A SUBMISSION TO THE CAPABILITY REVIEW OF ASIC

from the

FINANCE INDUSTRY DELEGATION

SCOPE: NATIONAL

Relevant ASIC Section/Division:

Deposit Takers, Credit and Insurance Stakeholders' Team

Industry sector:

Small amount, short term lenders

To the:

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Is this submission confidential? No.

STATEMENT OF INTENT

The supporters of the Finance Industry Delegation (the Delegation) wish the Expert Panel every success. Delegation supporters, part of the small amount, short term lending industry sector, have a vested business interest in the Capability Review and its outcome succeeding, with an essential change in ASIC culture.

A capable ASIC means a compliance environment which is a competitive level playing field for all lenders, unlike the current environment, where the law abiding compliant lender is at a significant competitive disadvantage to those lenders who currently continue to get away with breaking the law.

A capable ASIC also means effective and constructive communication of all kinds between ASIC and the industry sector, to universally enhance consumer protection and compliance environment certainty for the lender, rather than the current communication environment that is fundamentally flawed.

The Delegation alleges that the current culture endemic in much of the *Deposit Takers, Credit and Insurance Stakeholders' Team* does not satisfy ASIC's stated values of "*accountability, professionalism and team work*".

Introduction

Recent helpful contact with the Review Panel's Secretariat, at the Sydney Treasury office, encouraged the Delegation to present this submission in the manner that has been adopted. This contact was supplemented by then Minister Frydenberg's media statement and Treasury website comment on the scope and purpose of the review.

Under instruction from the Treasury Secretariat, the Delegation has attempted to keep this submission as brief as possible, with the knowledge and expectation that there will be later opportunity to present the substantial supporting explanation, plus evidence associated with the 58 issues raised, during the conduct of a series of meetings and roundtables, along with the promised complementary survey-based consultation.

About the Finance Industry Delegation

The Delegation is a consortium representing and/or reporting to the owners and management of 189 bricks and mortar and internet lending sites and 6 significant suppliers of services, including loan management software, marketing advice and compliance advice to the small amount, short term lending industry sector.

Approximately 80% of supporters are self-funded small and medium enterprises, including franchisees from 4 franchise groups. The balance includes 4 of the 8 largest companies - none of which are public companies. Supporters are located in every State and the ACT and customers are located all over Australia, New Zealand and Papua New Guinea.

Four fundamentals

We invite the Expert Panel to note four fundamentals:

1. The comments included in this submission relate only to that part of ASIC called the *Deposit Takers, Credit and Insurance Stakeholders Team* (hereafter referred to as ASIC, for brevity). The Delegation supporters have not had any substantial contact with other areas of ASIC, and therefore it would be inappropriate to comment on those areas.
2. In ASIC Report 444, "*ASIC enforcement outcomes: January to June 2015*", dated August 2015, at page 5, ASIC stated, "*...there needs to be a fundamental shift in the culture of the financial industry - to one that focuses on achieving and rewarding good conduct and good outcomes for consumers*".

   The Delegation submits that the achievement of this fundamental shift will be impossible while the current ASIC culture continues to manifest itself in the inappropriate corporate behaviour listed in this submission.
3. The adverse comments in this submission do not reflect on the employment behaviour of some of the professionally impressive ASIC officers who diligently work, or have worked, as part of the *Deposit Takers, Credit and Insurance Stakeholders Team* in the various capital city offices, since the Commonwealth takeover of compliance responsibility. The Delegation is very confident that the challenges listed in this submission can be met following a successful Capability Review, if specific officers who various supporters of the Delegation have dealt with in recent years are provided with appropriate roles and/or appropriate authority.
4. The adverse comments are those which one of the writers personally promised to present to the Review Panel, when speaking with them at the conclusion of the Governance Institute of Australia's conference in Sydney on 26 August this year. A copy was also promised to both the immediate past and currently responsible Ministers thereafter.

How efficiently and effectively does ASIC operate to achieve its strategic objectives?

The following issues have emerged as issues of significant concern and demonstrate ASIC's inefficiency and ineffectiveness in its attempts to achieve its strategic objectives. They demonstrate ASIC's current lack of professional capability in regard to compliance enforcement and a considerable lack of understanding of the small amount, short term lending industry sector.

The issues are listed to assist the Expert Panel address a major item in the terms of reference announced by then responsible Minister Frydenberg, in his media release dated 24 July 2015, concerning the Expert Panel's terms of reference:

"*The review will consider how ASIC uses its current resources and powers to deliver its statutory objectives and assess ASIC's ability to perform as a capable and transparent regulator*".

This statement was supported by a later comment under the subheading "*Consultation*" in the media release, *"The capability review should be informed by a review of ASIC's current processes...*". The Delegation asserts that you cannot review processes without measuring or assessing current action and outcomes.

In the absence of a discussion paper, the following subheadings reflect Minister Frydenberg's media release, Treasury website content and advice from the Treasury Secretariat.

Finance Industry Delegation concerns

1. Governance - Identification and analysis of past and immediate priorities

Concern: ASIC has demonstrated poor identification and analysis of past and immediate priorities. Without post-Capability Review change, this history may be repeated.

1.1 Failure, to date, to achieve one of ASIC's three strategic priorities - namely "*to ensure fair, orderly, transparent and efficient markets*" (ASIC's "*Corporate Plan, Focus 2015-16*", page 2 and 4).

1.2 Failure, to date, to achieve three out of the four responses to wrongdoing, or the risk of wrongdoing - namely, "*taking timely enforcement action... engaging with industry and stakeholders...* (effectively) *providing guidance to those we regulate*" (ASIC's "*Corporate Plan, Focus 2015-16*", page 5).

1.3 Failure to maintain the level of communication associated with the 2010 ASIC Roadshows and some early individual ASIC officer contact, which included genuine educational and industry understanding visits.

1.4 Failure to establish a continuing and effective rapport with the three industry sector representative entities, leaving token contact with the one entity dominated by the two large listed companies, as the only source of industry sector contribution to priority assessment. This despite published promises that "*ASIC will work with the payday lenders and industry bodies so they understand their obligations and to raise levels of compliance*".

1.5 Undertaking priority assessment based on procedurally very poor and obsolete ASIC and consumer advocate research.

1.6 Dissonance between public statement of concern and allocation of administrative and prosecution penalty.

1.7 Conduct towards lenders, and representatives of lenders, dominated by "power games" and an attempt to assert dominance regardless of continuing information collection opportunity and/or constructive outcome and/or contribution to effective prioritisation.

2. Identification of immediate and future risks

Concern: The risks may well be already entrenched, posing an even greater challenge to implement successful post-Capability Review change.

2.1 The risk that the consumer advocates and their legal centres, with all their demonstrated professional inadequacies and philosophy-driven bias, with or without Class Action lawyers, will take over compliance enforcement for publicly listed lenders such as Cash Converters.

2.2 The risk that, what some industry sector observers consider to be "sweetheart deals" between ASIC and one or more of the publicly listed companies, and two of the high profile internet lending companies, will continue. This not being available to the small and medium sized lending companies.

2.3 The risk that ASIC will continue to pursue expensive and ultimately ineffective prosecutions of atypical lenders, perceived within the industry sector as providing little relevance to most of the other lenders ASIC is attempting to supervise.

2.4 The risk that ASIC will continue to facilitate fundamentally inequitable and inconsistent decisions as to whether or not to proceed with a prosecution, simply imposing an enforceable undertaking without penalty, or coming to an arrangement without enforceable undertaking or penalty, for a favoured range of companies. This may require a re-drafting of ASIC's July 2014 "*Statement of Intent*", to clarify the criteria used in the exercise of ASIC's discretion in its choice between the several listed alternatives.

2.5 This contrary to the "*Model Litigant Rules*" included in the Attorney General's Legal Services Directions.

2.6 The risk that the current culture will continue to lead to compliance advisers being challenged by their lender clients, because "other companies (often very big ones) are doing it and getting away with it".

2.7 The risk that ASIC will continue to attempt - and substantially fail - to comprehensively enforce compliance on an industry sector it still does not understand and is still to effectively and comprehensively research in a timely manner and according to applicable best practice research methodologies.

2.8 The risk that such compliance enforcement will continue according to the latest poor research from government funded consumer advocate entities, poorly conducted and/or obsolete ASIC research, or media beat ups.

2.9 The risk that the proposed ASIC industry funded model will provide a burdensome opportunity for the smaller, compliant lender to be forced to pay for ASIC's ineffective compliance policing, particularly in regard to the listed companies and some of the larger lenders.

3. Resource prioritisation - allocation of resources

Concern: In the midst of calls for an industry funding model, which all assume to be a foregone conclusion, where is the substantial study of ASIC's current use of resources, inclusive of and appropriate rigorous audit, with transparent publication of the results?

3.1 Expensive prosecution on issues of law that have been superseded.

3.2 Selection of prosecution and administrative penalties, without regard to the consequences for borrower victims.

3.3 Allowing non-legally trained officers to effectively dominate ASIC lawyers in the conduct of their duties, with the subsequent imposition of questionably legal decisions and interpretations.

4. Enforcement selection and application

Concern: ASIC does not demonstrate any apparent consistency.

4.1 The implementation of two standards for compliance expectation - one for the two public companies and, generally, for two of the largest internet lenders - another for all other lenders.

4.2 The imposition of three self-funded audits on lenders, without any initial investigation or the receipt of any complaint - with an attempt to justify on the basis of allegedly not being "*confident*" that the lenders were compliant.

4.3 Distributing a list of external auditors for lenders to consider when an audit has been ordered, without widely published criteria and selection procedures of auditors and with a number on the list being former ASIC officers. This while claiming the list is not an ASIC approved list.

4.4 The imposition of a $1.128 million refund to consumers (only), with a public announcement raising consumer victim hopes in circumstances where ASIC knew, or should have known, of the company's corporate financial difficulty and that the subsequent actual repayment of only $240,000 would likely be the case.

4.5 Continuously presenting The Cash Store case and the $18.9 million fines, involving many thousands of loans, as a victory for ASIC - without explaining that it was undefended, one of the two companies (Assistive Finance Australia) no longer existed and that the other was in receivership, with very little chance of the fines ever being paid.

4.6 Conducting an indifferent prosecution against Teleloans and Finance & Loans Direct, concerning an obsolete legislative provision, while ignoring other issues associated with hundreds of allegedly non-compliant loans that were revealed by the investigation. Further, unlike other prosecutions against smaller lenders, extraordinarily agreeing to each side paying its own costs.

4.7 Engaging expensive senior and junior counsel, involving three ASIC solicitors and one solicitor or paralegal, all transported from Sydney and Brisbane and accommodated in Cairns for a 3-week trial, just to prosecute a relatively simple case against a one-store lender, involving 10 loans, in circumstances where no Enforceable Undertaking or other administrative measure was ever offered.

4.8 Not taking any personal action against the "gatekeepers" associated with larger companies (directors and responsible managers), while taking personal action against the owner of the small, one-store Cairns lender.

5. Responsiveness to emerging issues - decision making processes

Concern: How can ASIC interface successfully with emerging issues, when the decision making is based on a lack of industry sector knowledge, inadequate and/or obsolete research, and a lack of recognition of the content of the primary legislation?

5.1 Demanding the use of exact template forms in the National Consumer Credit Protection Regulations, including obsolete or irrelevant content, despite legislative and regulatory provisions allowing adaptation to suit purpose.

5.2 Despite initial concern, failing to address the rise of so called "credit repair" companies and their use of External Dispute Resolution scheme costs, to attempt to blackmail lenders into illegally removing correctly included adverse credit listings with credit reporting bodies - thus seriously threatening the utility of obtaining useful credit reports. This despite ASIC Regulatory Guide 209 recognising the utility of credit reports and individual ASIC officers and ASIC counsel expecting credit reports to be obtained as part of the lender's assessment process.

5.3 Presenting public statements and statements in letters to lenders, implying an understanding of consumer behaviour or potential behaviour, without any consumer research to support such presumptions.

5.4 Asserting consumers may be confused with regard to a lender's documentation, without proof or complaint.

5.5 The continuing presentation of ASIC Report 426, involving a study of only 13 lenders - chosen because they had negatively come to the attention of ASIC - and only 288 loans issued over 2 weeks in **August 2013**, only 6 weeks after the new laws commenced. These 288 loans were not randomly selected, but were selected because of a specific range of negative "*attributes*" and from over 16,000 loans offered by the 13 companies during the 2 week period. 92% of the 288 loans came from only 4 lenders. The Report was not published until **17 March 2015**.

During the interim period from 2013 until publication, relevant information from Treasury and an updated ASIC Regulatory Guide were published that provided greater clarification of relevant elements of the 2013 law for lenders to observe. However, ASIC has claimed the Report currently applies to the whole industry sector.

This ignores appropriate research standards and also ignores the Minister's Explanatory Memorandum at paragraph 2.109, which recognised that the manner in which Australian Credit Licensees would meet their statutory obligations would change over time "*in the light of experience and changes in the operating environment*". The report has been continuously mentioned as an indication that the entire industry needed to lift their standards.

5.6 Conducting a poorly compiled Small Amount Credit Data Survey in August/September 2015, in preparation for an ASIC submission to the statutory required SACC Review. This survey was compiled without effective communication with key loan management software service suppliers, without any contact with the three industry sector representative bodies, or without any known "road testing" of the survey before distribution. This resulted in the majority of lenders only being able to answer just 5 of the 18 questions, two of which being their company name. Only a statistically irrelevant number of lenders were able to answer any more than those 5 questions and that included a number of questions where there was more than one possible interpretation as to the nature of the answer required.

5.7 Repeated public statements and administrative conduct presuming that leasing is simply an "avoidance" business model. This ignoring the fact that leases are an entirely different form of finance to credit contracts, comprehensively regulated in the 615 page National Consumer Credit Protection Act (NCCP), inclusive of the National Credit Code and the associated 352 page NCCP Regulations, and that ASIC actually specifies the activity as an authorised and approved activity for the particular licence holder, on the ASIC-issued Australian Credit Licence.

5.8 Imposing an Enforceable Undertaking that demanded the disclosure of a cost price for the goods in a leasing model, the disclosure of which is not required by the legislation.

6. Skills, capabilities of the Commission

Concern: There are things that just have to be done better.

6.1 Inconsistency in statutory interpretation as between state offices.

6.2 Demands for prompt provision of information, followed by inordinately slow investigation and resolution processes. Practices that particularly place and unfair and unnecessary burden on small businesses.

6.3 In responding to a licensee's request for clarification associated with an inaccurate and untested allegation of compliance breach, presenting that the response could be found in a substantially erroneous ASIC media statement, implying it was a definitive assessment of "the law".

6.4 Demands for a lender to remove a mandatory provision in a document.

6.5 Inconsistent demands between ASIC state offices, for information and documentation concerning Australian Credit Licence applications.

7. The continuing culture of the Commission

Concern: ASIC - inequitable and/or inconsistent dominance.

7.1 Ignoring the earlier recommendations of an ASIC approved compliance auditor, formerly a senior compliance officer with ASIC, after a lengthy three-audit process, and demanding extension and substantial change at the last moment, reflecting a response to the first audit of several months before and not supported by the legislation.

7.2 Entrapment, by way of encouraging contact to assist in completing an ASIC survey.

7.3 The issuing of letters containing vague and imprecise allegations of regulatory breach, without any detail as to the legislative sections, but with a demand for the lender to admit guilt and choose from a selection of penalties. Such penalties claimed to have been applied in the past (but not necessarily for the same alleged "offence").

7.4 Demanding that an Australian Credit Licensee adopt an entirely different business model, while admitting that none of the sections of the legislation had been breached, but that the officer simply "did not like" the current business model.

7.5 Offers of a meeting with Australian Credit Licensees under investigation being indefinitely postponed, following the licensees indicating they would be bringing their compliance adviser to the meeting.

7.6 The inclusion of inaccurate and highly prejudicial content in an ASIC media release, asserting agreement that had not been reached, implying the conclusion of an

investigation process which was not concluded, and implying that named licensees had committed offences of similar magnitude or impropriety as a list of totally unconnected companies, with totally different circumstances - presumably included to maximise tabloid interest.

This process provided an opportunity for ASIC to avoid making a formal decision, thereby denying the licensees the opportunity to challenge the decision in the Administrative Appeals Tribunal.

7.7 Continuing failure to engage during an investigation, when licensees provide substantial explanation for their position, including detailed legislative analysis and precedent-based defence.

7.8 Tolerance of inaccurate and inflammatory public statements by consumer advocates and not-for-profit lending organisation representatives, with ASIC colleagues in the *Misconduct & Breach Reporting Assessment & Intelligence Stakeholder Group* determining that, despite industry sector complaint, there is no necessary "broader public benefit" justifying ASIC action - and the risk of such statements inciting public expectation that the *Deposit Takers, Credit and Insurance Stakeholders Team* will prioritise action.

7.9 The unreasonable attempt to extend (and enforce) the words contained in the legislation concerning a critical topic - consumers' "*requirements and objectives*" - to embrace a multi-faceted collection of criteria, not all within consumer consideration, in the relevant ASIC Regulatory Guide 209. This beyond Ministerial expectation and beyond any Ministerial or Treasury co-ordinated consultation with the industry sector.

7.10 The treatment of ASIC Regulatory Guide content as if it were legislation passed by the Parliament, or regulation not rescinded by the Parliament, which was contrary to the division of powers under the Commonwealth Constitution, the introduction to every ASIC Regulatory Guide and evidence provided to the Federal Court by a senior ASIC lawyer.

7.11 A culture that, in public statements and in contacts with licensees, attempts to impose the legally improper and rejected draft Section 323A National Credit Code provision, being Schedule 6 of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012.

This rejected Bill, never presented to the Parliament, proposed to empower ASIC to simply declare that "*it was reasonable to conclude*" that a business activity or model was an avoidance "*scheme*" without the requirement for investigation or published justification, and with the burden of proof transferred to the licensee, rather than the officer alleging the breach.

This imposition contradicting Section 1(1)(a) of the ASIC Act, which requires ASIC to "...<u>administer</u> such laws of the Commonwealth...", not create them.

7.12 Listing lenders in media releases in a manner implying that adverse court decisions ("outcomes") had been handed down - which was not true.

8. Internal Review and improvement mechanisms

Concern: Mechanisms that operate in a vacuum, isolated from the external reality, may not deliver the best results.

8.1 The development and publication of ASIC Regulatory Guides without any industry sector consultation. This in contrast to the extensive opportunities provided by Treasury during the development of the credit legislation and regulation process.

8.2 The failure to include any industry sector representation on any relevant stakeholder ASIC panel or liaison committee.

9. Organisational governance and accountability arrangements - training and professional development

Concern: Again, mechanisms that operate in a vacuum, isolated from the external reality, may not deliver the best results.

9.1 Making it so extremely difficult and unpleasant to finalise arrangements for the Delegation to meet with senior ASIC officers, to present and discuss industry issues of mutual concern, that such discouraged further attempts at keeping ASIC informed.

9.2 Avoiding any opportunity to report to consumers and the general public on the outcome of penalty impositions and the associated success in the collection of fines and the repayment process.

9.3 Avoiding any opportunity to report to taxpayers as to the actual costs involved in the inconsistent prosecutions.

9.4 Not creating an opportunity for lenders and/or lender representatives to give presentations to ASIC training sessions.

Additional power for ASIC

The Delegation is most concerned to learn of general calls for ASIC to have more power. The Delegation is unaware of any such general call being accompanied by an objective study as to how ASIC is using its current powers in regard to the enforcement of compliance for small amount, short term lenders.

Should these calls attract any interest from the Expert Panel in regard to small amount, short term lending, Panel members are invited to consider the draconian amount of power which ASIC has already been granted by the Commonwealth Parliament over small amount, short term lenders.

The Delegation contends that no industry analyst has been able to discover an Australian industry sector more regulated and more subject to draconian penalty than the small amount, short term lending sector. Every element of the lenders' business processes, documentation, training and loan price is strictly regulated.

The Delegation notes that, in its current Discussion Paper concerning the statutory Small Amount Credit Contract Review, Treasury comments, "(the) *regulatory framework results in a great amount of complexity for* (small amount credit) *providers than for credit providers offering other products*".

This issue calls for more effective compliance enforcement - not more power.

It is very relevant to note the average payday or small loan offered by Delegation supporters varies between $250 and $500, with very few Delegation supporters lending over $5,000. However, the range of offences is extensive and the penalties frequently onerous.

There are two relevant Acts:

Part 2, Division 2 of the ASIC Act - particularly in regard to Sections 12BB (misleading representations), 12CB (unconscionable conduct), 12DA (misleading and deceptive conduct), and 12DB (false and misleading representations) provide ASIC with a very broad scope of power over Australian Credit Licensees - all attract penalties in the ASIC Act's most severe penalties range. Penalties include injunctions, adverse publicity orders, compensation to consumers, fines of up to $340,000 for individuals and up to $1.7 million for companies.

The National Consumer Protection Act includes very substantial opportunities for ASIC to exercise administrative power and impose penalties (fines, temporary cancellation or termination of licenses, substantial enforceable undertakings, orders to repay consumers), or to undertake prosecution.

In the NCCP Act, there are 126 criminal offences that do not have a gaol sentence as an option (72 of which attract strict liability), but have fines ranging from $510 to $17,000. There are 70 criminal offences that do have the option of gaol sentences, with fines from $170 through to $340,000 and gaol sentences from 3 months to 5 years (with 7 of these strict liability). There are also 114 civil offences each attracting a maximum fine of $340,000.

In addition, there are 34 overlapping offences, where the court can impose a penalty calculated as the total interest or permitted fees collected (up to $500,000) and, in these cases, the court can expand the coverage to include all consumers associated with a class of contracts. Further, for any offence, a court can order restitution or compensation for consumers, injunctions and adverse publicity orders.

Courts are also empowered to declare a contract void, in whole or part, with consumers being refunded, plus paid compensation for loss or damage. Courts can declare conduct unfair or dishonest, with the standard of proof being "more likely" (than not), with the opportunity for refunds, plus compensation for loss or damage.

In the lead up to the Capability Review, none of the calls for more ASIC power concerning the regulation of relatively small amount, short term lending, by any of the consumer advocates, have been supported by comprehensive and objectively collected evidence.

Where one-off examples have been cited relevant to the post-Commonwealth regulatory takeover, there has not been any attempt to consider actual or better enforcement of current legislation and regulation.

The Delegation contends that it is not a matter of more ASIC power that is required - what is required is more efficiency, more consistency between states and in the application of prosecution policy, more constructive contact with the industry sector in order to be better informed, better targeting and use of current ASIC power, along with a change in ASIC culture.

In this context, it may be useful to note the current message on the ASIC "*Welcome to the Consumer Credit Website*" includes the following:

"*The national regime has established a consistent and robust legislative framework. It gives consumers greater confidence and better outcomes when using credit products and addresses practices that could effect the stability of the industry, particularly the systematic provision of credit to consumers who cannot afford to meet the repayments*".

Further, there follows a comment concerning the legislation introduced on 1 July, 2010:

"*The main features... include:* (dot point 4) *improved sanctions and enforcement powers for the national regulator, ASIC...*". The Delegation was unable to discover any calls for more ASIC powers on this website.

In support of not extending ASIC's current powers, in a report released on 20 August 2015, ASIC Deputy Chair, Mr Peter Kell, stated that ASIC was not asking for changes to responsible lending law and said, "*the law as it stands allows us to push for higher standards*".

Conclusion - Compliance Benefits

The Delegation concludes where it began.

A successful Capability Review and a successful change to the current ASIC culture would provide clarity as to the application of compliance standards.

Competition will no longer be measured by how much more extraordinary profit the non-compliant lender is making, compared to the compliant lender.

A successful appropriate change will also mean the compliant lenders will not be left wondering whether or not ASIC will ever bother to demand compliance from the large non-compliant lenders and all types of lenders will be treated equally.

For the first time, a level playing field would exist that would encourage competition, including the opportunity for small and medium lenders to continue to participate in the market.

The Delegation thanks the Expert Panel and the Treasury Secretariat for their consideration of this submission and trusts that it has been of assistance.

25 September 2015