions due to COVID-19, and as relief measures wind down and the economy worsens over the next three to six months, there is a real possibility that increasing numbers of vulnerable consumers may seek temporary relief by entering into continuing credit contracts.

AFCA believes that it is essential to ensure that all consumers entering these types of facilities, especially during this unprecedented time, have access to the consumer protections afforded under the NCC and free and independent EDR.

Identification of issues and industry standards

AFCA's responsibilities include identifying, resolving and reporting on systemic issues and notifying ASIC and other regulators of serious contraventions of the law.

If a financial firm is able to structure its provision of credit to meet exemptions in regulations and customers are unable to access our service, the ability for AFCA to identify broader systemic conduct and to work with financial firms to address these issues is reduced.

Vulnerable consumers can suffer from increased stress, spiralling debt and further hardship as a result of this kind of credit

As outlined above, the continuing credit model identified targets those consumers who are most vulnerable and have very little option but to use unregulated credit products. This vulnerability creates a risk that financial firms who provide unregulated credit will take advantage of consumers.

Consumers' who access this type of credit do so to try and alleviate some of their financial stress. The outcome, however, can be the complete opposite, due to the significant fees and charges involved.

These kinds of products can exacerbate financial stress, which then has flow on effects into other areas of the consumer's life. The Reserve Bank of Australia,⁸ has acknowledged that financial stress has a very real human cost. This can include a deterioration or stress on personal relationships, but also a significant health impact.

We are deeply concerned by the continuing credit lending model and any other arrangements that result in the inappropriate unregulated provision of credit to consumers.

AFCA strongly believes that all financial firms who offer credit products to consumers that in substance fall within the consumer credit laws should be held to appropriate standards and be regulated by the credit regulations which seek to protect consumers.

Other harmful products

ASIC's proposed intervention order in relation to continuing credit contracts aims to close potential loopholes where consumers are being charged excessive lending and service fees and financial firms appear to be structuring services to bypass regulation and oversight.

AFCA has previously provided submissions to ASIC⁹ and the Senate Economics Reference Committee¹⁰ about the impact of other products on consumers. The consistent themes to these products are:

- problems relating to fees, which may be high, 'front-loaded' or unclear
- unfair sales techniques
- inadequate disclosure of risks
- failure to refer consumers to free services such as financial counselling and EDR
- consumers without access to EDR may not understand that they do not have the same rights as other consumers of comparable financial services.

We support a broader consideration of short-term lending, continuing credit contracts and other products including debt management, with the view to bringing these credit products and associated service providers under the same regulatory framework. We also support ensuring that consumers who enter into these products have access to independent external dispute resolution, by requiring these organisations to be a member of AFCA.

⁸ Speech by Michelle Bullock, Assistant Governor (Financial System) at the Reserve Bank of Australia, [Household Indebtedness and Mortgage Stress](#), 20 February 2018

⁹ AFCA's submission in response to ASIC's consultation paper 316 - Using the product intervention power: short term credit

¹⁰ Credit and financial services targeted at Australians at risk of financial hardship - Submission to the inquiry by Senate Economics References Committee

- D1Q3 Are you aware of entities other than Cigno and BHFS that are issuing, or likely to issue, continuing credit contracts in the way described in paragraphs 16–22?

AFCA is unable to confirm other entities that are issuing, or likely to issue, continuing credit contracts in the way described by ASIC.

The continuing credit contract model appears to be designed to avoid regulation and the entities identified by ASIC are not members of AFCA. It is possible that other entities may also choose to structure their products in a similar way if ASIC does not use its product intervention powers.

D1Q4 Do we agree with ASIC’s proposal to make an intervention order by legislative instrument prohibiting credit providers and their associates (including directors of such entities) from issuing continuing credit contracts in circumstances where total fees exceed the maximum permitted under the continuing credit exemption and reg 51 of the National Credit Regulations?

Market wide product intervention order is appropriate

AFCA agrees that this is an appropriate approach in the circumstances. The proposed order will prevent credit providers and their associated collateral services providers from providing unregulated credit in purported reliance on the continuing credit contract exemption.

4 An intervention order is the best option

D1Q5 What alternative approaches could ASIC take that would achieve our objectives of preventing the detriment to retail clients identified in this paper?

We consider ASIC’s industry-wide approach is the most appropriate to discourage these kinds of arrangements. If ASIC takes no action, AFCA believes consumer harm will continue. We strongly support ASIC taking the proposed action.