National Competition Policy Review of the

Credit (Finance Brokers) Act 1984

Final Report

DEPARTMENT OF FAIR TRADING
NSW Consumer Protection Agency

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Background to the review

The *Credit (Finance Brokers) Act 1984* has been reviewed as part of the NSW Government's commitment under National Competition Policy to review all of its legislation which restricts competition. The Competition Principles Agreement requires that legislation should not restrict competition unless it can be demonstrated that the benefits to the community as a whole outweigh the costs of the restriction and that the objectives of the legislation can only be achieved by restricting competition.

The review was conducted by a Steering Committee chaired by the Department of Fair Trading. A Reference Group was also formed for the purpose of informing the review, comprised of representatives of consumer and industry organisations with an interest in the consumer credit industry. An Issues Paper was released for public comment and submissions were invited through press advertisements and the Department's web site. Submissions made to the review, along with the Reference Group's input and the Department's experience in administering the Act, form the basis of the review findings, which are set out in this report.

The finance broking industry

Finance brokers provide intermediary services between persons seeking finance and credit providers, usually in return for a commission paid by either the client or the credit provider. A finance broker's principal function is to find suitable potential lenders offering credit products which match their client's needs, refer the client's application to a credit provider and obtain approval for the loan. The loan contract is then taken out between the credit provider and the client.

Since the de-regulation of the Australian finance sector in the 1980s, the number and type of consumer credit products on the market has proliferated. Increased competition between lenders has resulted in a high level of consumer awareness of the range of competitive finance products available, accompanied by increased motivation to negotiate the best possible credit arrangement. The finance broking industry is experiencing a corresponding period of growth, as consumers increasingly seek the assistance of brokers in comparing and assessing the available products. The industry is predicting that, by the end of the decade, up to 50% of home loans in the eastern States of Australia will be negotiated through finance brokers.

Although many finance brokers negotiate credit for commercial purposes, the *Credit (Finance Brokers) Act* applies only to the negotiation of housing loans and consumer credit. The Act regulates the conduct of finance brokers by:

- requiring written contracts;
- requiring the keeping of records of transactions;
- requiring valuation fees paid by consumers to be held in trust;
- restricting when commission may be charged;
- providing for consumer redress where excessive commission is charged; and
- enabling disciplinary action to be taken by the Director-General of the Department of Fair Trading for breaches of the Act.

Finance brokers are also subject to the *Consumer Credit Administration Act 1995*, which provides for the investigation and discipline of unjust conduct. This Act enables the Director-General to take a range of disciplinary actions, ranging from requiring the giving of undertakings as to future conduct, to the issue of a prohibition order preventing a person from being involved in providing finance broking services. The *Fair Trading Act 1987* also applies to finance brokers, and includes provisions which prohibit unconscionable or deceptive conduct, false representations and misleading advertising.

Victoria, Western Australia and the Australian Capital Territory currently administer legislation which regulates the conduct of finance brokers. The remaining jurisdictions rely on fair trading and consumer credit legislation generally to protect consumers. Queensland has recently set up a working group to examine the need for regulation of finance brokers in that State.

Objectives of the legislation and justification for government intervention

In accordance with the Competition Principles Agreement, this review was required to clarify the objectives of the *Credit (Finance Brokers) Act*, to consider whether the objectives remain relevant to the current marketplace and to assess the Act's effectiveness in achieving its objectives. The objectives were considered in the context of government regulatory objectives generally.

The Council of Australian Governments (COAG) has agreed that an important regulatory objective is that government intervention should be limited to situations of market failure. The National Competition Council has identified a range of problems or market failures which may warrant legislative intervention, including natural monopoly, externalities, public goods, information asymmetry and high transaction costs. The nature of these problems is described in part 4.1 on pages 11-12 of this report. Other goals of government intervention include the improvement of economic efficiency, achievement of social welfare, distributional or equity targets and improvement of occupational or consumer health and safety.

The review identified the implied objectives of the Act as being to:
- address information asymmetry between finance brokers and their clients;
- reduce consumers' transaction costs in obtaining information and enforcing contracts with finance brokers; and
- protect consumers from financial loss.

The submissions made to the review and the experience of the Department's complaint handling and compliance areas indicate that consumers continue to experience a degree of risk in their dealings with finance brokers. The main risks were identified as:
- lack of broker independence where commission is paid by lenders, which may result in consumers entering into overpriced credit arrangements (this problem was also assessed as having a potential impact on competition and the economy);
- consumer loss where the broker's commission is paid in advance and the credit is not subsequently obtained;
- the charging by brokers of excessive, undisclosed commissions or other fees;

- unethical conduct whereby consumers may be persuaded to borrow larger amounts than needed or to include fraudulent information in credit applications; and
- difficulty in obtaining redress where the consumer has not been provided with a copy of their agreement with the broker.

The degree of risk faced by the majority of consumers in dealing with finance brokers was assessed by the Steering Committee as being moderate. However, it is considered that a risk of significant and potentially irreversible harm exists for some consumers in financially vulnerable positions, who are also more likely to approach finance brokers operating on the fringe of the industry. The assessment indicated a possible case for intervention in the consumer finance broking industry, which was then considered in relation to competition issues.

Costs and benefits of the Act and effects on competition

The review found that the Act has minimal impact on competition, given that it:
- does not impose barriers to entry or exit from the industry;
- does not impose controls on pricing levels;
- imposes few compliance costs;
- imposes few restrictions, all of which were assessed as being outweighed by their benefits to the community.

The cost benefit analysis in table 3 in part 6.4 of this report demonstrates an overall net benefit provided to the community by the Act. The Act imposes direct costs on finance brokers of contract preparation, record keeping and trust accounting for valuation fees paid in advance by the client. Contract preparation and record keeping are considered to be standard good business practices. The cost of keeping valuation fees in trust was assessed as being minimal, given that valuations are rarely required except for property loans, in which case they are usually arranged by the lender, and because the cost is easily avoidable by having the consumer pay the valuer direct. Other potential costs may arise as a result of delays in receiving commission payments or the necessity to defend court or Tribunal proceedings. These costs were assessed as forming part of the standard risk faced by any business, and in any case are outweighed by the benefits to the community.

The benefits of the Act include:
- access to records to facilitate court and Tribunal proceedings;
- consumer protection from potential loss of monies paid in advance;
- written contracts assist in the enforcement of both parties' rights under the agreement;
- consumers are protected from being required to pay commission where the credit obtained does not meet the terms of the contract; and
- access to redress with respect to excessive commission charges, which is a potential benefit to the economy as well as to consumers.

Conclusions and key recommendations

The Steering Committee concluded that the provisions which provide the benefits listed above, or equivalent or similar provisions, should be retained in any future regulation of the consumer finance broking industry. Several of the provisions require amendment to improve their effectiveness, for example, to clarify that written contracts must be prepared regardless of whether the client or the credit provider is to pay commission and to ensure that the client receives a copy of the contract.

The review also found evidence of marketplace problems which are not effectively addressed by the provisions of the current Act, for example, failure by brokers to inform consumers of the amount of commission they will be required to pay, loans secured for amounts significantly greater than requested and conflicts of interest where different amounts of commission paid by various lenders may influence the broker's recommendations. The review identified several means by which the benefits and effectiveness of the legislation could be significantly increased without imposing additional costs on the industry or government. These include requirements that brokers disclose in advance the amount of commission payable and, where relevant, the fact that they will receive financial or other benefits from credit providers. The Steering Committee recommends that the consumer redress provisions be expanded to enable consumers to apply to the Fair Trading Tribunal with respect to unjust conduct by a finance broker and to allow for relief from the payment of commission where the consumer does not accept the credit offer because the amount negotiated by the broker is significantly greater than that specified in the contract.

The review considered a number of alternative options for the future regulation of finance brokers, including repealing the Act and relying on industry self-regulation, retaining the current Act or introducing a mandatory code of practice prescribed as a regulation under the *Fair Trading Act*. The Steering Committee's recommended option is to repeal the Act and to insert a new part into the *Consumer Credit Administration Act* dealing with the regulation of finance brokers. This option would mean that all provisions specifically regulating finance brokers would be contained in one statute, thereby minimising duplication of regulation. This option would also be broadly consistent with reforms implemented in Victoria and the Australian Capital Territory following NCP reviews of former stand-alone finance broker legislation in those jurisdictions.

The *Consumer Credit Administration Act* is considered the most appropriate place for the inclusion of finance broker regulation, as it already provides for the discipline of brokers with respect to unjust conduct. If this recommendation is implemented, the *Consumer Credit Administration Act* will require amendment to provide consumer access to redress, as it currently only provides for action to be taken by the Department of Fair Trading.

List of recommendations

In accordance with the findings of the review, the Steering Committee recommends that:

1. the *Credit (Finance Brokers) Act 1984* be repealed; and
2. the *Consumer Credit Administration Act 1995* be amended to include a new Part relating to the conduct of finance brokers, providing for the following:
   - a specific statement of the objectives of the regulation of finance brokers;
   - an amended definition of *finance broking* and any other definitions required to clarify the intent of the legislation, e.g. *client* and *commission*;
   - up-front disclosure of the amount of (or method of calculating) commission payable by the client and information about when and how commission will be payable;
   - up-front disclosure, where relevant, of the fact that financial or other benefit is to be received by the broker from the credit provider or that recommendations will be drawn from a limited range of potential lenders;
   - a requirement that the contract between the broker and their client be in writing regardless of who is paying commission, set out the terms of the credit to be negotiated and details of commission payable by the client, be signed by the client and that a copy be given to the client before negotiation of the credit is commenced;
   - a requirement that brokers make and keep records of transactions, including copies of contracts with clients, for at least three years;
   - prohibition on receiving commission in advance of securing the credit;
   - valuers' fees to be payable direct to valuer or by cheque (or similar) payable to valuer;
   - a link between the broker's right to commission and the credit meeting the specifications set out in the contract, enabling the consumer to reject the offer where the amount of credit is significantly greater or lower than the amount sought or is on less favourable terms, without being liable to pay commission; and
   - consumer access to redress with respect to unconscionable or excessive commission charges or unjust conduct or for breach of contract by the broker.

1 BACKGROUND TO THE REVIEW

1.1 National Competition Policy and the review of laws that restrict competition

The review of the *Credit (Finance Brokers) Act 1984* has been undertaken as part of the NSW Government's commitment under National Competition Policy to review all of its legislation which restricts competition.

The aim of National Competition Policy is to promote and maintain competition in order to increase economic efficiency and community welfare while continuing to provide for consumer protection. The Government believes that, provided the public interest is safeguarded, competition will benefit the people of New South Wales by creating a stronger and more vital economy.

The National Competition Principles Agreement requires that legislation should not restrict competition unless it can be demonstrated that the benefits to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.[1] The *Credit (Finance Brokers) Act* was identified as potentially restricting competition and accordingly listed for review. This report contains the findings of the review.

Although the emphasis of this review was on competition related matters, the review also examined other concerns of consumers and industry groups. Areas in which the law could be made more efficient and equitable were also considered.

1.2 Market failure and consumer protection

Legislation, such as the *Credit (Finance Brokers) Act*, may be imposed by government to address problems that arise in an unregulated marketplace. These are sometimes known as "market failures." An example of such a problem is 'information asymmetry', where service providers possess vital information about the service they are providing, and the consumer does not have access to that information. This limits the ability of the consumer to make informed choices, and may necessitate regulation to ensure that the service provider discloses relevant information. However, regulation may also restrict competition between service providers by controlling who can provide services or limiting the services that may be offered. This may result in new problems or costs for business, consumers and government that are not justified in relation to the nature of the problem which the intervention was seeking to address in the first place.

The provisions of the *Credit (Finance Brokers) Act* were based on those of the *Moneylending Act 1941*. Few documentary records remain as to the nature of the marketplace problems that prompted the introduction of the *Moneylending Act*. Moreover, the consumer credit marketplace has changed considerably since that time, particularly over the past 16 years since the introduction of the *Credit (Finance*

[1] Council of Australian Governments 1995, *Competition Principles Agreement*, Clause 5(1).

Brokers) Act. In accordance with National Competition Principles, this review of the Act was required to consider:

- the objective of government regulation of finance brokers (see Part 4);
- whether regulatory intervention is still justified (see Part 4.5);
- the impact of the current Act on competition within the industry and the costs and benefits of the Act (see Parts 5-6); and
- whether the Government's objectives can be met by any less restrictive mechanism (see Part 7).

1.4 The review process

It is the Government's policy to ensure that reviews of legislation take into account the full range of public benefits and costs and that all views are thoroughly considered before any reforms are proposed.

The review of the *Credit (Finance Brokers) Act* has been oversighted by a Steering Committee, chaired by the Department of Fair Trading and comprising representatives of the NSW Treasury and The Cabinet Office. To help ensure that a broad range of views was taken into account, a Reference Group was also established to inform the review, made up of representatives from:

- the Financial Counsellors' Association of New South Wales;
- the Consumer Credit Legal Centre (NSW) Inc;
- CreditLine Financial Counselling Service;
- the Mortgage Industry Association of Australia;
- the Australian Equipment Finance Association Inc.;
- the Australian Finance Conference; and
- the Finance Brokers Association of Australia.

An Issues Paper was released in April 2000 to stimulate discussion within the community and to assist interested individuals and organisations wishing to lodge a submission. Six hundred copies of the paper were distributed to interested parties and responses sought on the issues it raised, as well as any other relevant matter. Fourteen submissions were made to the review by the parties listed in Appendix I. The terms of reference for the review are listed in Appendix II.

1.5 The final report

The Steering Committee has prepared this report for consideration by the Minister for Fair Trading and the New South Wales Government to satisfy the review requirements under the Competition Principles Agreement. It is based on the Committee's analysis of the issues raised during the review, including those provided by way of written submissions and by members of the Reference Group.

2 PROFILE OF THE INDUSTRY

2.1 The role of a finance broker

The role of a finance broker is to act as an intermediary between a client and credit provider to negotiate the approval of credit, usually in return for a commission paid by either the client or the lender. A finance broker's principal function is to find suitable potential lenders offering credit products which match their client's needs, refer the client's credit application to a credit provider and obtain approval for the loan. The loan contract is then taken out between the credit provider and the client. The finance broker is an agent, or 'go-between', who does not determine the terms between the credit provider and prospective debtor, but merely interprets or negotiates between them.[2]

2.2 The size of the industry

The precise number of finance brokers currently operating in New South Wales is not known. In October 1996, just prior to the removal of licensing requirements, there were 1,878 finance brokers licensed by the Department of Fair Trading under the *Credit (Administration) Act 1984*. The finance broking industry is currently experiencing a period of growth in the area of consumer finance, apparently correlating with the increase in the number and variety of home finance products appearing on the market.

2.3 The role of professional associations

Professional associations play an important role in monitoring service standards among finance brokers. A number of industry associations have finance brokers among their membership, including the Finance Brokers Association of Australia, the Australian Equipment Finance Association, the Australian Equipment Lessors Association and the Mortgage Industry Association of Australia. The Australian Equipment Lessors Association is the national association for the equipment leasing and financing industry, and is associated with the Australian Finance Conference, the national association representing financiers in Australia, although it functions as an independent body.

The Finance Brokers Association of Australia (FBAA), based in Queensland, currently has around 60 members in New South Wales. The FBAA administers a Code of Ethics which encourages its members to, among other things, act in the best interests of clients by providing full and accurate information, ensure the validity and accuracy of all documentation and provide advice and guidance to enable clients to select the most appropriate credit facility for their needs.[3]

The Mortgage Industry Association of Australia (MIAA) represents participants in all aspects of the real estate mortgage industry, describing itself as the peak industry

[2] Cavanagh, S.W. & Barnes, S. 1988, *Consumer Credit Law in Australia*, Butterworths, pp. 695-696.
[3] FBAA web site, http://www.financebrokers.com.au/

body for the mortgage industry in Australia.[4] The MIAA has developed a Code of Practice which sets out minimum ethical standards to be observed by its members, including requirements to disclose to clients all information relevant to the lending transaction and any conflict of interest they may have. A Mortgage Industry Ombudsman Scheme has been established under the Code from 1 July 2000, to assist MIAA members and their customers to resolve certain disputes. The Code also establishes a Mortgage Industry Review Committee, comprising industry and consumer representatives, to oversee and report on the operation of the Scheme.

2.4 The changing nature of the consumer credit marketplace and regulatory environment

All businesses operate in a changing technological and regulatory environment. With respect to the regulation of finance brokers, a number of factors need to be taken into account when determining the appropriate approach:

- the increasing variety of consumer credit products available, particularly for home finance;
- growth in the number of specialist mortgage brokers who receive their commission from the credit provider rather than the client;
- more recent consumer protection legislation such as the *Fair Trading Act 1987*;
- the effects of the *Consumer Credit Code* (which commenced operation on 1 November 1996); and
- an increasing sense of professionalism within the industry, fostered by industry associations and the development of industry codes of conduct.

The increase in the number and type of consumer credit products on the market since the de-regulation of the Australian finance sector in the 1980s appears to be having two key effects on the finance broking industry:

- consumers are increasingly aware of the range of competitive finance products available and are correspondingly motivated to negotiate the best possible credit deal; and
- consumers are increasingly making use of finance brokers, either to assist in comparing and assessing the available products or to save themselves time in shopping around for credit deals.

Industry reports are that, in the eastern States of Australia, approximately 20% of home loans are currently sourced through finance brokers, and there are predictions that this figure could grow to something approaching 50% over the next decade.[5]

[4] MIAA Corporate Profile, www.miaa.com.au
[5] Mortgage Choice Australia Limited, submission to review; Mortgage Industry Association of Australia.

3 THE REGULATION OF FINANCE BROKERS

3.1 History of the regulation of finance brokers in NSW

Prior to 1984, finance brokers and credit providers in this State were regulated by the *Moneylending Act 1941*, part VI of which provided for the registration of finance brokers. The specific provisions dealing with the marketplace conduct of finance brokers were eventually brought forward into the *Credit (Finance Brokers) Act*, which was part of a credit reform package introduced in 1984 in New South Wales, Victoria, Western Australia, the Australian Capital Territory and, a few years later, Queensland.[6]

The New South Wales government introduced the package of credit legislation in May 1984, as a *Credit Bill* and several associated bills covering various aspects of the consumer credit industry. The key bills were enacted as:

- the *Credit Act 1984*,
- the *Credit (Administration) Act 1984*,
- the *Credit (Finance Brokers) Act 1984*,
- the *Credit (Home Finance Contracts) Act 1984* and
- the *Commercial Tribunal Act 1984*.[7]

As a result of this development, the core consumer credit legislation embodied in the various jurisdictions' Credit Acts was largely uniform in its regulation of credit providers. However, it was agreed by the legislators that administrative matters such as licensing, discipline and the constitution of Tribunals should be left to blend with the existing policies and structures of each State. In New South Wales, these matters were addressed in the *Credit (Administration) Act 1984* and the *Commercial Tribunal Act 1984*. The *Credit (Administration) Act* provided for the licensing and discipline of credit providers and finance brokers. The *Commercial Tribunal Act* established the Tribunal and gave it responsibility for the grant, renewal and cancellation of licences and for hearing disciplinary proceedings against finance brokers and credit providers.

3.2 The Credit (Finance Brokers) Act 1984

Following the implementation of the package of consumer credit laws in 1984, finance brokers were for the first time regulated under separate legislation, the *Credit (Finance Brokers) Act 1984*. Licensing of finance brokers and credit providers was also introduced, under the *Credit (Administration) Act 1984*. The requirement to be licensed was subsequently removed with the repeal of the *Credit (Administration) Act* on 1 November 1996.

[6] The legislation was not implemented in Tasmania or the Northern Territory. South Australia had already implemented the *Consumer Credit Act 1972*.

[7] Of these, only the *Credit (Finance Brokers) Act*, the *Credit Act* and the *Credit (Home Finance Contracts) Act* are currently in operation. The *Credit Act* and the *Credit (Home Finance Contracts) Act* now apply only to fixed-term contracts made prior to the commencement of the *Consumer Credit (New South Wales) Act*, ie prior to 1 November 1996. The intention is that these Acts will be repealed when there are no longer any existing contracts covered by them. Most other consumer credit contracts are now covered by the *Consumer Credit Code*. The *Commercial Tribunal Act* was repealed on 1 March 1999 on the commencement of the *Fair Trading Tribunal Act 1998*.

The *Credit (Finance Brokers) Act* provides that:

- finance brokers make records containing full particulars of transactions and preserve those records for at least three years;
- before demanding, receiving or accepting commission, a broker must include particulars of the credit to be obtained in a written contract signed by the person to be charged commission;
- commission must not be demanded, received or accepted before the credit is secured or where the credit secured is for an amount less than specified, at a rate of interest or charge greater than specified or for a term less than the term specified in the written contract;
- monies received from the consumer for the estimated cost of obtaining a valuation of security offered for proposed credit must be held in trust and any balance after payment of the valuation fee must be refunded to the consumer;
- a finance broker must not induce or attempt to induce a person to enter a credit contract by any false, misleading or deceptive statement, representation or promise or by any dishonest concealment of material facts; and
- a court or the Fair Trading Tribunal may re-open a transaction where commission charged is considered to be excessive and relieve the client or their guarantor from the liability to pay any commission in excess of an amount determined by the court to be reasonable remuneration for the services provided by the broker.

Although many finance brokers negotiate credit for commercial purposes, the Act applies to a finance broker's business only in relation to housing loans and consumer credit transactions covered by the *Consumer Credit Code* or the *Credit Act*. Consumer credit transactions include personal loans, housing loans, consumer leases[8] and continuing credit. A finance broker is not precluded by the Act from carrying on other kinds of business in addition to finance broking, however only activities relating to consumer finance broking are covered by the *Credit (Finance Brokers) Act*.

3.3 Other legislation

The Fair Trading Act 1987

Like other New South Wales traders, finance brokers became subject to the *Fair Trading Act 1987* on its commencement. The *Fair Trading Act* mirrors the consumer protection provisions of the Commonwealth *Trade Practices Act 1974* and includes a range of provisions which prohibit practices that seek to exploit or misinform the community, such as unconscionable or deceptive conduct, false representations and misleading advertising. A major policy objective of the *Fair Trading Act* is that consumers can expect that the information they are given about products or services they are buying is accurate so that they can choose those that best satisfy their needs.

The *Fair Trading Act*, in section 68, gives consumers a right to compensation for loss or damage which occurs as a result of conduct that is in contravention of the Act, (except in relation to the unconscionable conduct provisions in section 43). This right is available to private consumers and is accessed by action in the Supreme, District or Local Courts or the Fair Trading Tribunal.

[8] A consumer lease is an agreement for the hiring of goods under a fixed term contract where the total cost is greater than the cash value of the goods.

The Uniform Consumer Credit Code and the Consumer Credit Administration Act 1995

The *Consumer Credit Code* consists of nationally uniform legislation which was passed by the Queensland Parliament in 1995 and subsequently adopted as law in each State or Territory's respective Consumer Credit Act.[9] The *Consumer Credit (New South Wales) Act 1995*, which appends the *Consumer Credit Code*, commenced operation on 1 November 1996 and substantially replaced the *Credit Act 1984*, however that Act was not repealed since it continues to regulate contracts entered into before the Code commenced unless they are continuing credit contracts.

The key purpose of the *Consumer Credit Code* is to provide a set of laws to regulate all forms of consumer lending and all credit providers and which are uniform in all jurisdictions in Australia. The legislation is based on the principle of truth in lending which allows borrowers to make informed choices when purchasing credit. The policy of the legislation is to rely generally on competitive forces to promote price restraint but to provide significant redress mechanisms for borrowers in the event of a failure to comply with the legislation.[10] Administrative arrangements under the Code are able to be provided for separately in each State and Territory.

In New South Wales, administrative arrangements are dealt with in the *Consumer Credit Administration Act 1995*, which repealed the *Credit (Administration) Act 1984* and introduced new provisions for the discipline of credit providers and finance brokers. The most immediate impact of these changes on finance broking in New South Wales was the removal of the requirement that finance brokers (and credit providers) be licensed. In developing the *Consumer Credit Administration Act*, the New South Wales government took the opportunity to review the administration regime and bring it into line with current policy, which focuses on giving the community the protection it needs without imposing unnecessary regulatory burdens on industry.

It was found that the licensing regime committed considerable departmental and tribunal resources to a process which had no bearing on the conduct of licensees in providing finance broking services and which imposed an administrative and financial burden on all parties. It was considered that the new legislation would remove barriers to entry to the industry.[11]

The *Consumer Credit Administration Act* applies to both credit providers and finance brokers in respect of the supervision of the consumer credit industry. The Act provides for the investigation and discipline of unjust conduct in the course of providing consumer credit or finance broking. The stated purpose of the disciplinary provisions of the Act is to ensure compliance by credit providers and finance brokers with the consumer credit legislation and with appropriate standards of honesty, fairness, competence and diligence.[12]

The Act provides for a range of disciplinary action that can be applied according to the severity of the unjust conduct. Options include requiring undertakings as to future conduct, requiring action to rectify the consequences of unjust conduct, requiring a

[9] Except in Western Australian, where a number of different provisions were included in the Code.
[10] Explanatory Memorandum to the *Consumer Credit (Queensland) Act 1995*.
[11] *Parliamentary Debates*, NSW Legislative Assembly (15 November 1995), pp. 3209-3211.
[12] *Consumer Credit Administration Act* 1995, section 11.

broker to show cause as to why further disciplinary action should not be taken, issuing a reprimand and directing compliance with specified requirements. If disciplinary action proves unsuccessful in curbing unjust conduct, the Director-General may, under section 19, issue a prohibition order preventing a person from being involved in providing finance broking services. A person who contravenes a prohibition order may be fined up to $22,000 upon conviction. Consumers with whom the broker has contracted in contravention of a prohibition order are not liable to pay any amount under the contract and are entitled to recover any amounts paid.

The implementation of the *Consumer Credit Code* legislation has significantly reduced the risk to those who most need regulatory protection. The Code aims to discourage credit providers from allowing debtors to unknowingly overcommit themselves when taking out a loan. The Code also provides a mechanism by which transactions can be reviewed and certain orders made if the transaction is found to be unjust.

3.4 Regulation in other jurisdictions

The regulation of finance brokers is not uniform among Australian jurisdictions. Finance brokers in New South Wales and the Australian Capital Territory were subject to the credit legislation introduced in the mid 1980s.[13] In Victoria and Western Australia the regulation of finance brokers was the subject of pre-existing legislation.[14] Tasmania, Queensland, South Australia and the Northern Territory do not provide for specific regulation of finance brokers, relying on fair trading and credit legislation generally to protect consumers.

In recent years, Victoria and Western Australia have reviewed their finance broker legislation and have implemented or proposed reforms. Queensland has recently set up a working group to examine the need for the regulation of finance brokers in that State.

Victoria

Prior to 1999, a licensing scheme for finance brokers operating in Victoria was in place under the *Finance Brokers Act 1969*. Following a National Competition Policy review of the legislation, the Victorian Government implemented the *Consumer Credit (Finance Brokers) Act 1998*.

The purpose of this Act, which commenced on 1 July 1999, was to repeal the 1969 Act, thereby abolishing the licensing scheme and the cap on commissions, and to amend the *Consumer Credit (Victoria) Act 1995* to provide for the future regulation of finance brokers. A new Part was inserted into that Act which:

- continues the ban on up-front fees, so that brokerage fees are not chargeable until a loan as described in the broker's appointment is secured;
- provides for an agreed termination fee for the broker's reasonable costs where the client voluntarily withdraws from the arrangement, but only if the amount of the fee has been agreed to in the document of appointment;

[13] The *Credit (Finance Brokers) Act 1984* (NSW); the *Credit Ordinance 1985* (ACT).
[14] The *Finance Brokers Act 1969* (VIC); the *Finance Brokers Control Act 1975* (WA).

- disqualifies certain persons from engaging in finance broking, for example if they are under 18 years of age, have been convicted of certain offences or are insolvent;
- allows disqualified persons to apply to the Business Licensing Authority for permission to engage in finance broking – conditions may be imposed;
- valuation and credit application fees are to be paid to the valuer or credit provider rather than the finance broker;
- requires finance brokers to keep copies of documents of appointment for 7 years;
- allows disputes about brokers' fees to be taken to the Victorian Civil and Administrative Tribunal.[15]

Western Australia

In Western Australia government regulation of the finance broking industry differs from that of other Australian jurisdictions in that the relevant legislation, the *Finance Brokers Control Act 1975*, regulates the private mortgage investment market as well as consumer credit finance broking of the kind covered by the New South Wales legislation. Private mortgage investment schemes involve the arranging of loans and/or the management of funds on behalf of private lenders, for example, retirees investing by lending out their savings to private borrowers. In New South Wales, these services are provided by legal firms rather than finance brokers and are not regulated by finance broker legislation. The issue of solicitor lending was considered by the Post Implementation Review of the *Consumer Credit Code*.[16]

A review of the Western Australian finance broking industry conducted in 1998 concluded that the *Finance Brokers Control Act* does not provide effective remedies for losses suffered by private lenders who invest in the private mortgage investment market. Secondly, the review considered that the provision of finance broking services to consumer borrowers is adequately covered by consumer credit and fair trading legislation, and recommended that a voluntary code of practice for finance broking be developed by industry associations in place of legislation.[17]

The Western Australian Government subsequently appointed the Gunning Committee of Inquiry to examine the operation of the Finance Brokers Supervisory Board. The Committee reported in September 2000, recommending, among other things, that the definition of *finance broker* in the *Finance Brokers Control Act* be amended so that it applies only to brokers who arrange and/or manage loans on behalf of private lenders and private borrowers, with finance intermediaries who arrange loans from a *credit provider* within the meaning of the *Consumer Credit Code* to be excluded.[18] The Report recommendations are currently under consideration by the Western Australian Government, which is reviewing the current Code of Practice under the *Finance Brokers Control Act*.[19]

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[15] *Parliamentary Debates*, Victoria Legislative Assembly (3 September 1998), p. 197.
[16] The project team recommended that the Code be amended to give solicitors acting in this capacity the responsibilities of credit providers.
[17] Finance Brokers Industry Reference Group December 1998, *Review of Regulation of the Mortgage and Financial Services Industry: Final Report*, Ministry of Fair Trading.
[18] Gunning Committee of Inquiry 1 September 2000, *Report of the Gunning Committee of Inquiry into the Finance Brokers Supervisory Board*, Executive Summary, page x.
http://ww2.slp.wa.gov.au/publications/publications.nsf/gunning?openpage
[19] Finance Brokers Supervisory Board web site: www.financebrokers.wa.gov.au/14code.shtml

Queensland

While finance brokers in Queensland have not been subject to specific regulation in the past, recent problems in some sectors of the industry have prompted the Minister for Fair Trading to establish a working party to consider whether the introduction of a regulatory scheme is warranted. Issues under consideration include the form that any such regulation might take, whether coverage should be limited to consumer credit and whether a licensing or registration regime is appropriate.

Australian Capital Territory

Part 3 of the *Consumer Credit (Administration) Act 1996* (ACT) deals with the regulation of finance brokers in the Australian Capital Territory. The Act brought forward the provisions of the *Credit Ordinance 1985*, which had provided for the licensing of finance brokers (and credit providers) and included provisions virtually identical to those of the *Credit (Finance Brokers) Act* (NSW).

The 1996 Act replaced the licensing of credit providers and finance brokers with a registration scheme and introduced a number of new provisions. The other key difference from the New South Wales system is with regard to payment of commission. The ACT legislation continues to provide for a maximum level of commission, which is prescribed in the *Consumer Credit (Administration) Regulation 1996* at 2% of the amount negotiated up to $5,000, plus 1.5% of any amount exceeding $5,000 or $6.50; whichever is the greater.

Commonwealth

In 1997 the Commonwealth Government commenced a Corporate Law Economic Reform Program (CLERP), involving the review of key areas of business and investment regulation and the development of recommendations to reform companies and securities legislation. CLERP Paper No. 6, entitled *Financial Markets and Investment Products*, proposed a new regulatory regime for financial instruments such as securities, futures, foreign exchange, superannuation, general and life insurance and deposit accounts. The proposed legislation will not apply to consumer credit finance broking activities, and finance brokers will not be required to be licensed in order to negotiate consumer credit.[20]

The reforms were included in the *Financial Services Reform Bill*, which was released for public comment in February 2000. Uncertainties which have subsequently arisen about the constitutional validity of the proposed national scheme have resulted in the introduction of the legislation being placed on hold.[21]

[20] Commonwealth Department of the Treasury web-site, http://www.treasury.gov.au/publications/Bills,ActsAndLegislation/CorporateLawEconomicReformProgram/Paper06/Default.asp

[21] The Hon J Hockey, MP, Minister for Financial Services and Regulation, 29 November 2000, Press Release No FSR/077 http://www.minfsr.treasury.gov.au/pressreleases/2000/077.asp

4 OBJECTIVES OF THE LEGISLATION

4.1 Regulatory objectives of government

Government regulation may be used to achieve many valuable social and economic objectives, however, unless the objectives are clearly identified and are achieved in the most effective manner, business competitiveness and the productivity of the economy may be impaired, thereby undermining the achievement of the regulatory goals.[22] National Competition Policy accordingly requires that this review clarify the objectives of the *Credit (Finance Brokers) Act* and assess its effectiveness in achieving those objectives.

The objectives and purpose of the *Credit (Finance Brokers) Act* need to be considered in the context of government regulatory objectives generally. The Council of Australian Governments (COAG) has agreed that government intervention in markets should generally be restricted to situations of market failure and that each regulatory regime should be targeted on the relevant market failure or failures.[23]

The National Competition Council has identified a range of market failures which may warrant legislative intervention by government. For example, *natural monopolies* can occur where the costs of establishment, resources or infrastructure mean that a good or service can be provided more efficiently by one producer operating on a large scale. The resulting lack of competition may lead to overpriced goods or services and inefficient outcomes, which may warrant government intervention in the market.

Another type of market failure arises where market transactions have positive or negative impacts on third parties, and pricing mechanisms do not exist to allow the affected parties to charge for costs incurred or pay for benefits received. Examples include pollution (because third parties suffer from its production but are not compensated) or education (because third parties can benefit from another person's increased knowledge without paying for the benefit). These types of market failure (known as *externalities*) may lead to non-optimal levels of production and consumption in the absence of regulatory intervention.

Market failure in relation to *public goods* is another area which often justifies government intervention. In the unregulated market public goods will tend to be under-produced because, once people have purchased the product or service, they cannot stop others from using it (ie, they are *non-excludable*) or because the product is not used up with use (ie, it is *non-rivalrous*). Examples of these types of goods include footpaths and lighthouses.

Of more relevance to fair trading regulation, and the *Credit (Finance Brokers) Act*, are market failures arising from *information asymmetry* and *high transaction costs.* Information asymmetry occurs where information is uncertain or unavailable to one party in a transaction, which may result in buyers being deceived. Information

[22] Centre for International Economics February 1999, *Guidelines for NCP Legislation Reviews, Prepared for the National Competition Council*.

[23] Council of Australian Governments, *Report of the Task Force on Other Issues in the Reform of Government Trading Enterprises*, released as part of the first COAG communique, 1991, p22.

asymmetry is often addressed in regulation by requiring the provision of certain information to the other party in a transaction.

High transaction costs, such as information, negotiation or contract enforcement costs between individual buyers and sellers, may render an economic activity unviable. Government responses to this type of problem may take the form of requiring particular terms to be included in contracts or providing for financial redress in certain circumstances. An example of this type of intervention is found in section 7(2) of the *Credit (Finance Brokers) Act*, which relieves consumers of the obligation to pay commission if the amount of credit negotiated by a broker is less than that specified in the contract between the consumer and broker.

Other goals of government intervention in markets relevant to this review include:
- improvement of economic efficiency;
- achievement of social welfare, distributional or equity targets; and
- protection of consumers, employees and the environment (to overcome problems of externalities and imperfect information in the marketplace).[24]

Problems such as those outlined above are not necessarily evidence of market failure warranting direct government intervention in the marketplace. Markets sometimes develop means for addressing market imperfections of their own accord. It may be that the market is already taking some action to address a market imperfection or is capable of doing so. For example, voluntary provision of information by professional associations and/or consumer organisations or the establishment of voluntary accreditation and the use of quality assurance systems may assist consumers to overcome some aspects of market failure. An assessment needs to be made of the impact of the problem on the market and consumers before intervention is considered. This issue is discussed further in section 4.5 of this report.

4.2 Implied objectives of the Credit (Finance Brokers) Act

The provisions of the *Credit (Finance Brokers) Act* were brought forward virtually unaltered from the *Moneylending Act 1941*. There are no specific objectives stated in the Act and the Minister's Second Reading Speech provides no explicit indication of the Government's intent in relation to the Act.

Taking into consideration the foregoing discussion of market failure, and based on the specific provisions contained in the legislation, the Steering Committee determined that the implied objectives of the Act would appear to be to:
- address information asymmetry between finance brokers and their clients;
- reduce consumers' transaction costs in obtaining information and enforcing contracts; and
- protect consumers from financial loss.

Table 2 on the following page sets out how the provisions of the Act may contribute to meeting these objectives.

[24] Centre for International Economics February 1999, *Guidelines for NCP Legislation Reviews, Prepared for the National Competition Council*, page 30. The Allen Consulting Group for the Queensland Government Department of Employment Training and Industrial relations; *Final Report of the Review of the Private Employment Agencies Act 1983 A Public Benefit Assessment Test Under National Competition Policy*, 2000, p.13.

Table 2: Objectives of the Credit (Finance Brokers) Act

Objective 1	Problem / risk to consumers	How the Act addresses the problem
Address information asymmetry	Lack of available information about what would be an appropriate level of payment for the finance broker's services leads to the risk that consumers will pay too much for finance brokers' services.	Pricing of finance broker services is not regulated, but is subject to competition in the marketplace. Section 11 provides for consumer redress where excessive fees are charged. The Fair Trading Tribunal may relieve a consumer of all or part of the liability to pay commission.
	Lack of information about what would be an appropriate fee payable for the valuation of security offered for proposed credit brings risk of fraud where broker overstates fee and retains excess.	Section 8 requires that, where a broker has received monies for the estimated cost of valuation, any balance remaining after the payment of valuation fees must be repaid to the consumer.
	Inability to verify the truthfulness of information provided by finance broker brings the risk that consumers may enter into inappropriate credit contracts.	Section 9 prohibits a broker from using false, misleading or deceptive statements or representations to induce a person to enter into a contract.
Objective 2	**Problem /risk to consumers**	**How the Act addresses the problem**
Reduce high transaction costs	Risk of incurring high search costs: in the absence of educational requirements or accreditation, consumers may spend considerable time in searching for a reputable broker.	The Act sets enforceable, standards of conduct with which all finance brokers are required to comply in all their dealings in consumer credit. The Act imposes penalties for breach of its provisions and provides access to redress for consumers.
	Contract enforcement costs can be high due to the cost and delays involved in taking legal action for breach of contract.	The Act provides consumers with access to the Fair Trading Tribunal as a low-cost and comparatively speedy means of obtaining relief where the terms of the contract are broken.
	Consumers may be required to pay commission even though the credit negotiated by the broker does not match their requirements.	Section 7(2)(c) provides that commission must not be charged if the credit secured is for an amount less than specified, at a rate of interest or charge greater than specified or for a term less than the term specified.

Objective 2 (cont.)	Problem /risk to consumers	How the Act addresses the problem
Reduce high transaction costs	Contract enforcement costs may be increased if records of transactions are not available.	Section 6 requires records of finance broking transactions to be made and preserved for at least 3 years.
Objective 3	**Problem**	**How the Act addresses the problem**
Protect consumers from financial loss	Loss of commission paid in advance where finance broker is not subsequently successful in negotiating credit.	Section 7(2)(b) provides that commission must not be charged before the credit is secured.
	Where consumers' funds are held by a broker for payment of the costs of valuation of security offered for a loan, there is a risk of loss of monies due to fraud or insolvency.	Section 8 protects consumers' funds by providing that they be held in trust by the broker.

Submissions

The submissions made to the review by industry associations suggested that the consumer protection objectives of the Act are adequately met by general fair trading legislation introduced since 1984. For instance, the *Fair Trading Act* contains provisions which require finance brokers to be truthful in their dealings with clients, by prohibiting deceptive conduct and false representations. The *Fair Trading Act* also provides for penalties for breaches and gives consumers access to redress through the Fair Trading Tribunal. The *Consumer Credit Administration Act* provides for the discipline of finance brokers who engage in unjust conduct, which would appear to encompass most of the problems listed in the table above. Unjust conduct is defined as conduct that is:

- unfair, dishonest or fraudulent, or
- in breach of contract, or
- in breach of any consumer credit legislation.

On the other hand, several submissions from consumer groups suggested that the truthfulness requirements of the *Credit (Finance Brokers) Act* remain valid, and moreover need to be supported by stronger disclosure provisions if the Act is to adequately address the information imbalance between brokers and their clients. Furthermore, the Consumer Credit Legal Centre proposed that the objectives of the Act be broadened to introduce more responsibility into the industry, for example, by providing for fair contract terms and conditions and addressing high pressure selling.

The validity of the Act's objectives are next considered in the context of the areas of market failure relevant to finance broking.

4.3 Areas of market failure

The submissions to the review and the experience of the Department of Fair Trading's complaint handling and compliance areas indicate that consumers continue to experience a degree of risk in their dealings with finance brokers. For the purposes of discussion, the risks are broadly grouped into the categories of broker independence, commissions and fees and unethical or illegal conduct by brokers.

Broker independence

A significant number of submissions raised the issue of the finance broker's role in finding the best available credit deal for their client. This issue is becoming increasingly topical given the trend for lenders to pay commission to brokers for introducing borrowers, particularly in the area of home loans. Because some lenders may pay higher amounts of commission than others, there is a concern that unethical brokers may be motivated more by the level of commission they will receive than by their client's desire to find the best possible deal.

This issue is not addressed in the *Credit (Finance Brokers) Act*, which deals only with commission paid by the person for whom the credit is obtained, ie, the broker's client. Section 7(2)(c) of the Act protects the client from having to pay commission where the credit secured:

(i) is for an amount less than the amount sought;
(ii) is at a higher interest rate or charge than that specified by the client; or
(iii) is for a repayment period of less than that specified by the client.

These provisions would appear to be based on the supposition that consumers approach brokers to help them find a credit product to meet specific, pre-determined requirements. While many consumers still use the services of finance brokers for this purpose, the industry reports that finance brokers are increasingly being called on to assist in sourcing the credit arrangement most financially beneficial to their client.

This change in consumers' reasons for using the services of finance brokers is a result of changes in the market which have occurred since the de-regulation of the finance sector in the 1980s. There is now a far greater degree of competition between lenders with the result that the number and type of consumer credit products on the market, particularly in relation to home loans, has proliferated. Finance brokers are increasingly being used by consumers to save time in searching for the best available deal.

Given these developments, a finance broker's independence is more important to consumers now than it was in 1984 when the Act was introduced. However, many consumers unfamiliar with the credit marketplace may simply assume that finding the best deal for them is part of the service offered by the finance broker. The current legislation does not require finance brokers to disclose their relationships with lenders or explain the nature of the service being provided. In this respect, the submission to the review by Wizard Financial Services noted that lenders which do not pay commissions rarely receive business from brokers, although they may be offering a superior product to the one recommended by the broker. Consumers may be unaware that their broker's recommendations are drawn from a limited range of lenders. Submissions made by consumer groups suggested that disclosure requirements be imposed on finance brokers to address this area of information asymmetry. This issue is considered further later in this report.

The submissions also suggested that confusion sometimes arises as to whether the broker's client in this situation is the borrower or the lender that pays the commission. The Steering Committee's view is that the client is the person who appoints the broker to negotiate consumer credit on their behalf, regardless of who is paying the broker's fee. The Committee concluded that this issue should be addressed in any future regulation of finance brokers by clarifying the definitions of terms such as *finance broking* and *commission*.

Commissions and fees

The respondents to the review raised three main areas of commission related problems for consumers as being:

- payment of commission in advance where the credit is not subsequently obtained;
- the charging of excessive amounts of commission; and
- other unconscionable fees and charges.

The submissions from consumer groups and the Department's complaints records indicate that the practice of charging commission or other fees in advance of securing credit still occurs in parts of the industry despite its being prohibited in the legislation. The Department's experience is that, in many of the reported cases, the consumer did in fact subsequently obtain the credit. However, the submissions highlighted examples where an advance fee is charged by an unethical broker where it is obvious that the client is not likely to be granted credit by a lender, for example because they have a poor credit history or lack of stable income. Another problem relates to 'finance broking' schemes involving the use of telephone applications which require a long interview using a 1900 or similar number where the consumer is kept talking and accrues a large telephone bill and where credit is never provided.[25]

The Australian Equipment Finance Association suggested in its submission that activities such as these which are designed solely to defraud consumers, and where there is no intention to procure credit, cannot be described as *finance broking* and should be disregarded for the purposes of the *Credit (Finance Brokers) Act*. The Steering Committee notes that such conduct is covered by criminal law and the provisions of the *Fair Trading Act* and *Trade Practices Act* which prohibit deceptive and unconscionable conduct and false representations. Most prosecutions of finance brokers undertaken by the Department of Fair Trading have been for breaches of these provisions of the *Fair Trading Act*. Civil remedies are also available under section 53 of that Act, which prohibits a person from accepting payment for goods or services where they do not intend to supply them.

The Steering Committee agrees with the view that outright 'scams' and other fraudulent enterprises designed solely to part consumers from their money cannot be termed as *finance broking* for the purposes of occupational regulation. The Committee agrees that such activities are best dealt with under fair trading and criminal legislation.

[25] Ministerial Council on Consumer Affairs, August 1999, *Uniform Consumer Credit Code Post Implementation Review: Final Report*, page 108.

A number of submissions indicated that unconscionably high fees and commissions also remain a problem for consumers. The Consumer Credit Legal Centre reported instances of consumers being charged thousands of dollars in commission on basic home loans, citing one example where a consumer was charged $2,500 on a loan of $115,000. The submission called for the reintroduction of the limit on commissions, which was imposed by the *Credit (Finance Brokers) Regulation 1984* until its repeal on 1 September 1997.

Alternatively, it was suggested that placing a legislative requirement on brokers to disclose in advance the amount of commission or method of calculating of commission payable would assist in enabling consumers to avoid incurring unconscionable charges. It was noted that section 11 of the Act, which enables the Fair Trading Tribunal to relieve a consumer of all or part of the liability to pay commission, provides a redress mechanism for consumers wishing to dispute excessive fees, but that disclosure requirements would increase the Act's effectiveness by preventing many such problems from arising.

The Steering Committee does not support the reintroduction of a limit on commissions. The Committee believes that less restrictive means of protecting consumers from paying excessive commission are available, for example, by requiring up-front disclosure by the broker of the amount of commission payable and providing access to a low-cost dispute resolution forum.

A related problem reported by submissions occurs where a finance broker fails to disclose the *way* in which the client will be charged commission. One respondent reported instances where a broker's commission is added by the lender to the amount borrowed without the consumer's prior knowledge. This results in increased costs for the consumer due to the additional interest payable on the higher loan amount. It was suggested that disclosure requirements would be useful in addressing this problem.

The Consumer Credit Legal Centre noted a possible gap in the Act's coverage in that it refers only to commission but not to other fees charged by finance brokers. The submission suggests that the term *commission* is intended to encompass all fees charged by brokers, regardless of the name they may go under, for example, 'termination fees'. The Steering Committee agrees that the provisions of the Act support this interpretation, and considers that it may be desirable to clarify this by the inclusion of a definition for *commission* in any future regulation of finance brokers.

As was noted above in the discussion of the finance broker's role, section 7(2) of the Act prohibits the taking of commission if the amount of credit obtained is *less* than the amount the consumer was seeking. A court which finds a finance broker guilty of an offence under this provision can order the broker to refund commission paid by the consumer or relieve the consumer of the liability to pay commission.

Some submissions suggested that a problem often experienced by the more vulnerable sections of the community occurs where the amount of credit obtained is significantly *more* than the consumer requires, and sometimes more than they can afford to repay, leading to a worsening of their existing financial difficulties.

The *Credit (Finance Brokers) Act* does not provide the consumer with protection from this practice, although the *Consumer Credit Code* includes provisions which aim to ensure that credit providers properly assess a potential borrower's capacity to repay.

There is however no guarantee that the lender will verify the accuracy of the information included in application forms. (This issue is considered further under the next heading).

The Steering Committee observes that the regulation of finance brokers in Victoria provides protection for consumers in this situation by providing that the broker is entitled to receive commission only if the credit negotiated is on the same terms or "reasonably comparable" terms to those specified in the contract between the consumer and the broker.[26] The Steering Committee agrees with the view that the broker's right to receive payment commission should be dependent on the negotiation of credit which meets the client's specifications. Potential for consumer loss exists where the amount of credit negotiated is significantly higher or lower than required. Where the amount is lower, the consumer may incur costs in seeking additional finance elsewhere. Where the amount is higher the consumer may incur serious losses if they experience repayment difficulties. In both scenarios, regulatory intervention in the form of relief from the obligation to pay commission enables the consumer to walk away from the unsuitable credit deal without loss.

Unethical or illegal conduct

The submission by the Financial Counsellors' Association of NSW outlined practices by unethical operators who target financially vulnerable consumers by advertising 'easy finance' along with statements such as "bankrupts and pensioners welcome", "no documents required" and "no credit checks". Consumers contacting such brokers may then be encouraged to apply for high-interest credit cards with limits far greater than the amount of finance they were seeking.

The Wesley Community Legal Service submission reported that some unscrupulous brokers, aware that a client's credit application would certainly be rejected, encourage application to be made under a false name and/or with the inclusion of false information about the consumer's employment, level of income and home ownership status. This conduct is apparently facilitated by the practices of some credit providers, which balance cost savings achieved by reducing the amount of verification they undertake of credit applications against planned-for levels of 'bad debts'. Whilst credit providers are able to absorb such losses against resource savings, the impact on individual consumers can be devastating. The Consumer Credit Code's hardship provisions are ineffective in such cases, as the consumer has committed fraud, albeit perhaps at the instigation of a finance broker, and is therefore reluctant to take action under the Code. Although the *Consumer Credit Administration Act* allows for action to be taken against the finance broker, consumers in this situation are usually unlikely to make a formal complaint against the broker.

As was noted above, the Steering Committee believes that, in general, misleading and illegal activities are best dealt with under fair trading and criminal legislation.

4.4 Relevance of objectives

A number of submissions noted that the majority of finance brokers provide a professional service to consumers wishing to save time or find the best deal or who

[26] *Consumer Credit (Victoria) Act 1995*, section 37J.

are having difficulty finding a credit arrangement to suit their specific requirements. The Wesley Community Legal Service noted that the challenge for legislative reform is to ensure effective controls for the minority of "bad guys" while loosening regulation for "the good guys", and suggested that the way to achieve this would be by setting minimum standards for broker conduct.

The majority of submissions from industry associations suggested that the Act should be repealed on the basis that its objectives are now achieved by general fair trading and credit legislation. Two submissions from individual finance brokers noted that the 'reputable' sector of the industry would support the implementation of standards which would encourage increased professionalism in their competitors.[27]

On balance, the Steering Committee believes that the implied objectives of the *Credit (Finance Brokers) Act* – to address information asymmetry, reduce high transaction costs and protect consumers from financial loss – remain relevant.

Steering Committee's Conclusion: Relevance of Objectives
The Act's implied objectives remain relevant in today's consumer credit marketplace.

4.5 Can government intervention be justified?

The Council of Australian Governments (COAG) guidelines for regulatory action propose that a risk analysis be undertaken as the first step in determining whether or not to regulate.[28] These Guidelines suggest that risk analysis should consider:

- societal and individual risk;
- whether there is choice in incurring the risk, or adequate information about the consequences of incurring the risk (ie, whether the risk is voluntary or involuntary); and
- the probability of the harm occurring.

Diagram 1, overleaf, provides a framework for assessing risk in order to determine when government regulation of occupations is justified.[29] In a similar way to the COAG model, the framework considers the following aspects of the risk:

- significance of the harm caused; [30]
- whether or not the harm is reversible;[31]
- whether the assumption of the risk is voluntary;[32] and
- the probability of the harm occurring.

[27] Steven McLure, Partner, Finance Select; John Rowe, Finance Broker.
[28] *Council of Australian Governments*, Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-setting Bodies, November 1997.
[29] New Zealand Ministry of Economic Development June 1999, *Policy Framework for Occupational Regulation: A Guide for Government Agencies Involved in Regulating Occupations,* http://www.med.govt.nz/buslt/bus_pol/policyframework/
[30] The policy defines *significant harm* as significant harm to one person or moderate harm to a large number.
[31] Such as a permanent disability, as opposed to a reversible harm such as moderate food poisoning.
[32] Voluntary risks are those that the public generally know about and therefore avoid or control.

The model proposes that, given the compliance costs of intervening in occupations, it is important to limit intervention to cases where the harm has the potential to be significant and irreversible. Under this model, the only scenario where intervention is can be absolutely justified is where there is significant harm, the harm is irreversible, the risk is involuntary and there is a high probability of the risk occurring. In all other cases, the justification for intervention needs to be made in terms of the net public benefit arising from intervention.

The diagram sets out the relationship between the type of harm and the nature of risk and the case for regulation of an occupation:

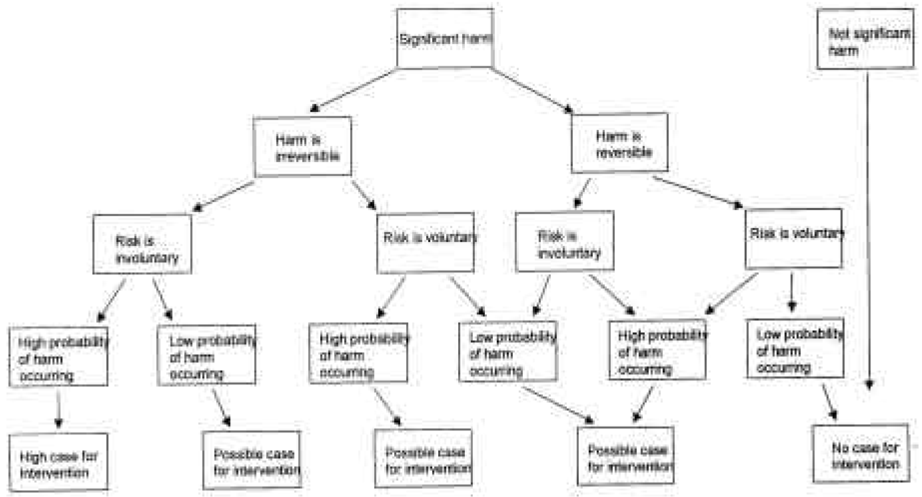

Diagram 1: When is there a case for intervention in an occupation?

The potential risks faced by consumers who receive incompetent service from finance brokers may be summarised as:

- payment of excessive amounts in commission and other fees;
- loss of commission paid in advance where credit is not subsequently obtained;
- financial loss as a result of entering into an unaffordable or highly priced credit contract; and
- risk of being unable to enforce the contract with the finance broker.

Using the model's four levels of harm assessment, an assessment can be made of these potential risks as follows:

Level 1

Potential for significant harm to individuals or moderate harm to a large number.	The risks could generally be described as moderate, depending on the amount lost and the consumer's financial position. However, the submissions to the review reported cases where individual consumers have suffered significant harm as a result of incompetent service provided by a finance broker, for example, the loss of their home.[33]

[33] Wesley Community Legal Service submission: Case study of a consumer who approached a broker to assist in consolidation of credit card and personal debts totalling $28,000. The broker obtained a solicitor loan of $63,000 which the consumer later found she could not afford to repay, resulting in the forced sale of her home.

Level 2

Is the harm reversible?	In most cases, the harm is relatively small and/or potentially reversible, as the consumer may apply to a court or tribunal for compensation or relief from payment under fair trading or consumer claims legislation. In cases such as the one mentioned above, the harm could be considered irreversible, as the consumer might not be in a financial position to buy another home in the future.

Level 3

Is the risk voluntary?	The risks in dealing with finance brokers could be classed as involuntary. Although consumers voluntarily seek the services of a broker, they generally would not know if they were being overcharged or recommended an overpriced product.

Level 4

Is there a high probability of the harm occurring?	For the majority of consumers, the probability of experiencing significant harm as a result of dealing with a finance broker is low. Significant harm is most likely to be experienced by consumers who are already in a vulnerable financial position. Such consumers are also more likely to approach operators on the fringes of the industry.

Steering Committee's Conclusion: Case for intervention

On the basis of this assessment, the Steering Committee believes there is a case for intervention in finance broking, however it is necessary that this be considered further in light of competition issues.

5 IMPACT OF THE ACT ON COMPETITION

5.1 How legislation may limit competition

This review is required to consider whether any restrictions on competition imposed by the *Credit (Finance Brokers) Act* are reasonable given the benefits provided. The National Competition Council has suggested seven ways in which legislation may limit competition.[34] Legislation may limit competition if it:

- governs the entry into or exit of firms or individuals out of the market;
- controls the prices or production levels;
- restricts the quality, level or location of goods and services available;
- restricts advertising and promotional activities;
- restricts price or type of input used in the production process;
- is likely to confer significant costs on business; or
- provides advantages to some firms over others by, for example, shielding some activities from pressure of competition, restricting consumer access or by benefiting one consumer group over another.

5.2 Assessment of the Act's impact on competition

Restrictions on entry into or exit from the market

The Act does not impose any explicit barriers to entry into or out of the industry. There are no licensing or registration requirements or specific qualifications required to operate as a finance broker.

Finance brokers are currently subject to a form of negative licensing. The *Consumer Credit Administration Act* enables the Director-General of the Department of Fair Trading to prohibit a person from conducting business as a finance broker. Negative licensing does not present a barrier to entry for legitimate brokers and imposes far lower cost on government than a positive licensing or registration regime. This provision of the Act has not been used to date.

Controls on prices or production levels

There are currently no controls on levels of pricing imposed by the legislation. While the Act, in section 7(2)(a), allows for the making of regulations to prescribe a maximum level of commission, there has been no prescription in place since 1 September 1997.

Restrictions on the quality, level or location of goods or services available

No instances of this type of restriction on competition were identified by the review.

Restrictions on advertising and promotional activities

Section 5 of the Act requires that any advertising by a finance broker include the name and address of the licensee of the business. As finance brokers have not been

[34] National Competition Council, *National Competition Council Legislation Review Compendium*, 1997.

required to be licensed since 1 November 1996, it is considered that this provision has been inoperative since that date.

The Act provides that a finance broker must not induce or attempt to induce a person to enter a credit contract by any false, misleading or deceptive statement or representation or promise or by any dishonest concealment of material facts. This ‘restriction’ is not considered by the Steering Committee to have a negative impact on competition. In fact, the provision could be considered to be pro-competitive in that brokers who use misleading or deceptive advertising are acting in an anti-competitive fashion by depriving their competitors of a level playing field.

Restrictions on price or type of input used in the production process

No instances of this type of restriction on competition were identified by the review.

Conferring of significant costs on business

The Act contains several provisions which could impose direct compliance costs or potential indirect costs on finance broking businesses. Direct costs are incurred as a result of the requirements for written contracts, record keeping and trust accounting. Indirect costs may result from the Act’s restrictions on how commission may be charged.

Record keeping and the preparation of contract documentation are not regarded as imposing any costs that would not arise from good business practice. The requirement to keep fees paid by the client for valuation of security in trust imposes costs in the establishment and maintenance of trust accounts which would not arise except as a requirement of legislation. However, a finance broker could avoid incurring such costs by having their client pay the valuation fee direct to the valuer or by cheque made payable to the valuer. The Steering Committee noted that the Victorian legislation prohibits finance brokers from receiving valuation fees except in the form of a cheque, money order or transfer made payable to the valuer concerned. The Committee suggests that the introduction of a similar provision in New South Wales would remove the need for trust account requirements in the legislation.

The Act prohibits a finance broker from being paid commission before the credit is secured for their client. The postponement of payment may pose an indirect cost to brokers, in that the broker’s time is expended and expenses may be incurred in advance of reimbursement being received. Where the client withdraws from the transaction before credit is secured, the finance broker cannot claim reimbursement for work already done.

Finance brokers are also prohibited from being paid commission where the credit secured is for an amount less than specified, at a rate of interest or charge greater than specified or for a term less than the term specified in the contract. There is a risk to the broker that, if the credit secured differs slightly from specifications in the contract, the broker may technically lose entitlement to commission.

The risk of not being paid for services rendered is considered by the Steering Committee to be a feature of almost any kind of business operation. A broker’s ability to manage their business effectively to minimise such losses is a key element in their competitiveness. There would not appear to be any justification for finance brokers in particular to be shielded from such competitive pressures.

The provisions of the Act which allow for access to redress for consumers and the taking of disciplinary action by the Director-General impose potential costs of defending legal action as well as the cost of any penalties imposed by the court. The maximum penalty imposable upon conviction for an offence under the Act is 50 penalty units, which translates to $5,500 in today's terms. The Steering Committee's view is that the redress and enforcement provisions of the Act enhance competition by providing for action to be taken against dishonest or unethical brokers who might otherwise gain unfair advantage in the marketplace. Penalties only impact on those who seek to evade the Act.

Provides advantages to some firms over others

Section 7(1) of the Act provides that a broker must not demand or receive commission unless the appointment to act is in writing signed by the person to be charged with the payment of commission and contains particulars of the credit to be procured. The intention of the provision appears to have been to ensure that the terms of the agreement between the consumer and the broker are documented. However, as was noted in the discussion under part 4.3 of this report, it is becomingly increasingly common for finance brokers to receive their commission from the credit provider rather than their client. The wording of this provision raises doubts about whether brokers who receive their commission from the lender can be required to prepare a written document of appointment. Given that the preparation of a written agreement is a direct cost imposed by the Act, albeit a small one, brokers who are paid by lenders receive a slight potential cost advantage over their competitors.

Another potential advantage may be provided to firms exempted from the operation of the Act. Section 12 of the Act enables the Governor, by Order published in the Government Gazette, to exempt persons or transactions from any or all of the provisions of the legislation. Implementation of exemptions may result in unequal requirements within the industry where exempted brokers are not subject to the Act's compliance costs.[35]

Submissions

The submissions from both consumer and industry groups generally agreed that the Act does not impose any significant compliance costs or restrictions on finance broking businesses and would not appear to have an impact on the competitiveness of the industry. In the words of one respondent, "there is little in the Act that is not required by good business practice".

Steering Committee's Conclusion: Impact on competition
The Steering Committee concluded that the *Credit (Finance Brokers) Act* has minimal impact on competition.

[35] Only one exemption is currently in place, with respect to National Mutual Assets Management and National Mutual Property Services, only in so far as its business of finance broking involves the provision of credit by the Permanent Trustee Company Limited.

6 COSTS AND BENEFITS OF THE ACT

6.1 NCP review requirements regarding costs and benefits

One of the key aims of this review is to identify and assess any costs imposed by the legislation on business, consumers and the government and to balance these against any public benefits which accrue from the legislation. This section of the Report lists the costs and benefits identified by the Steering Committee and provides, in table 3, an assessment of their impacts.

6.2 Costs arising from the Act

The costs imposed on brokers by the specific provisions of the Act were considered in section 5.2 above. These were identified as the costs of contract preparation, record keeping and trust accounting for valuation fees. Other potential costs may arise as a result of delays in receiving payment or the necessity to defend court or Tribunal proceedings.

6.3 Benefits

Record Keeping Requirements

The record keeping requirements provide a potential benefit to consumers in that evidence of the details of the transaction with the broker can be subpoenaed in the event of a necessity to apply to a court or Tribunal for relief from the payment of commission or the refund of excessive commission. The provision may also benefit government by facilitating the gathering of evidence in support of disciplinary action against a broker.

Requirement for written contract

The linking of the broker’s right to receive commission with the requirement that the contract with their client be in writing potentially benefits consumers by ensuring they are provided with certain information before they can be charged commission. However, this benefit may be somewhat reduced due to the lack of a requirement that the client be given a copy of the contract.

Prohibition on charging of commission before credit is secured or where credit secured does not match the specifications set out in the contract

The Act’s main benefit to consumers arises from the requirement that the terms of the credit to be obtained are set out in the agreement between the broker and their client and the linking of the right to receive commission to securing credit on the specified terms. These provisions protect the consumer from being required to pay a commission where the broker is not successful in negotiating credit or where the client does not wish to proceed with the credit application because the amount offered is insufficient to meet their requirements or is at a cost or term which would make the debt difficult to repay.

Valuation fees

The requirement that money paid for the valuation of security be kept in trust provides some protection for consumers' funds from misappropriation or loss due to the broker's insolvency. The requirement that the balance remaining after payment of the valuer be refunded to the consumer reduces the likelihood of consumers being overcharged for valuation fees. These requirements may also benefit government by reducing the level of complaints.

Penalties

The provisions of the Act which allow for the taking of disciplinary action and the imposition of penalties on finance brokers provide a potential benefit to consumers and the economy by discouraging overcharging, misappropriation of monies and other unfair conduct by brokers.

6.4 Impact of costs and benefits and restrictions on competition

In assessing the effects of the costs and benefits which arise from the legislation, it is necessary to consider the actual or potential impact of each cost or benefit in order to determine whether the benefits to the community as a whole outweigh the costs of any restrictions.

In assessing the benefits of the legislation, the Steering Committee took into account the potential risks to consumers in their dealings with finance brokers, as well as the following matters as required by the Competition Principles Agreement:

- social welfare and equity considerations;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or a class of consumers;
- the competitiveness of Australian business; and
- the efficient allocation of resources.[36]

Table 3 on the following page provides a comparison of the potential impacts of the identified costs and benefits of the *Credit (Finance Brokers) Act*.

[36] Council of Australian Governments 1995, *Competition Principles Agreement*, Clause 1(3). Other factors listed for consideration, where relevant, are matters related to ecologically sustainable development and occupational health and safety, industrial relations and access and equity. The Steering Committee considers that these matters are not relevant to the review of the *Credit (Finance Brokers) Act*.

Table 3 Assessment of costs and benefits of the provisions of the Act.

Benefits					Costs			
Provision	**Objective**[37]	**Beneficiary**	**Description of Benefit**	**Likely impact**	**Nature**	**Incidence**	**Description of cost**	**Likely impact**
Record of transaction to be kept for at least 3 years.	Objective 2	Consumers, community and government	Access to records may reduce contract enforcement costs for consumers by facilitating the hearing of cases by courts or the Tribunal. Quicker resolution frees up court and Tribunal resources for other users and reduces cost to Government. Facilitates gathering of evidence to support disciplinary action.	Low[38]	Direct cost	Finance brokers	Costs of making and keeping records. However, brokers would need to maintain records as a matter of good business practice and in accordance with other legislative requirements.	Low
Agreement to be in writing.	Objective 2	Consumers	Provides a record of agreement between broker and client. Impact lessened by lack of a requirement for client to receive a copy of the contract.	Medium	Direct cost	Finance brokers	Costs of contract preparation. However, preparation of written contracts is a matter of good business practice.	Low
Broker may not demand commission before credit is secured.	Objective 3	Consumers	Protects consumer from loss where the broker is not successful in negotiating credit.	High	Indirect cost	Finance brokers	Time expended and expenses incurred in advance of reimbursement being received. Where the client withdraws from the transaction before credit is secured, the broker cannot claim reimbursement for work already done.	Medium

[37] The Objective column in the table indicates which objective the provision appears intended to meet:

- Objective One – Address information asymmetry.
- Objective Two – Reduce high transaction costs.
- Objective Three – Protect consumers from financial loss.

[38]The Steering Committee assessed this benefit as having low impact because finance brokers are already required by Corporations and Taxation Law to keep records.

Benefits						Costs			
Provision	**Objective** [37]	**Beneficiary**	**Description of Benefit**	**Likely impact**		**Nature**	**Incidence**	**Description of cost**	**Likely impact**
Right to commission dependent on credit meeting specification in contract.	Objective 2	Consumers	Protects consumer from being required to pay a commission where they do not wish to proceed because the amount offered is insufficient to meet their requirements or is at a cost or term which would make the debt difficult to repay.	High		Indirect cost	Finance brokers	Risk to the broker that, if the credit secured differs slightly from specifications in the contract, they may technically lose entitlement to commission. Risk may be minimised or avoided by care taken in drafting terms of contract.	Low
Court may order refund of commission.	Objective 2	Consumers, economy.	Reduces likelihood of overcharging or misappropriation of monies.	High		Indirect cost	Finance Brokers	Potential loss of commission; cost of defending legal proceedings.	Medium
Valuation fees to be held in trust; balance refunded to consumer.	Objectives 2 and 3	Consumers, government.	Protects consumers from loss of money due to fraud or insolvency. Reduces likelihood of overcharging for valuation fees. Reduces level of complaints to government.	Low[39]		Direct cost	Finance brokers	Cost of maintaining trust account. However, cost can be avoided by having client pay fees direct to valuer or by cheque payable to valuer.	Low
No false or misleading representation to induce a person to enter a credit contract.	Objective 1	Consumers, finance brokers, community.	Promotes effective competition by forcing businesses to compete on the fundamentals of price and quality.	Nil[40]		No cost	Not applicable	Not applicable	Nil

[39] Valuation of security is rarely done except for home loans. Property valuations are usually arranged by the lender rather than the finance broker.
[40] This benefit is already provided by the *Fair Trading Act 1987*.

Benefits					Costs			
Provision	**Objective** [37]	**Beneficiary**	**Description of Benefit**	**Likely impact**	**Nature**	**Incidence**	**Description of cost**	**Likely impact**
Relief from liability to pay excessive commission.	Objective 2	Consumers, community, economy.	Reduces likelihood of overcharging. Court/Tribunal decision helps guide community as to appropriate fee levels.	High	Direct and indirect costs	Finance brokers	Cost of defending action. Potential loss of commission.	Medium
Exemption from coverage	Not applicable	Exempted brokers	Reduced costs for exempted brokers.	Low[41]	Anti-competitive.	Consumers, brokers that are not exempt, government & community.	Unequal requirements within industry – brokers not exempted have compliance costs.	Low.[42]

Steering Committee's Conclusion: Assessment of costs and benefits

On balance, the provisions of the *Credit (Finance Brokers) Act* result in net public benefit. The Act imposes few costs or restrictions, while providing several significant benefits to consumers and the economy.

The Steering Committee considers that the benefits of the legislation could be increased significantly by the inclusion of information disclosure requirements which would ensure that consumers are informed of commission charges in advance, of the finance broker's relationship with credit providers and that they receive a copy of the contract with the finance broker. These provisions would increase the legislation's effectiveness in achieving its objectives without imposing additional costs or restrictions, thereby maintaining a net public benefit.

[41] This benefit is considered to be low in that the Act imposes few costs or requirements.
[42] There have been three exemption orders made under this provision of the Act, two of which have since been repealed.

7 REGULATORY OPTIONS

7.1 Introduction

As well as assessing the impact of the *Credit (Finance Brokers) Act* on competition, this review is required to consider alternative options for the regulation of the industry. The review Issues Paper raised for consideration the following options for the future regulation of finance brokers:

- retain the current Act, with some updating and clarification of provisions;
- de-regulation;
- implement minimum core regulation of finance brokers as a division in the consumer credit legislation;
- industry self-regulation or
- mandatory code of practice.

In evaluating these options, the Steering Committee has given consideration to achieving consumer protection objectives without imposing unnecessary costs or restrictions on the industry. The capacity of the regulatory options to address the identified concerns of consumers (raised in part 4.3 of this report) were also taken into account. In addition to removing unnecessary restrictions on competition, any future regulation of the industry must aim to overcome any shortcomings and problems that currently exist.

7.2 Option one - Status quo

This option involves retaining the *Credit (Finance Brokers) Act*, with minor amendments to clarify, update or remove redundant provisions.

Potential costs and benefits

The benefit of this option would be the retention of both the consumer protection benefits currently provided by the Act and its minimal impact on the industry.

However, members of the review Reference Group suggested that the Act imposes costs on the community due to the ineffectiveness of certain provisions and gaps in its protection. The Consumer Credit Legal Centre suggested that costs arise because of the Act's failure to require brokers to disclose in advance the amount of commission the client will be required to pay. While the Act allows for a court or the Tribunal to grant relief from the payment of excessive commission, a disclosure requirement would enable many such disputes to be avoided, thereby relieving consumers, finance brokers and government of the cost of legal proceedings.

It was suggested that the lack of a disclosure requirement with respect to the payment of commission to brokers by credit providers also potentially imposes costs on consumers. Many consumers engage a finance broker in order to find the most cost-effective credit deal for their needs, on the assumption that the broker's role is to act in their best interest. However, a recognised problem in the industry is the potential for less ethical brokers to be influenced by the amount of commission they will be paid by the lender when making their recommendation to the client. Consumers may accept a broker's recommendation on this basis, with the result that they do not choose the most competitively priced credit product available to them.

The effect of such costs on the economy in general also needs to be considered. The economic philosophy underlying competition policy is that competitive markets for goods and services will efficiently allocate the economy's resources based on consumer preferences. Consumers are considered to influence the supply of goods and services through making optimal purchasing choices. Where consumers unknowingly choose to purchase overpriced or inferior goods and services, the competitiveness and efficiency of the economy may be affected.

Submissions

This option was not generally supported by the submissions made to the review. Industry groups argued that the Act is redundant, in that most of its provisions are out of date or are duplicated in other legislation. Several submissions suggested that consumers are adequately protected by general fair trading and consumer credit legislation.

Consumer groups also did not support retention of the Act in its current form, suggesting that it is inadequate in providing for consumer protection. If the Act were to be retained, these groups suggested that it would require significant amendment to increase its benefits to consumers. The Steering Committee notes that these benefits would need to be weighed against any additional costs or restrictions imposed by the amendments.

7.3 Option two - Deregulation

This option involves removing the current Act and placing reliance on common law and general fair trading and consumer credit laws. The Issues Paper suggested that this option could be supported on the basis that the Act's provisions are largely duplicated in fair trading and consumer credit legislation. The Issues Paper included a table setting out the provisions of the Act and equivalent or similar provisions in other legislation. This table is duplicated in Appendix III of this report.

Potential costs of deregulation include:

- increase in complaints to government;
- higher search, contract negotiation and contract enforcement costs for consumers;
- increase in applications to Fair Trading Tribunal to resolve disputes between consumers and brokers.

Potential benefits of deregulation include:

- industry standards which are more flexible and responsive than legislated standards;
- possible reduced costs to finance brokers.

Submissions

Submissions from industry groups largely supported this option, on the basis that the rights, remedies and enforcement tools contained in the *Credit (Finance Brokers) Act* exist in other laws. On the other hand, consumer groups argued that there is a continued need for specific regulation of finance brokers, for example, in order to maintain the prohibition on up-front commissions and provide for consumer redress with respect to excessive commissions.

7.4 Option three - Regulate finance brokers under consumer credit legislation

Those objectives of the *Credit (Finance Brokers) Act* which are deemed as justifying continued legislative intervention could be addressed in updated provisions included as a separate finance broker division in the consumer credit administration legislation. Similar approaches were recently implemented in Victoria and the Australian Capital Territory following NCP reviews of former stand-alone finance broker legislation.[43]

In New South Wales, the *Consumer Credit Administration Act* currently applies to both credit providers and finance brokers and includes disciplinary provisions. If this option is implemented, this Act is a possible location for provisions for the regulation of finance brokers.

Potential costs:

- government administration costs;
- depending on the provisions adopted, possible compliance costs or restrictions on finance broking businesses;
- the *Consumer Credit Administration Act* does not provide consumers with access to redress.

Potential benefits:

- would enable the removal of a number of duplicated provisions in the current legislation;
- continued consumer protection benefits.

Submissions

Industry submissions in general did not support any of the options involving government intervention in the regulation of finance brokers. Consumer groups on the whole supported this option, with some conditions. The Consumer Credit Legal Centre’s support depended on the inclusion of new provisions covering disclosure, consumer access to redress and the introduction of a cooling off period. A cooling off period was suggested on the basis that it would discourage high pressure selling and give the consumer time to reflect on the terms and conditions of the finance broking agreement.

[43] Further detail can be found in part 3.4 of this Report.

The Steering Committee supports the inclusion of a requirement that brokers disclose in advance the amount of commission that the client will be required to pay, as this is seen as a cost-effective means of reducing the level of disputes about commissions. In this context the Steering Committee notes that mandatory disclosure regimes are among the least restrictive means of regulating occupations[44] and can in fact enhance competition by enabling consumers to more effectively compare prices before entering into a contract with a broker. Disclosure requirements are also considered appropriate where the risk of harm is to an individual's finances (as opposed to their health) and where they have a choice about using a particular service or not.[45]

However, the Steering Committee does not support the introduction of a cooling off period. The provision of the current Act which prohibits the charging of commission before the credit is secured means that consumers are able to terminate their contract with a finance broker at any time prior to the credit being secured without being required to pay commission, thus avoiding the need for a cooling off period. The Committee supports the retention of this or a similar provision in any future regulation of finance brokers as it provides an important consumer protection without imposing significant costs on the industry.

The Eurobodalla Financial Counselling Service supported the implementation of option three, noting that it could assist in making consumer rights with respect to finance brokers more visible. The Wesley Community Legal Centre however did not support this option, on the basis that finance brokers' roles are quite different to those of credit providers and should be regulated separately. This organisation also noted that the *Consumer Credit Administration Act* does not provide for consumer access to redress. Action for breach of its provisions, for example in relation to unjust conduct, can only be taken by the Director-General of the Department of Fair Trading. If this option were to be implemented, the inclusion of consumer redress provisions in the legislation would also be necessary.

7.5 Option four - Industry self-regulation

Under this option, the performance and conduct of finance brokers would be determined by market forces and the effectiveness of industry bodies and voluntary codes of practice implemented by them. General consumer rights and access to redress would be determined by common law, the *Crimes Act* and general fair trading and consumer credit legislation.

The Steering Committee noted that the success of voluntary codes depends on the existence of a strong industry body which represents most of the industry and which can implement complaint handling and dispute resolution provisions and enforce the code's standards against industry members. This situation does not presently exist in the finance broking industry.

[44] For example, compared to registration or licensing regimes.
[45] New Zealand Ministry of Economic Development June 1999, *Policy Framework for Occupational Regulation: A Guide for Government Agencies Involved in Regulating Occupations*, http://www.med.govt.nz/buslt/bus_pol/policyframework/

Potential benefits of this option include:

- removal of costs imposed by legislation;
- codes can potentially provide for best practice benchmarks which exceed minimum legal obligations as required under fair trading and trade practices law and can thus provide participants with a competitive, commercial advantage over others in the industry.[46]

Potential costs include:

- association membership fees payable by finance brokers;
- increase in complaints to government and applications to Tribunal if codes are not effectively enforced by industry associations.

Submissions

This option was unanimously rejected by consumer groups as well as by most industry associations. Industry submissions noted that there is little value in developing a code since general consumer legislation adequately covers the ground, and that brokers are already informally accredited by the financiers with whom they do business.

7.6 Option five - Mandatory code of practice

The *Fair Trading Act* provides regulatory power to prescribe mandatory codes of practice in industries where government intervention to address problems is warranted. Mandatory codes prescribed under the *Fair Trading Act* outline minimum standards of legal behaviour in respect of industry or sector-specific practices of direct concern to consumers. They interpret relevant general fair trading law by clarifying rights, obligations and expectations of the specific consumer-trader relationship to create greater certainty.

Mandatory codes of practice are prescribed as a regulation, and therefore have the status of law, however they are considered to offer a greater degree of flexibility than other forms of legislation. However, mandatory codes can restrict competition in the same ways that legislation may, for example, by imposing compliance costs or restricting business innovation. There are also substantial doubts that codes are the appropriate regulatory method where governments require mandatory compliance with a set of rules. A judgement by the NSW Court of Appeal in relation to the former *Retirement Village Code of Practice* has raised doubts about the effectiveness of prescribed codes of practice as regulatory mechanisms, due mainly to difficulties in enforcement.[47]

[46] Commonwealth Government, June 1998, *Fair Trading Codes of Conduct*: *Why have them, how to prepare them.*
[47] NSW Court of Appeal, *Murphy & 112 Ors v Overton Investments Pty Limited & Anor,* Matter No. CA 40045/98. The Court's decision confirmed the predominance of contractual rights over the Code of Practice, ruling that the Code did not override specific contractual obligations with which it conflicted.

Potential benefits of a mandatory code of practice

- may offer more flexibility than legislation;
- can provide clarification of application of consumer protection laws to finance broking.

Potential costs of a mandatory code of practice

- compliance costs for finance brokers;
- government administration costs;
- possible enforcement difficulties.

Submissions

There was not a high level of support for this option in the submissions. Industry associations maintained, as in their responses to the other options raised, that specific regulation of finance brokers is not justified in any form. Consumer groups generally supported increased regulation of brokers, whether in the form of a mandatory code or other form of law.

7.7 Other issues of concern raised in submissions

Cap on commissions

The Consumer Credit Legal Centre suggested that, in addition to the inclusion in the legislation of disclosure requirements, the former limit on the amount of commission chargeable by a finance broker should be re-introduced. The submission argued that a limit on commission is necessary in addition to disclosure requirements, because consumers who need finance desperately may be unable to walk away even where the disclosed amount of commission is excessive.

The Act currently allows for the making of regulations with respect to the charging of commission. Until its repeal on 1 September 1997, the *Credit (Finance Brokers) Regulation 1984* limited the amount of commission chargeable to 2% of the amount of the credit negotiated up to $5,000, plus, where the amount of credit negotiated exceeded $5000, 1.5% of the amount over $5000 or $6.50, whichever was the greater.

The potential benefits of this proposal to a small number of consumers need to be considered against the restrictions it would impose on the industry and consumers generally. For example, it is possible that the maximum fee would become a standard fee for the industry, thus denying consumers the benefit of vigorous competition on pricing. Rather than being able to determine an appropriate charge based on the complexity of the client’s requirements, brokers would be limited to charging the set maximum regardless of the amount of work involved. In order to maintain business profitability, brokers may find it necessary to charge the maximum fee in other cases which may involve less work.

The Steering Committee concluded that there is insufficient justification for the imposition of a maximum level of commission. The Committee’s view is that a requirement to disclose the amount of commission in advance, coupled with the availability of redress through the Fair Trading Tribunal, would provide for consumer protection in a less restrictive manner than by providing a statutory limit on commission.

In addition, section 18 of the *Consumer Credit Administration Act* enables the Director-General of Fair Trading, when taking disciplinary action against a finance broker for unjust conduct, to order a finance broker to rectify the consequences of unjust conduct. Such rectification could include orders for the refund of excessive commission.

Extend protection to cover small business consumers

Several submissions to the review made by consumer groups suggested that small businesses tend to experience the same difficulties in dealing with credit as do consumers of credit for personal and domestic purposes, and that the protection of the Act should be extended to small business consumers. The issue of small business coverage was considered by the Post Implementation Review of the Consumer Credit Code. The review findings did not support the extension of the Code to small business.[48]

The Steering Committee does not support extending the coverage of the *Credit (Finance Brokers) Act* to small business in isolation from the credit regulation regime in general. The Steering Committee also noted that the provisions of the *Fair Trading Act* which prohibit misleading or deceptive conduct and false representations protect small business consumers, as do the unconscionable conduct provisions of the *Trade Practices Act*.

Re-introduction of licensing

Support for a licensing regime was expressed by several individual brokers, on the basis that it would increase professionalism in the industry and give a competitive advantage to reputable brokers over the 'cowboys' in the industry who would be less likely to apply for a licence. The Consumer Credit Legal Centre also noted that it would support the re-introduction of licensing.

Finance brokers are currently subject to a form of negative licensing regime. The *Consumer Credit Administration Act* enables the Director-General of the Department of Fair Trading to prohibit a person from conducting business as a finance broker. Negative licensing does not present a barrier to entry for legitimate brokers and imposes far lower costs on government than a positive licensing or registration regime.

There would appear to be no benefits of a licensing regime for brokers which could be balanced against these costs. No educational qualifications are required to operate as a finance broker and there is minimal risk of significant or irreversible harm arising from finance broking activities. The only benefit to consumers of licensing may be a reduction in search costs when selecting a finance broker, however without educational requirements or other ongoing fitness checks, the possession of a licence does not provide a guarantee of quality service.

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[48] Ministerial Council on Consumer Affairs June 1999, Report of the *Uniform Consumer Credit Code Post Implementation Review*, pages 59-60.

8 CONCLUSIONS AND RECOMMENDATIONS

8.1 Conclusions

Part 1 of this report noted that this Review of the *Credit (Finance Brokers) Act* was conducted in order to:

- clarify the objectives of the legislation;
- identify any restrictions on competition;
- consider whether any costs imposed by the legislation are outweighed by its benefits to the community as a whole; and
- determine whether the objectives of the legislation can be achieved by less restrictive means.

The Review found that the Act has little, if any, impact on the competitiveness of the finance broking industry. The Act does not impose any significant compliance costs on businesses nor does it establish barriers to entry into the industry. On the other hand, the Act provides important benefits in terms of consumer protection from the more blatant abuses practised by some finance brokers, including up-front commissions and unconscionable levels of commission, without imposing any significant restrictions or costs on the industry. The provisions of the Act were therefore assessed as providing a net public benefit.

The review also considered the Act's effectiveness in achieving its implied objectives, which were identified as:

- addressing information asymmetry between finance brokers and consumers;
- reducing high transaction costs for consumers in negotiating and enforcing contracts with finance brokers; and
- protecting consumers from loss of monies paid to finance brokers.

The Steering Committee's examination of these objectives in light of problems experienced by consumers in the current marketplace indicated that the objectives remain relevant and that there is sufficient justification for the maintenance of some regulatory intervention in the consumer credit finance broking industry.

The Steering Committee therefore recommends that any proposed regulation of finance brokers retain (with any appropriate amendments) the provisions which currently provide for:

- the keeping of records by brokers;
- the prohibition on receiving commission in advance of procuring the credit;
- the requirement that the agreement between the broker and consumer be in writing, with amendments to clarify that this requirement applies regardless of whether commission is payable by the client or by the credit provider, and to ensure the client receives a copy;
- the right to receive commission being dependent on negotiating an amount of credit not less than the amount specified in the agreement and on terms at least as favourable as those set out in the agreement; and
- consumer access to courts or the Tribunal for relief from the payment of excessive commission.

The Steering Committee also noted problems, reported by the submissions to the review, which are not effectively addressed by the current Act, for example:

- failure by brokers to inform consumers of the amount of commission they will be charged;
- brokers being influenced in their recommendations to clients by the amounts of commission payable by credit providers; and
- negotiation of loans for amounts significantly greater than the consumer requested, or could afford to repay.

The Steering Committee believes that these problems could be addressed and the effectiveness of the legislation in achieving its consumer protection objectives significantly increased without imposing further costs or restrictions on competition by implementing provisions which:

- require disclosure of the amount, or method of calculating the amount, of commission and require that this information also be included in the written contract;
- require disclosure, where relevant, of the fact that financial or other benefit is to be received by the broker from the credit provider or that recommendations will be drawn from a restricted range of potential lenders;
- provide for consumer access to the Tribunal for redress in relation to unjust conduct and commissions charged in breach of the terms of the contract or of the legislation.

The review was also required to consider alternative means, both regulatory and non-regulatory, for achieving the Government's objectives with respect to the regulation of finance brokers. The Steering Committee considers that the potential for consumer detriment as a result of dealing with finance brokers and the absence of a strong industry self-regulatory body which could satisfactorily enforce a voluntary code of practice provides justification for legislative intervention in the industry. The shortcomings of the current Act and concerns about the effectiveness of mandatory codes of practice led the Committee to reject these as options for the future regulation of finance brokers.

Costs and benefits of preferred option

The Steering Committee's recommended option is to repeal the *Credit (Finance Brokers) Act* and include provisions to regulate finance brokers in a new Part in the *Consumer Credit Administration Act 1995*, which already provides for the discipline of finance brokers for unjust conduct. The following table sets out the provisions of the proposed legislation and the Steering Committee's assessment of net cost benefit that would be provided:

Provision	Benefit	Cost	Assessment
Continue to require records to be kept for 3 years.	Low	Low	Brokers are required by other laws to retain records. The provision benefits government by facilitating disciplinary action by against brokers. (See also Table 3 on page 26).

Provision	Benefit	Cost	Assessment
Amend requirement that agreement be in writing to ensure it applies regardless of who is paying the commission, and introduce requirement that copy be given to consumer.	High	Low	Benefits consumers by ensuring they are aware of terms of agreement and have a record of it. The requirement to provide a copy to the consumer increases benefit without increasing cost to broker (cost of copying contract is negligible). (See also Table 3 on page 26).
Continue the prohibition on brokers receiving commission before the credit is secured.	High	Medium	Protects consumer from loss of monies where broker is not successful in negotiating credit. Imposes acceptable level of indirect costs to brokers (see part 5.2 and Table 3).
Introduce requirement for pre-contractual disclosure of commission payable by client & of any benefit the broker will receive from the credit provider.	High	Low	Disclosure requirements do not impose compliance costs on brokers. They enhance competition by enabling consumers to compare the costs and services of brokers and enter into appropriate arrangements with brokers. Advance disclosure of broker commission would be expected to reduce the level of complaints to government about excessive commission. Disclosure of broker's relationship with lenders would increase the likelihood of consumers entering into competitively priced credit products, thus saving consumer transaction costs and supporting a competitive credit industry.
Retain link between right to commission & negotiation of credit on terms as specified.	High	Low	Consumer protected from being required to pay commission where they do not wish to proceed because the amount offered is insufficient to meet their needs or terms of loan are unaffordable. (See also Table 3).
Provide for consumer access to Tribunal for redress where broker breaches terms of agreement or engages in unjust conduct or charges excessive or unconscionable commission.	High	Low to medium	Reduced likelihood of overcharging or engaging in unjust conduct. Consumer protected from being required to pay commission where they do not wish to proceed because loan arranged is for amount greater than needed. Reduced level of complaints to government. Costs to brokers of defending actions.

8.2 Recommendations

In accordance with the conclusions drawn above, the Steering Committee recommends that:

1. the *Credit (Finance Brokers) Act 1984* be repealed; and
2. the *Consumer Credit Administration Act 1995* be amended to include a new Part relating to the conduct of finance brokers, containing the following provisions:
   - a specific statement of the objectives of the regulation of finance brokers;
   - an amended definition of *finance broking* and other definitions required to clarify the intent of the legislation, e.g. *client* and *commission*;
   - up-front disclosure of the amount of (or method of calculating) commission payable by the client and information about when and how commission will be payable;
   - up-front disclosure, where relevant, of the fact that financial or other benefit is to be received by the broker from the credit provider or that recommendations will be drawn from a limited range of potential lenders;
   - a requirement that the contract between the broker and their client be in writing regardless of who is paying commission, set out the terms of the credit to be negotiated and details of commission payable by the client, be signed by the client and that a copy be given to the client before negotiation of the credit is commenced;
   - a requirement that brokers make and keep records of transactions, including copies of contracts with clients, for at least three years;
   - a prohibition on receiving commission in advance of securing the credit;
   - a link between the broker's right to commission and the credit meeting the specifications set out in the contract, enabling the consumer to reject the offer where the amount of credit is significantly greater or lower than the amount sought or is on less favourable terms, without being liable to pay commission; and; and
   - consumer access to redress with respect to unconscionable or excessive commission charges or unjust conduct or for breach of contract by the broker.

APPENDICES

APPENDIX I SUBMISSIONS MADE TO THE REVIEW

Thirteen submissions were made to the review steering committee during the public consultation period, from the following persons and organisations:

1. Advance Investment Securities Australia Pty Ltd
2. Australian Finance Conference
3. Australian Lease Brokers Association Inc.
4. Consumer Credit Legal Centre
5. Denis Kenna & Associates Pty Ltd
6. Eurobodalla Financial Counselling Service
7. Finance Brokers Association of Australia
8. Financial Counsellors' Association of NSW
9. Finance Select Macarthur – Mr Steven McClure (Partner)
10. Mortgage Choice
11. Motor Traders' Association of NSW
12. Mr John Rowe
13. Wesley Community Legal Service
14. Wizard Financial Services

APPENDIX II TERMS OF REFERENCE FOR THE REVIEW

1. The review of the *Credit (Finance Brokers) Act* 1984 shall be conducted in accordance with the principles for legislation reviews set out in the Competition Principles Agreement. The guiding principle of the review is that legislation should not restrict competition unless it can be demonstrated that:

    a) the benefits of the restriction to the community as a whole outweigh the costs; and
    b) the objectives of the legislation can only be achieved by restricting competition.

2. Without limiting the scope of the review, the review is to:

    a) clarify the objectives of the legislation, and their continuing appropriateness;
    b) identify the nature of the restrictive effects on competition;
    c) analyse the likely effect of any identified restriction on competition on the economy generally;
    d) assess and balance the costs and benefits of the restrictions identified; and
    e) consider alternative means for achieving the same result, including non-legislative approaches.

3. When considering the matters in (2), the review shall also:

    a) identify any issues of market failure which need to be, or are being, addressed by the legislation; and
    b) consider whether the effects of the legislation contravene the competitive conduct rules in Part IV of the *Trade Practices Act* 1974 (Cth) and the NSW Competition Code.

4. The review shall consider and take account of relevant regulatory schemes in other Australian jurisdictions, and any recent reforms or reform proposals, including those relating to competition policy in those jurisdictions.

5. The review will consider the general effectiveness of the legislation and examine issues of concern to consumers and industry.

6. The review will consult with and take submissions from consumer groups, business organisations, government agencies and other interested parties.

APPENDIX III EQUIVALENT PROVISIONS IN OTHER LEGISLATION

Key to abbreviations used in table

CCAA = Consumer Credit Administration Act 1995 (NSW)
CCC = Consumer Credit Code
FTA = Fair Trading Act 1987 (NSW)
TPA = Trade Practices Act 1974 (Cth)
CRA = Contracts Review Act 1980 (NSW)
CCA = Consumer Claims Act 1998 (NSW)

Comparison of provisions of the Credit (Finance Brokers) Act and equivalent provisions in other legislation

Credit (Finance Brokers) Act 1984	**Equivalent or similar provisions elsewhere**
The Act applies to a finance broker in respect of consumer credit and housing loans – section 4(2)	CCAA applies to finance brokers and all consumer credit contracts – section 4
S.5 prohibits advertising without specifying licence name and address ***Inoperative since repeal of licensing***	S.42 FTA (s.52 TPA) prohibits misleading and deceptive conduct. The *Business Names Act* 1962 requires registration if a finance broker is operating under a name other than their own – publications must include the business name, which consumers can use to check the name, address and other details of the trader in the register maintained by the Department of Fair Trading. Other State and Commonwealth laws require the registration of partnerships and corporations.
S.6 requires records of finance broking transactions to be kept for 3 years.	S.6 CCAA empowers the Director-General to require production of documents/information. Taxation and Corporation laws also provide for record keeping.
S.7 generally prohibits taking commission if contract is not in writing with all particulars, if the credit is not secured or if the credit obtained does not meet the terms of the contract.	S.12 CCAA allows a person to complain to the Director-General about unjust conduct, which includes “unfair”, “dishonest” and “fraudulent” conduct, or conduct in breach of the contract; S.19 CCAA provides for a prohibition order to prevent a person from trading as a finance broker – commission is not payable if a finance broker acts in contravention of such an order; S.53 FTA (s.58 TPA) prohibits taking money without intention or ability to supply service.

Credit (Finance Brokers) Act 1984	**Equivalent or similar provisions elsewhere**
S.7(2) specifically prohibits taking commission of an amount not authorised by the regulation ***Inoperative since repeal of Regulation***	No equivalent Level of commission has been left to marketplace since 1 September 1997; CCAA unjust conduct provisions.
S.7(3) prescribes maximum interest rate of 8% on court ordered refunds ***Inoperative since repeal of regulation***	Court may apply appropriate rate [e.g., as prescribed under s.39A *Local Court (Civil Claims) Act* 1970]
S.8 allows the taking of fees for valuation of any security offered for the credit; fees must be kept in trust and any balance repaid to the client	No equivalent Unjust conduct provisions of CCAA would be applicable.
S.9 makes it an offence to induce entry to a contract by false or misleading statement or representation. S.10 provides a defence of ignorance.	S.144 CCC prohibits inducing entry to contract by false representation; S.140 CCC governs credit advertising; S.42 FTA (s.52 TPA) prohibits misleading/deceptive conduct; S.44 FTA (s.53 TPA) prohibits false representations.
S.11 enables a court or the Fair Trading Tribunal to re-open a transaction if commission appears excessive, and make orders for relief from payment or for refund.	S.18 CCAA Director-General may order rectification of consequences of unjust conduct. S.7 CRA Court order for relief in respect of unjust contract. S.6 CCA enables consumer to apply to Fair Trading Tribunal for determination of a consumer claim, including refund of money, relief from payment, supply or replacement of goods or services.
S.15 provides 3 year limit for bringing action.	S.44 CCAA also provides for 3 year limit.
S.16 Body corporate offence is also an offence by officers.	S.41 CCAA Corporation offence taken to be an offence by persons involved.
S.17 offence proceedings may be taken by any person with authority of Minister or prescribed officer.	S.42 CCAA proceedings with authority of Minister.
S.18 disposal of proceedings by Local Court – Magistrate sitting alone.	S.43 CCAA – Local Court, Magistrate sitting alone.