



Phone: 02 6273 8222
Mobile: 0412 146 828
Fax: 02 6273 9399
PO Box 6278
Kingston ACT 2604

Mr Christian Mikula
Manager
Consumer Credit Unit
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: poscredit@treasury.gov.au

Re: The Exemption of Retailers from the *National Consumer Credit Protection Act (Cth) 2009*

This submission has been prepared for the consideration of The Treasury by the Australian Motor Industry Federation (AMIF). AMIF is a federation of the various state and territory motor trades associations and automobile chambers of commerce. Through its Member Bodies, AMIF represents the interests of over 100,000 retail motor trades businesses employing over 308,000 people. Those businesses have an aggregated annual turnover typically in excess of \$162 billion, which, in combination with the industry's scope and size, makes the retail motor trades the largest small business sector of the Australian economy.

The retail motor traders represented by AMIF can be found throughout more than 35 distinct trade-based sectors. Those sectors cover all aspects of an automobile lifecycle from sale; to servicing, maintenance and repair; tyre, fuel and lubricant consumables; repair following collisions; right through to, and including, its decommissioning at end of life.

Issues such as those canvassed by Treasury's Discussion Paper -- *The Exemption of Retailers from the National Consumer Credit Protection Act 2010* -- are of considerable interest to AMIF, its member body the Australian Automobile Dealers Association and motor vehicle dealer members. Treasury will be well aware of AMIF's representation of those vehicles dealers' interests through Treasury's Point of Sale Working Group, albeit those representations were made by AMIF's predecessor organisation, the Motor Trades Association of Australia (MTAA).

POSITION SUMMARY

AMIF's position is one of full support for Option 1. AMIF rejects Option 2. AMIF considers that, in the vehicle sales area at least, Option 3 may well be already evident as representing the behaviour and assumed compliance of a minority of dealers.

AMIF does not consider there to have been a case made by the Discussion Paper for the need for any further regulation.

SUBMISSION CONTEXT

AMIFs assessment of the Discussion Paper is that it seeks to obtain stakeholder and public views as to whether further regulation is required in the point of sale (POS) area of consumer credit and, if so, the nature of that regulation. To that end, the Paper identifies a number of *potential* regulatory gaps in relation to the conduct of presently exempt vendor introducers and proceeds to set out three options in relation to regulating same. Those Options are:

1. a maintenance of the status quo, by retaining the existing exemption in the Credit Regulations for vendor introducers;
2. requiring vendor introducers to comply with the Credit Act; or
3. modifying the application of the obligations in the Credit Act to vendor introducers, according to the functions they are performing, so that vendor introducers who are more actively involved in product selection and delivery would be subject to a higher level of regulation.

Of these presented scenarios, AMIF notes that Option 3 enjoys specific clarification within the Discussion Paper and ponders why that might be the case.

The current provisions of the Act have been in existence for some time and are providing strong measures to ensure high levels of consumer protection. The Paper identifies *potential* gaps only, rather than any of an actual nature. It is also something of a disappointment to AMIF – and to many of its Member Bodies to whom the Paper was referred for comment – that the manner of representation of dealer vendor representatives in pages 3 to 5 of the Paper, and of the descriptions of their activities, was not only inaccurate, but also imbued with a sub-text inferring, or insinuating, a need for those activities to be subject to further regulation.

AMIF concedes that there may well be motor vehicle dealerships for who the descriptions of activity outlined on pages 3 to 5 may have some relevance and / or credence. But, AMIF asserts those operations to be in the extreme minority among Australia's 4400 dealership outlets. Further, that those among that minority will most likely also be already party further licensing, as well as being compliant with other regulatory requirements as specified by the Credit Act. No disclaimer, or acknowledgement, to that effect appears in the Paper. The Paper gives the impression, therefore, to a broader audience – one that is likely completely unfamiliar with the realities, complexities and nuances attendant to motor vehicle dealership finance and insurance (F&I)¹ operations – that could lead them to consider a need exists for motor vehicle dealership F&I activities to be broadly regulated.

This submission seeks to correct and provide context (and, if required, caveats) around the dealership F&I operations described within the Paper. Of course, it demands to be noted that this correction will be after the fact of the semiotics already transmitted by the Paper and the filtering already conducted by readers through either internal discursive frameworks, or as a result of the effect of any cognitive dissonance, viewer-held ontological and epistemological perspectives, or other strongly socialising affects.

Treasury is invited to note that the comment provided to it by AMIF is largely an aggregation of comments, supplied by dealer members, of AMIF's Member Bodies. Almost all of those comments were provided by either the dealer principles, or financial controllers, of the respondent dealerships. AMIF also notes that, of those parties, a majority claim to be qualified as Certified Practising Accountants.

¹ This Submission will use 'F&I' throughout. Almost all dealers responding to AMIF provided comment around the Discussion Paper's employment of 'FNI'.

COMMENTARY

The Paper makes the point, at par 12 (b), of there being, “. . . *about 630 vehicle dealerships (with an estimated 30,000 persons engaged in credit activities).*” AMIF would be interested to see the source of those figures, as they are in no way accurate. In fact, it might be fairly said that those figures are plainly misleading.

By AMIF’s reckoning there are approximately 4400 new motor vehicle dealership outlets in Australia. Almost paradoxically, there are thought to be only some 2600 dealers. This disparity is due to the incidence of dealers holding multiple franchises.

AMIF’s understanding is that there is also likely to be only one or two persons at each dealership outlet who could be regarded as vendor introducers. Even if there are two at every dealership, that would make the figure estimated to be persons engaged in credit activity to be 8800: a long way short of 30,000. Of course, if it is to be contended that all sales staff are to be considered as being, “. . . *persons engaged in credit activities*” then that is an altogether different equation. But, that is not the proposition advanced by the Discussion Paper. Perhaps clarity needs to be provided by the consideration of the Paper being isolated to those persons, “. . . *engaged directly in credit activity.*”

Paragraph 14, on page 3 of the Paper states:

In general terms there are significant differences in the structure of these businesses, with a different dynamic operating in relation to the role of POS finance. In the retail store context the retailer makes a profit from the sale or supply of goods or services, and the availability of credit maximises the volume of sales, and therefore the profitability of the business. However, in relation to vehicle dealerships, cars can be sold at a loss or break-even price, with the dealership earning a profit on the transaction through the provision of finance and the sale of extra items (for example, servicing agreements, insurance and warranties). In other words, where no or minimal profit is generated from the sale of the vehicle the dealership will be under economic pressure to maximise the profit earned through commissions and other financial benefits payable in relation to the finance, and from the sale of items (other than the vehicle) financed through the credit contract.

It is completely true that there are, “. . . *significant differences in the structure of these businesses . . .*” For instance, the ‘generic’ retailer will ‘own’ their stock holdings. The only stock holdings ‘owned’ by a motor vehicle dealer are likely to be in the form of used cars and spare parts (and accessories). While it can be suggested that, “. . . *cars can be sold at a loss or break-even price [sic] . . .*” that is not a common occurrence. Nor does that statement acknowledge supplier / dealer arrangements such as ‘hold back’. And while it can be said that the statement, “. . . *the dealership earning a profit on the transaction through the provision of finance and the sale of extra items . . .*” has some veracity, it is a statement that fails to acknowledge the other profit centres within a dealership operation and the respective business orientation around those profit centres. (Please refer to the discussion elsewhere in this submission for context in that regard).

All of which makes the summation within that paragraph of, “. . . *In other words, where no or minimal profit is generated from the sale of the vehicle the dealership will be under economic pressure to maximise the profit earned through commissions and other financial benefits payable in relation to the finance, and from the sale of items (other than the vehicle) financed through the credit contract.*” somewhat lacking in persuasiveness. Such a statement is, in acknowledgement of reality, a sophistry, rather than an aphorism based on the fullness of the available facts or context.

It is a common and completely erroneous conclusion to make that motor vehicle dealership operation and, hence, profitability bears any similarity to more generic retailing. Acknowledgement of the 'significant differences in the (relative) structures of those businesses' ought to be sufficient to make any comparison invalid other than that they are both 'retailing'. But, there are other important distinctions that can be made. Generic retailing, generally, is the simple selling of a product. Once the product is sold, the relationship between retailer and consumer is generally concluded. In dealership operations, however, the selling of a product – a motor vehicle – is typically the beginning of an ongoing relationship.

The business model around dealership operations, therefore, has evolved into one comprising four profit centres. Those profit centres are; new vehicle sales; used vehicle sales; parts sales and service operations. Those four centres are characteristically structured thus:

- New vehicle sales represent 34 per cent of dealership orientation for a gross profit contribution in the order of 7 to 9 per cent;
- Used vehicle sales represent 21 per cent of dealership orientation for a gross profit contribution in the range of 14 to 16 per cent;
- Parts sales represent 15 per cent of dealership orientation for a gross profit contribution around 23 to 27 per cent;
- Service operations represent 30 per cent of dealership orientation with a gross profit contribution of in the region of 63 to 67 per cent (mainly labour cost related).²

It needs to be also remembered that a typical, mid-sized, metropolitan motor vehicle dealer may employ at least 40 people (and as many as 90) and have an annual turnover in the region of \$90 million. Yet, it is also likely to be a family-owned and run (small) business. And, as mentioned, unlike a JB Hi-Fi, or Harvey Norman outlet, it will not own its (new vehicle) stock. Rather, that stock will be on bailment from a 'floor plan' financier. It will also likely have a capital loan to cover the costs of premises, equipment, used vehicle stock and spare parts. It is not unusual for a dealer's capital investment to run into the tens of millions of dollars.

Other characteristics of a typical new motor vehicle dealership are:

- Dealership net profit as a percentage of sales is in the region of 2.5 per cent to 3 per cent;
- A dealership will only break even on 25 days out of every 30;
- The average dealership will have 40 – 55 days vehicle stock;
- The average dealership turns over its stock 7 to 9 times a year; and,
- Every dollar of salary paid requires \$17.00 of sales.

The salient points to this discussion, however, lie predominantly in the various contributions to dealership gross profit from the respective profit centres. While AMIF acknowledges that the contribution of F&I is significant, it needs to be acknowledged that 'dealership' F&I penetration into most dealership's new and used vehicle sales areas is typically only in the region up to 35 per cent of all sales.

² Figures stated can be found at: https://www.eprofitfocus.com/pdflinks/BMCards/2012BenchmarkCard_Volume.pdf (accessed 14 / 2 / 13; 1510 hrs). It needs to be noted that these figures represent the performance of the top 30 per cent of dealers in Australia. A more 'typical' net profit as a percentage of sales, for example, would be in the vicinity of 1.3%

With net profit more typically in the realm of 1.3 per cent, of which a portion comprising 0.712 per cent might be derived from new or used vehicle sales, and of which a mere 0.25 percent might have connection to dealership F&I, it can only be accurate to say that dealers, “. . . maximise the profit earned through . . . financial benefits payable in relation to the finance.” Even then, it is more accurate to say that dealers *optimise* their profits, just as any other retail operation will. The inference in the Discussion Paper, therefore, that dealers are heavily reliant on these arrangements and will go to any length to support them is disingenuous and, indeed, unedifying.

Paragraph 16 of the Discussion Paper, on page 4, states that;

Consumers who opt to use POS finance are likely to approach the financing decision as an incidental matter once the primary decision to purchase goods or services has been made. Research demonstrates that consumers purchasing items such as household goods are often focused on obtaining the product and are financially or psychologically committed to the transaction. A review of practices in this area was undertaken by Professor Justin Malbon, in a report conducted for the Post Implementation Review of the Uniform Consumer Credit Code. His report, ‘Taking Credit: A Survey of Consumer Behaviour in the Australian Credit Market’ (the Malbon report), found that 46 per cent of respondents reported they had entered into a credit contract simply to purchase an item, rather than because of the terms of the credit offered.

It is not at all clear to AMIF that Professor Malbon’s review canvassed consumers who had recently engaged in the act of purchasing a motor vehicle. It is difficult to see, then, how the outcomes of that review might have any relevance to the activities of motor vehicle dealers. As one representative dealer who responded to AMIF’s request for comments stated:

This statement (regarding the 46 per cent of respondents) may be correct for items of relatively small value. For these items the finance offered in store may be the only option available to the customer. Banks and credit unions require customers to finance a minimum amount, normally \$5000.00 for personal loans they offer.

Given vehicle dealers who have a wholesale floor plan with a major finance company and on-site F&I consultants generally stock vehicles above \$5000.00, the above statement does not apply to credit transactions involving motor vehicles. The consumer is consistently educated on their financing options when purchasing vehicles from their own bank / credit union and other finance providers through every form of advertising medium prior to stepping into a vehicle dealership. Therefore, consumers take a different view on the importance of the credit decision when purchasing vehicles than what they might when purchasing smaller, less expensive products. The finance and insurance offered by dealerships need to be relatively cheaper than other finance offers to procure the customer’s finance business.[sic]

The reality described above doubtless also goes part way to explaining why dealership F&I typically only enjoys sales penetration up to 35 per cent. It also makes the statement made in Paragraph 17, on page 4, that, “This means that consumers are unlikely to be familiar with the cost or terms of POS finance available before deciding to purchase goods or services.” unlikely to be at all accurate within an automotive sales context. Yet, no effort is made by the Paper to confirm that Professor Malbon’s review has contextual relevance in that regard.

It is at Paragraph 20 of the Discussion Paper, spread, as it is, over pages 4 and 5, that generated the most comment from dealers responding to AMIF's call for comments on it. It is clear to AMIF that a significant disparity exists between the conceptions held by Treasury of dealership operations generally, and F&I operations specifically, and the realities experienced by the overwhelming majority of dealers. Taking 20 (a) as a starting point, which states;

Vendor introducers are more actively involved in arranging the provision of credit or a consumer lease. They tend to be persons who are trained in finance and will arrange finance on a full-time basis. They will usually discuss options for the structure of the loan and the transaction with the consumer before submitting an application (for example, as to the term, amount of deposit, repayments, or effect of taking out insurance).

There was broad agreement among respondents that F&I people tend to be, “. . . persons who are trained in finance and will arrange finance on a full-time basis.” But, respondents were also quick to point out that the statement seemed to be lacking further definition. Many respondents pointed out that dealership F&I staff are specifically accredited to operate under the National Consumer Credit Protections most commonly provided under the current POS exemptions by financiers.

Further, that accreditation typically involved factors such as; demonstrating a level of competence in the consumer finance field; demonstrating an understanding of the rights of a consumer under law; and undergoing thorough background checks. As a result, F&I staff *are* specialists in this area, but are *also* qualified to discuss matters such as those outlined in 20 (a) with consumers. It might be an interesting comparison to make, however, between the qualifications of a dealership F&I Officer and a Teller at the local branch of any bank.

The Paper continues at paragraph 20 (c) where it is stated that:

The dealership can exercise significant control over the terms on which credit is likely to be provided, with the financier typically agreeing to the terms proposed by the vendor introducer in the application (provided the transaction satisfies the financier's 'parameter matrix', that is, all eligibility requirements are satisfied).

That statement is false. Dealerships ***do not*** exercise significant control over the terms on which credit is likely to be provided. This is a position that AMIF – and MTAA before it – makes (and made) abundantly clear to Treasury on numerous occasions. It is disappointing to AMIF and its Member Bodies in the extreme that it seems a point that Treasury seem unable to grasp. Further, that it is an inaccurate view that has now been promulgated -- through the Discussion Paper -- to a wider audience: an audience that likely lacks a detailed understanding of the reality of dealership business models, structures and operations.

The reality is that it is the financier that exercises the significant control. It is the financier's guidelines (or 'parameter matrix') that are assiduously followed. It is the financier that dictates the limits within which an F&I person may assist a consumer applicant. It is the financier that has the complete control to actively reject any term that fits outside its guidelines. And, while it might be construed that the dealership's F&I Officer might work closely *alongside* the financier and consumer in various negotiations, it remains the financier's -- and only the financier's -- decision to accept or reject an application, or to approve one. Suggestions that dealers exercise 'significant control' are, therefore, simply not true.

Paragraph 20 (e) states that:

The dealership may have arrangements with some financiers in which the higher the interest rate (above a base rate) the greater the commission earned by the dealership. These arrangements can influence the FNI (F&I) rep in the way they select an interest rate and encourage them to earn more by selecting a higher interest rate (provided the proposal otherwise satisfies the parameter matrix). These arrangements are called flexi-commissions in this Discussion Paper. These arrangements can result in the terms of the contract being settled by the vendor introducer first determining the maximum amount of repayments the consumer can afford, and then proposing an interest rate that will result in that level of payments.

Dealer respondents to AMIF regarded this statement as a simplistic description, failing to encompass the many variables that exist. The incentive structures available to dealerships vary depending on factors such as brand of vehicle, volume of vehicles sold, dealership location, prime market area (PMA) penetration values and so on. Suggestions that the pre-determinative behaviour described therein as characteristic, or typical, were vociferously rejected by dealer respondents. Just as AMIF is often compelled to produce evidence of behaviours in the market before issues can be addressed by regulators, AMIF might enquire if Treasury has evidence to substantiate the assertions made in this paragraph.

AMIF adopts a similar position with paragraph 20 (f), which suggests that;

It is common for the dealership to seek to arrange finance with the lender who provides finance to the dealership for the purchase of stock³ or to underwrite their floor plan. The dealership may secure financial benefits that increase according to the volume of business placed with the financier, through volume bonus arrangements (where the amount of commission paid increases according to the level of business) or offset arrangements (where the amount of interest paid by the dealership to the financier in relation to their floor plan is reduced according to the level of business).

AMIF contends that such a statement is a misinterpretation of available evidence. It may be true to say that a dealership will, “. . . seek to arrange finance with the lender who . . . underwrite(s) their floor plan.” It is also conceivable that the dealership might be incentivised to write more business with that financier. That incentivisation might even take the form of offset arrangements in regards to the floor plan costs.

But, there is a failure within that statement to acknowledge factors similar to those missing from paragraph 20 (e), above (in relation to brand, volume, location and the like). The statement becomes, therefore, suppositional on the basis only of incomplete information. To then further imply that arrangements such as these become primary, covert, imperatives for consideration in the provision of F&I services to consumers is, therefore, a flight of fancy.

³ Again it is brought to Treasury’s attention that dealers rarely purchase vehicle stock other than used cars. Those purchases, however, are commonly separate to floor plan arrangements. Those purchases may, however, be made under the capital loan – also often a separate arrangement to the provision of floor plan – which also funds spare parts stock and the like.

For example, is it not equally plausible that a floor plan provider might incentivise a dealer to have as minimal a stock holding as possible? It is, in reality and after all, the *financier's* stock and the *financier's* risk. Given a dealer's most base motivation is to 'move units' -- irrespective of if their client's pay cash, or use their own bank finance, or avail of the F&I services at the dealership – would a dealer not wish to also achieve that objective? Does that not also suggest that to propose offset arrangements to be significant or, perhaps even relevant to this discussion, to be spurious at best? Is it not a simple business efficiency decision such as any other retailer might take in the interests of optimising a return on their investment, or in the reduction of costs? Scarcely anything sinister in a free market economy.

There was also significant issue taken by dealers with the assertion made in the Paper at paragraph 20 (g) that, “*FNI (F&I) reps are commonly remunerated by being paid a relatively low base salary plus commissions. They can operate in a way that is largely insulated from other aspects of the car dealership business.*” It might be argued that there exists a serious imputation in those two sentences that by ‘commission’ is meant ‘kick back’ from financiers. Representations made to AMIF by dealers also suggest that statement to be misleading and false.

It is possible that some dealers offer an incentive component to their F&I staff as part of those employee's remuneration. There is some doubt, however, if such a practice remains ‘common’. To suggest those incentives to be ‘commissions’ is, though, perhaps a stretch of reality. Moreover, any imputation that those ‘commissions’ might be directly received from financiers could be regarded as nothing short of scurrilous. To then also suggest that F&I Officers are, “. . . *largely insulated from other aspects of the car dealership business*” is a nonsense. F&I staff play an integral role in the overall service delivery of a dealership and have a substantial input, and impact, on dealership client relations.

AMIF's Member Bodies also commented on the overall imputation carried by the Discussion Paper and expressed their disappointment with that aspect of it. To some, it seemed as if there had been a distortion of the facts and realities as previously tendered by MTAA to Treasury to direct an audience towards a foregone outcome or determination. They, too, like many of the dealer respondents to the Paper, wish to see evidence of any market failure, widespread consumer detriment or disadvantage, or other negative impacts to the economy arising as a direct result of the current operation of the Act and its Regulations. Or, indeed, evidence suggesting that the image of dealership operations portrayed by the Discussion Paper as possessed of accuracy.

SUMMARY

AMIF contends, therefore, that pages 3 to 5 (inclusive) of the Discussion Paper represent the fulcrum upon which arguments for any of the three Options presented rests. AMIF further contends that it is a fulcrum of a scarcely credible nature and, thus, one that renders any argument for any Options other than Option one to be invalid.

The Discussion Paper also fails to canvass the responsibility of those entities that have the ultimate discretion in matters of responsibility in the context of consumer finance: the financiers themselves. In what way are motor vehicle dealers responsible for their behaviour in the market, or for the products that they offer? Where is the comparative analysis of the regulatory frameworks applicable to the F&I department of a dealership with those of the customer service officer at the local bank or building society branch? Where is the justification outlined in the Paper for the need to impose even higher levels of regulatory burden on small businesses? In this instance, small businesses that are already subject to compliance with state and / or territory legislation (various

Sale of Motor Vehicle Acts for instance), which places a raft of behavioural demands upon them (and from which generic retailers are free).

AMIF reiterates that it does not see the Discussion Paper as representing a case being made for the adoption of any change in regulation. That evidence which has been advanced has been shown by this submission – and the representations and comments of motor vehicle dealers throughout Australia – to be spurious in the least and a misrepresentation at the most.

AMIF would be happy to assist Treasury in whatever way possible in obtaining a more accurate view of dealership operations in the F&I area. And, in thanking Treasury for the opportunity to provide comments on this matter, offers the opportunity in return to discuss this submission more fully at any time of Treasury's convenience. AMIF also hopes to continue its long-held cooperation with Treasury in these matters in the event of it choosing to re-convene the POS Working Group.

22 March 2013
AMIF National Secretariat
Canberra

Mr Colin Duckworth
AMIF Director Policy

Mr Richard Dudley
AMIF CEO

(02) 6233 0800