

Australian Securitisation
Forum Response to
consultation paper: *An
Australian Consumer Law*

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Australian Securitisation Forum

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1 Introduction

This submission is made by the Australian Securitisation Forum (“ASF”). The ASF was formed in 1989 to promote the development of securitisation in Australia. As the peak industry body representing the securitisation market, the ASF performs a pivotal role in the education of government, regulators, the public, investors and others who have an interest or potential interest both in Australia and overseas, regarding the benefits of securitisation in Australia and aspects of the securitisation industry.

The ASF welcomes the opportunity to respond to the proposals for reforms to Australian consumer regulation as outlined in the recent consultation paper “*An Australian Consumer Law: Fair Markets - Confident Consumers*” (“**Consultation Paper**”) released for comment by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP on 17 February 2009.

Due to the short period of time in which the ASF has had to prepare submissions, this response proposes to deal only with the aspects of the Consultation Paper relating to unfair contract terms, and the impact of the proposed unfair terms regime on the securitisation industry. The ASF may wish to provide further specific comments following further industry consultation.

Typically, a securitisation transaction involves the issue of rated debt securities by a special purpose entity (“SPV”), the proceeds of which are used to acquire (or lend against the security of) a pool of financial assets from the seller/originator of those assets. **The rated debt securities rely most significantly on the enforceability of the underlying contracts acquired by the SPV (rather than the creditworthiness of the seller/originator).** The sellers/originators are in the business of providing finance in various forms to fund a large range of assets including residential mortgage loans, trade receivables, infrastructure projects, small/medium enterprise loans, equipment receivables, auto receivables, rural loans and commercial mortgages. The Australian securitisation market has provided these organisations with efficient and cost effective access to the wholesale capital markets, and the benefits of this funding (in the form of a lower cost of funds) has been passed on to business (small and large) and retail customers.

The ASF’s concern is that any regulatory change which increases the enforceability risk associated with the underlying contracts will reduce ability and willingness of the financial markets to provide funding to an SPV (whether on a temporary or permanent basis) and therefore lessen the supply of credit and liquidity to the real economy.

The ASF believes that some of the proposed reforms will have that effect and provides comments for their review in this submission.

2 Summary of ASF submissions

The ASF’s key submissions in relation to the Consultation Paper are set out below.

- The ASF understands the need for the Government to consider carefully (and, where necessary, reform) the laws that protect the community. However, the ASF believes that a number of the proposed reforms contained in the new national unfair terms regime affect the legal certainty of a number of key provisions of a loan contract. Accordingly, when considered in light of existing protections, the ASF submits that either their application should be excluded from certain types of clauses or transactions, or that those reforms are not necessary to protect consumers from unfair terms.

As stated above, certainty of enforceability of the underlying contract is critical to the securitisation of those contracts. Investors in a securitisation programme need to be comfortable that the underlying contracts are enforceable. The ASF believes that some of the proposals undermine that principle in material respects and therefore undermine the ability of the securitisation markets to provide liquidity and credit to the economy. The ASF submits that, on this basis, the proposed regime should exclude certain types of transactions from its application.

- In particular the ASF submits that:
 - the new unfair terms regime should not apply to contracts between business entities;
 - access to remedies should be restricted to retail consumers who are able to show detriment that is material or substantial;
 - a term that reflects a right or obligation under an industry code or legislation, and any term that reflects common law principles, should not be subject to challenge as an unfair term;
 - no terms should be prescribed as being unfair in all instances; and
 - any guidance provided on terms that may be unfair should consider the use of the term in different industries and the impact or prohibiting the use of that term on each of those industries.

3 Unfair terms

3.1 Existing legislation provides adequate protection to consumers from unfair terms

The ASF submits that a new national unfair terms regime is not necessary as part of national consumer protection legislation.

Standard form contracts are an essential instrument for many lenders because they allow them to provide their products to a broad base of customers in a fair, efficient and cost effective manner. Although these contracts do not provide scope for the negotiation and contracting process that is contemplated by traditional principles of contract law, the acceptance or otherwise of the terms in a standard form contract remains entirely the choice of the consumer.

The ASF is not aware of any particular issues or areas of substantial concern in relation to these consumer contracts that would warrant the imposition of a dedicated unfair terms regime, particularly considering the substantial costs of both implementation and compliance that would be involved in introducing such a regime (which would ultimately be passed on to the consumer).

Further, the ASF considers that there are substantial and effective mechanisms already in place to protect consumers from unfair terms in financial services contracts and that a dedicated regime such as the one proposed will add an unnecessary additional layer of complexity to the law regarding standard form consumer contracts.

In particular, the ASF submits that the unconscionability provisions in Part 2, Division 2, Subdivision C of the *Australian Securities and Investments Commission Act 2001* (Cth) (“ASIC Act”) provide adequate protection to consumers from unfair terms in financial services contracts.

Case law has indicated that the definition of what constitutes ‘unconscionable’ conduct is not closed, whilst cases on these particular provisions suggest that unconscionability can be found not only in circumstances where traditional equitable doctrines would be mobilised,¹ but also that the legislation ought not to be constrained by established legal principles, and should instead be interpreted according to their ordinary, dictionary meaning.² As noted in the foreword to the Australian Competition and Consumer Commission’s (“ACCC”) own guidelines into the equivalent Trade Practices Act provisions, the concept of unconscionability is not ‘static’, and it continues to ‘be refined as it is interpreted by the courts’³ in a variety of different commercial situations.

Given the fluidity of these provisions in the ASIC Act (and also the protection provided to consumers under the Code of Banking Practice, Uniform Consumer Credit Code (“UCCC”), Contracts Review Act (NSW) and various Fair Trading Acts) we question whether, without further analysis, there is currently sufficient justification to warrant the introduction of an entirely new unfair terms regime.

The ASF also notes that in the context of the Australian securitisation industry, many of the loans that are securitised are highly regulated by legislation that:

- (a) sets requirements for pre-contractual disclosure;
- (b) prescribes the form and context of the loan contract; and
- (c) gives borrowers the right to challenge unconscionable or unjust contractual terms (for example, in relation to a loan regulated by the UCCC a borrower could, under section 70, ask the court to set aside or to vary the loan contract on the basis that the contract is unjust).

¹ See for example *ACCC v Samton Holdings Pty Ltd* (2002) 117 FCR 301

² *ACCC v CG Berbatis Holdings Pty Ltd* [2000] FCA 1376

³ Foreword by J Martin in *Guide to unconscionable conduct* (ACCC, May 2008) p. iii
<http://www.accc.gov.au/content/item.php?itemId=596950&nodeId=9b16c76ec50e148f4adb13fe79c21e7e&fn=Guide%20to%20unconscionable%20conduct.pdf>

3.2 The new unfair terms regime should not apply to contracts between business entities

The Consultation Paper provides that the unfair terms provisions “would not be confined to individual consumers”⁴, but would extend to any business that entered into a standard form contract. The ASF submits it is not appropriate to extend provisions in a consumer protection law to all businesses regardless of their size.

We refer again to Part 2, Division 2, Subdivision C of the ASIC Act which already legislates against unconscionable conduct by a person in trade or commerce. Smaller businesses are specifically addressed, for instance, in Section 12CB(2) of the ASIC Act which prescribes that the Court may have regard to “the relative strengths of the bargaining positions of the supplier and the consumer” (see sub-paragraph (a)) and “whether the consumer was able to understand any documents relating to the supply or possible supply of the services” (see sub-paragraph (c)).

Therefore, the ASF submits there is an existing legislative framework which specifically contemplates protection for small businesses. Further, the ASF is unable to understand the legislative basis for further protection in the case of large businesses that are able to “fend for themselves”.

3.3 Access to remedies should be restricted to consumers who are able to show detriment that is material or substantial

The new unfair terms model described in the Consultation Paper provides that a remedy will be available to a claimant who is able to demonstrate as a consequence of a term that:

- (a) some detriment has occurred (individually or as a class); or
- (b) there is a substantial likelihood of detriment.

In our view, the requirement to merely show detriment (or a substantial likelihood of detriment), without further qualification, constitutes an ambiguous and unreasonably low threshold for a claimant to meet in order to be eligible for a remedy.

The ASF submits that this threshold should be raised so that a claimant will only be eligible for a remedy if they are able to demonstrate at least a material (and not negligible) detriment arising, or likely to arise, as a result of a term in the standard form contract.⁵

Alternatively, this type of remedy should only be available if the relevant detriment is not commensurate with, or is out of proportion to, the loss, expense or detriment of the person who is seeking to rely on that term.

3.4 Certain terms should not be able to be challenged as unfair

The ASF submits that the following terms should not be capable of being challenged as unfair:

- (a) a term that reflects a right or obligation under legislation or an industry code

⁴ at page 32

⁵ Such a requirement accords with recommendation 7.1 of the Productivity Commission’s report: *Review of Australia’s Consumer Policy Framework* (April 2008) at p.69

For example, the Consultation Paper provides that a clause that permits the supplier to unilaterally vary the terms of the contract may be unfair. However, the UCCC contemplates that a lender may make changes to a contract unilaterally and sets out the process for doing so (see Division 1, Part 4 of the UCCC). The ASF submits that if a term reflects a lender's rights under the UCCC to exercise a unilateral power of variation in a certain way then that term should not be capable of being unfair.

See more on this at paragraph 3.6(a) below.

- (b) a term that merely imports a common law principle

While the new unfair terms regime will not exclude the operation of common law principles in relation to a contract, a contractual provision could be considered unfair even though it does no more than explicitly apply an existing rule of common law.

For example, if a contract explicitly states that a lender has the right to assign a borrower's debt, then based on the ASF's understanding of the proposed new regime, this term could be unfair to the extent that it causes, or potentially causes, detriment to the borrowing customer. This would be the case even though the lender has the right to assign the debt at common law. For a securitisation transaction to be effective, it is essential that there be no doubt about the effectiveness of an assignment of the underlying contract from the seller/originator to the SPV. The SPV cannot take a risk of the sale of assets being re-characterised as a loan where the SPV ranks as a secured or unsecured creditor against the seller to get paid back the purchase price paid for the assets. This may be the outcome if it was held by a court that an assignment of the debt under a provision which expressly permitted assignment was deemed to be unfair and therefore not enforceable. At the very least, such a provision should not be open to question once a contract has been assigned (provided the original contract did not prohibit assignment without the counterparty's consent).

3.5 No terms should be prescribed as being unfair in all instances

The ASF does not support any proposal to enact legislation prohibiting the use of terms in a contract in every circumstance. Given the myriad of different industries and different products/services currently covered by standard form contracts, it is highly likely that a "one size fits all" approach would have unintended consequences for certain suppliers and consumers.

We do not believe that an accurate assessment about whether or not a term in a standard form contract is "unfair" can ever be made without proper regard to the particular facts and circumstances surrounding each contract. Those circumstances would include (without limitation) factors such as:

- (a) the specific benefits available to both the consumer and the supplier as a consequence of including a particular term;
- (b) the entirety of the relationship between the consumer and the supplier (which may extend beyond one standard form contract);
- (c) the context in which the consumer was made aware of the inclusion of an impugned term in the contract;

- (d) the presence of any particular benefit in the contract in favour of the consumer which counterbalances, or otherwise accounts for, the imbalance caused by the allegedly unfair term; and
- (e) the nature of the industry in question, and the availability or utility of alternative terms.

We further note that the Victorian Government, in introducing its unfair terms regime, did not legislate that any particular term would be void in all consumer contracts on account of being inherently "unfair" in every circumstance. Although Part 2B of the *Fair Trading Act 1999* (Vic) provides a mechanism for a term to be prescribed by regulation as unfair in all circumstances, our understanding is that no such terms have been prescribed since the legislation was introduced.

3.6 In providing examples of unfair terms the impact on various industries should be considered

Any guidance provided on terms that may be unfair should consider the use of the term in different industries and the impact of prohibiting the use of that term in those industries.

In the context of the securitisation industry, many of the examples provided in the Consultation Paper and described as "unfair" terms are industry practice for contracts that are securitised and accordingly a blanket prohibition on the use of those terms may have an adverse impact on the securitisation industry. The key reasons for the use of the terms in question in standard form contracts used in the securitisation industry is the high degree of legal certainty required in a contract so that it can be securitised in the most efficient way. For example:

- (a) clauses that permit the supplier to unilaterally vary the terms of the contract

Securitised loan contracts often allow the supplier to unilaterally vary certain terms relating to the price of the loan product (for example, the interest rate and/or certain fees). Such a right may, of course, be subject to conditions agreed between the supplier and the consumer (for example, the rate of interest on a fixed rate loan product may not be able to be varied by the supplier during the fixed rate period, but on the expiry of that fixed rate period, the supplier may be entitled to vary the terms of the contract by prescribing the floating rate of interest which is then to apply).

The existence of such a contractual right is important to a securitisation as the relevant securitisation vehicle ("SPV") (which acquires the loan contracts) will typically be required under its own securitisation funding documents to reset the interest rates on the loan contracts, from time to time, so as to ensure that the weighted average interest on the loan contracts is sufficient to meet the SPV's own costs of funding (which may vary from time to time).

We submit that a right to unilaterally vary the terms of the contract should not, of itself, be considered "unfair".

For example, to the extent that the cost of supplying a loan product to a consumer increases (as a result of the SPV's own costs of funding increasing), we query why it should be regarded as unfair for the SPV to pass on that cost (either in full or in part) to the consumer.

(b) clauses that prevent the consumer from cancelling a contract

We submit that such a prohibition may lead to uncertainty as to the enforceability of relatively typical (and otherwise "fair") clauses.

For example, this prohibition would appear to:

- disallow a restriction on a consumer's right to prepay a fixed term loan with a single payment of principal due at the maturity of the loan contract; or
- disallow a right of the supplier to require the payment of certain fees or costs on the cancellation of the contract (for example, on the basis that such a right may be seen as "economically" preventing the consumer from cancelling the contract).

In the case of securitised loan contracts, the SPV is likely to have obtained funding, or entered into hedging transactions, which match the anticipated cashflow from the loan contracts.

We submit that, to the extent that it is possible to securitise a contract with this constraint at all, it is likely that the SPV's own funding costs (and, as a result, the costs ultimately passed to the consumers) will increase if the SPV has no certainty as to the timing or amount of cashflows to be generated from the underlying securitised contracts (for example, because a consumer is not restricted from cancelling its contractual obligations).

(c) clauses that require the payment of fees when the service is not provided

We query whether this prohibition is to apply only where the service is not provided at all, or also where the service is provided in part only?

We submit that the prohibition in its current form would apply where the service is provided in part only due to an act or omission of the consumer (for example, a loan is prepaid before its scheduled maturity date, or a lease receivable is terminated prior to its scheduled end date due to default by the consumer).

In such cases, we submit that such a prohibition may also lead to uncertainty as to whether the prohibition would:

- prohibit establishment fees where the loan did not proceed;
- prohibit refinancing or deferred establishment fees; or
- prohibit a customer being required to pay break costs on prepayment of a fixed rate or fixed term loan.

If the supplier is unable to claim payment of such fees and costs, it is likely that this will adversely affect the ability of the supplier to obtain securitisation funding in respect of the underlying contracts.

(d) clauses that let only the supplier decide whether to renew or not to renew the contract

We submit that it is not "unfair" for a supplier to determine (in its absolute discretion) not to renew a contract.

There may be circumstances where the consumer, but not the supplier, wishes to renew the contract.

For example, in the case of a typical mortgage loan, the supplier of the loan should not be obliged to provide a new loan at the maturity of the original loan.

Further, such a feature would be inconsistent with most typical securitisation transactions, where the SPV does not have a guaranteed source of funding for the making of any such new loan.

Also, a "redraw" or a "further advance" (both of which are relatively typical features of many loan products) should not constitute a renewal of the contract for the purposes of this prohibition. We submit that the supplier should retain the right (in its absolute discretion) not to provide a "redraw" or a "further advance". In the case of a typical securitisation, the SPV will not have a guaranteed source of funding for the making of any such "redraw" or "further advance".

- (e) clauses that penalise only the consumer for breaches of the terms of the contract

We submit that such a prohibition may lead to uncertainty as to whether a prepayment of a loan (other than in accordance with its terms - for example, by repaying other than on the last day of an interest period) would constitute a breach of the terms of the contract.

Typically, in the case of such a prepayment, the customer would be obliged to pay "break costs" to the supplier in reimbursement of any costs incurred by the supplier as a result of that prepayment. It should not be regarded as "unfair" for the supplier to pass such costs on to the consumer.

If there are no break costs, but instead the supplier makes a gain from the prepayment, will this condition require the supplier to pass any such break benefit on to the consumer? We query why it should be regarded as "unfair" for the supplier to retain any such benefits (in such a case, the consumer has exercised its own discretion to prepay - the supplier may have had no involvement in the consumer's decision making process in this respect).

If break benefits are payable by the supplier to the consumer, such a feature may adversely affect the economics of a securitisation transaction.

- (f) clauses that permit the supplier to change the price of the goods or services contracted for without allowing the consumer to terminate the contract

See item (a) above.

- (g) clauses that permit the supplier to unilaterally determine whether a breach of the contract has occurred or to interpret the contract's meaning

We submit that such a prohibition may lead to uncertainty as to whether the supplier can exercise its discretion to determine whether certain contractual conditions have been satisfied.

If the supplier is not entitled to exercise its normal underwriting criteria, this is likely to adversely affect the ability of the supplier to obtain funding in respect of the underlying contracts.

- (h) clauses that allow the supplier to assign the contract to the consumer's detriment, without the consumer's consent

We submit that this prohibition is fundamentally inconsistent with securitisation market (and the broader financial services industry) practice. It is also inconsistent with the position at general law.

If implemented, the prohibition would likely result in many securitisation transactions becoming either impractical or uneconomic.

The assignment of securitised contracts typically occurs without notice to, or consent from, the relevant consumers. This is partly because the contracts are equitably assigned and because, for so long as the supplier/seller continues to operate, it is often in the best position to collect the debts on behalf of the SPV. The giving of notice typically only occurs on the occurrence of certain prescribed events (such as the insolvency of the supplier).

We query what would constitute "detriment" for the purposes of this prohibition. To open up debate about whether an assignment to an SPV would or could be to the consumer's detriment would be to create a level of uncertainty that would adversely affect in a material manner the ability of Australian business to raise securitised funding.

- (i) clauses purporting to limit the consumer's right to take legal action against the supplier

Typically, a loan contract includes a clause obliging the consumer to pay the supplier all amounts owing without set-off, counterclaim or deduction.

We submit that this prohibition may lead to uncertainty as to the enforceability of such a clause. In addition, for loan contracts that are regulated by the UCCC, the SPV's rights against the borrower will be limited to those held by the original lender and, as such, the enforcement of those rights by the SPV within those limits should not (of itself) be 'unfair'.

If this prohibition is implemented, we submit that it should be made clear that whilst the consumer may retain the right to take legal action against the supplier, this right should not affect the right of the supplier to be paid (in full) all amounts owing under the contract.

For a typical securitisation, it is critically important that the securitised contracts will produce a known (and certain) cashflow, assuming performance by the underlying customers. The absence of rights of set-off is an important part of that analysis.

- (j) clauses limiting the evidence that the consumer is permitted to use in legal proceedings based on the contract

It is usual in finance transactions for “conclusive evidence” provisions to exist in contracts in relation to the calculation of certain amounts, absent a manifest error. These clauses recognise that the supplier is generally in the best position to perform such calculations.

- (k) clauses that do not permit refunds to consumers when the goods or service are not provided, or which apply conditions to the way in which consumers are refunded

This may apply to regulate non-refundable establishment fees, refinancing fees and deferred establishment fees.

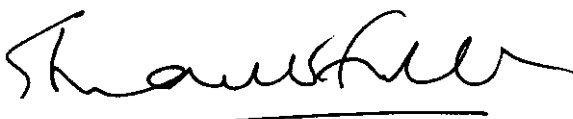
These fees may be important to the economics of the relevant securitisation transaction.

- (l) clauses that require consumers who breach a contract term or terminate early to pay penalties, in the form of specific additional payments, additional interest or indemnity legal costs, which do not reflect the suppliers’ reasonable costs

We submit that it is unnecessary to create a new statutory test which seeks to regulate an area which is already subject to established principles of general law (such as the law of “penalties”). There should be certainty in relation to how a supplier’s reasonable costs will be determined. If there is to be a specific legislative framework for these costs, then we submit that a supplier should be able to recover its average reasonable administrative and other costs in respect of that class of contract in relation to the relevant event. A concept of this type is contained in section 72 of the UCCC.

4 Conclusion

The ASF appreciates the opportunity to provide this submission in relation to this important area of law reform and looks forward to participating in the further development of these proposals. If you have any questions in relation to this submission, please contact Stuart Fuller on (02) 9296 2155.



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