

A VENDOR FINANCIER'S GUIDE TO THE NEW NATIONAL CREDIT ACT

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Overview

The new National Credit Act - officially, the National Consumer Credit Protection Act - will commence on 1 July 2010

The National Credit Act brings all consumer credit under Commonwealth control. It replaces the State credit laws.

The National Credit Act will cover consumer lending, mortgages, leases, hire purchase – all kinds of credit transactions throughout Australia.

The National Credit Act applies to all credit providers and advisors, from the largest banks, to the smallest lender in Australia.

The National Credit Act contains licensing requirements which will bring a new level of professionalism to all credit providers and to providers of credit advice. From 1 July 2010 there will be a clear divide between those who *are* licensed and who *can* provide and advise on finance, loans and other forms of credit, and those who *are not* licensed and who *cannot*.

The National Credit Act will have a direct impact upon vendor finance for residential real estate in Australia. In particular:

- All vendor financiers who have *Instalment Contracts* or *Second Mortgages* for residential real estate current as from 1 July 2010, must comply with the National Credit Code (the "NCC"), which replaces the former Uniform Consumer Credit Code (the "UCCC").
- All vendor financiers who intend to enter into new *Instalment Contracts* or *Second Mortgages* for residential real estate from 1 July 2010 should register as a credit participant with ASIC between 1 April and 30 June 2010. Registered credit participants will have until 31 December 2010 to apply for an Australian Credit Licence from ASIC under the National Credit Act.
- All vendor financiers who intend to become joint venturers, or who desire to advertise on websites or in the media from 1 July 2010, should register as credit participants and will need to obtain an Australian Credit Licence from ASIC under the National Credit Act.
- The National Credit Act will not apply to Lease Options for real estate, because entering into a Residential Tenancy Agreement or an Option to sell or purchase real estate is not a credit activity. This is the only form of vendor finance for residential real estate that falls outside of the National Credit Act.

Why are providers of Instalment Contracts and Second Mortgages, joint venturers and advertisers subject to the National Credit Act?

Providers of Instalment Contracts and Second Mortgages for residential real estate are subject to the National Credit Act because they are providing credit in the form of credit contracts. Note – the term 'Second Mortgages' is used in this guide but all mortgages, registered or unregistered are subject to the National Credit Act.

Joint venturers and advertisers offering advice and assistance to owners of residential real estate who wish to be relieved of their loan obligations are subject to the National Credit Act because they are providing or offering to provide credit services.

To better understand why they are subject to the National Credit Act, here are some useful terms which are defined in the National Consumer Credit Protection Act 2009 –

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engaging in credit activities – with a *consumer* – every person or corporation who *engages* in these activities is subject to the Act

a *consumer* means a natural person – the whole purpose of the National Credit Act is to protect consumers - the consumer must require the credit for a domestic, household or residential property investment purpose. A company (Pty Ltd) is not a consumer and so providing credit to a company is not covered by the National Credit Act – ‘company’ includes where a company is acting as the trustee of a trust

credit activities means providing *credit* by way of a *credit contract*; or benefiting from *mortgages* or guarantees relating to a *credit contract*; or providing *credit services* – an Australian Credit Licence is required to carry on credit activities

credit means (a) where the payment of a debt due is deferred or (b) where a deferred debt is created – these are the two ways that credit obligations can be created between a *credit provider* and a *debtor* – lenders who provide loans are covered under (a), vendor financiers who create debts, the payment of which is deferred, are covered under (b)

a *credit contract* means a contract entered into between a credit provider and a debtor where the credit is provided *wholly or predominantly for domestic or household purposes* (including to purchase owner occupied residential property) *or to finance residential property for investment purposes*

a *credit provider* means a person or corporation that provides credit, and includes a prospective credit provider (i.e. an advertiser)

a *debtor* means a person who is liable to pay (or repay) credit

credit services means providing credit assistance to a consumer (which includes providing advice on an existing credit situation)

an *instalment contract* means a contract for the sale of land where the purchaser takes possession and makes payments before the title is transferred

a *mortgage* means any interest in, or power over, property securing obligations of a debtor or guarantor, and a *second mortgage* means a mortgage that ranks second in priority after a first mortgage

residential property means land on which a dwelling is or will be affixed predominantly for residential purposes, and includes leases, licences, shares in and rights to occupy such land

ASIC means the Australian Securities and Investments Commission, which is the Commonwealth body that is to be responsible to administer the Australian Credit Licence and the National Credit Code throughout Australia

More information about the Australian Credit Licence

Why introduce an Australian Credit Licence?

Moneylenders were required to be registered under the Moneylenders Acts in all States of Australia ever since the early 1900s.

In 1995 the States agreed to introduce the Uniform Consumer Credit Code (the “UCCC”).

Under the UCCC, most of the States of Australia did away with registration for moneylenders except for Western Australia, Victoria and the ACT who continued licensing what they called credit providers. The provision of credit was in compliance with the UCCC, which was administered State by State by the Departments of Fair Trading or Business Licensing.

In 2008, the States of Australia agreed that the UCCC was not working effectively to provide consumer credit protection and so COAG (the Council of Australian Governments) agreed to a National Consumer Credit Protection Plan.

The Plan has been legislated as the National Credit Act. It commences on 1 July 2010. The plan has three main parts –

- (1) to require practically everyone who engages in credit activities to hold an Australian Credit Licence;
- (2) to introduce a new version of the UCCC, namely the National Credit Code (the “NCC”); and
- (3) to give ASIC the responsibility to administer the NCC and licensing. Existing State licensing and administration will cease.

The Australian Credit Licence is an important accreditation that is granted by ASIC. An Australian Credit Licence not only imposes obligations upon the licensees in their dealings with the public through requiring compliance with the NCC, but also enables ASIC to police the holders of licences with disciplinary measures including stop orders for certain activities, banning orders for individuals, closing down the business and criminal prosecutions.

The Australian Credit Licence and ASIC’s involvement is similar to the plan introduced in 2003 for the licensing of financial advisors, the Australian Financial Services Licence (the “AFS Licence”). Everyone who provides financial product advice or deals in a financial product must be the holder of an AFS Licence, otherwise it is illegal for them to provide financial advice. ASIC rigorously polices the AFS Licensing regime, and it can be expected that ASIC will rigorously police the Australian Credit Licensing regime. ASIC is well resourced financially to do so, unlike the State Departments.

While compliance with a licensing regime is an obligation, holding a licence provides the credibility of a Government imprimatur that the licensee is a ‘fit and proper person’ for the consumer to deal with and enables the licensee to operate.

Licensing regimes apply in many professions and industries such as lawyers, tax agents, real estate agents, travel agents, motor dealers, builders, stockbrokers, pharmacists, medical practitioners and financial advisors – the common thread is that the legislature considers that the consumer needs protection.

The ASIC brochure on National Consumer Credit Regulation and all of the information, Regulatory Guides and documents referred to in this guide are to be found on www.asic.gov.au/credit or in the legislation. The introductory guide is Information Sheet 96.

A copy of the National Consumer Credit Protection Act can be found on www.treasury.gov.au/consumercredit

What are the exemptions to an Australian Credit Licence?

The requirement - An Australian Credit Licence must be held by any person or entity who **engages in a credit activity** from 1 July 2010.

A **credit activity** means providing credit, benefiting from the provision of credit, or providing credit services relating to a **credit contract**. A **credit contract** means a contract with a consumer which is *wholly or predominantly for domestic or household purposes or to purchase residential property for investment purposes*. A **credit service** includes providing or advertising credit assistance for consumers. The advertising could be on a website or in a newspaper. The credit assistance could be to advise upon and provide a solution to an existing loan situation, or the sale of a residential property using an Instalment Contract or a Second Mortgage carry back.

The expression **engaging in a credit activity** means that the credit activity must be carried on as a business, or as part of a business.

The exemptions – are threefold, the first being activities which are not covered, the second being specific classes of persons who engage in credit activities, but are exempted, the third being for persons who continue credit contracts after 1 July 2010, but do not enter in to new credit contracts.

- A credit activity when applied to real estate is restricted to residential real estate - commercial and industrial property is not subject to the National Credit Act, and so no Australian Credit Licence is needed to be held to provide credit for commercial and industrial property.
- A credit activity is restricted to dealings with consumers – if a company is to enter into the credit contract as a borrower, even though there may be personal guarantors, no Australian Credit Licence is needed to be held to provide credit to companies.

- Engaging in a credit activity is restricted to a person who does so as a business – one-off credit activities are not subject to the National Credit Act, and so no Australian Credit Licence is needed to be held where one-off credit is provided. Therefore a one-off sale with an Instalment Contract or a Second Mortgage does not require an Australian Credit Licence. Note that ‘one-off’ should not be taken literally – it is possible to enter into more than one Instalment Contract or Second Mortgage without needing to hold a licence – the test is whether you *engaging* in credit activities, that is to say, are you *carrying on credit activities as a business*.
- Only the person or entity engaging in credit activities needs to hold an Australian Credit Licence – the directors, employees and representatives of a licensed credit provider need not hold a separate licence. Note the holder of the licence is responsible for the actions of their directors, employees and representatives, and so care needs to be taken in their selection.
- Each related person or corporation who engages in credit activities must hold a separate licence.
- Classes of persons who are exempted, even though they engage in credit activities are - lawyers and registered tax agents who provide credit assistance; publishers of material on credit activities; point of sale retailers who accept credit cards in payment; financial counselling agencies, provided no fees or charges are payable; and persons (such as real estate agents) who give notices or documents on behalf of a credit provider.
- Carry-over credit contracts are exempted – this is to say, provided that no new credit contracts are entered into from 1 July 2010, then no licence is required to administer the existing (carry-over) credit contracts.

ASIC’s Regulatory Guide 203 deals with Do I need a credit licence?

What should I do if I intend to engage in credit activities from 1 July 2010?

Register as a credit participant

As from 1 July 2010, it will be illegal to engage in credit activities without being registered as a credit participant or without being the holder of an Australian Credit Licence.

A vendor financier who intends to engage in credit activities from 1 July 2010 should register as a credit participant with ASIC between 1 April 2010 and 30 June 2010. By doing so, the vendor financier will be able to enter into and service new Instalment Contracts and Second Mortgages until 31 December 2010 without being the holder of an Australian Credit Licence.

If it is not intended to enter into new Instalment Contracts or Second Mortgages from 1 July 2010, then registration will not be required to administer existing credit contracts, what are known as ‘carried over instruments’.

A failure to register as a credit participant by 30 June 2010 will mean that credit activities (other than administering existing credit contracts) must cease as from 1 July 2010, unless and until an Australian Credit Licence is obtained.

Online registration as a credit participant will be available on www.asic.gov.au/credit from 1 April 2010. It is ASIC Form CS01.

ASIC’s Regulatory Guide 202 deals with Credit registration and transition.

ASIC warns - We will be processing a large number of registration applications in May and June 2010. You need to apply early for registration to ensure we can decide on your application by 30 June 2010. If you wait until after 18 June 2010 to apply, there is a risk that we won’t be able to make a decision on your application by the end of the registration period.

Apply for an Australian Credit Licence

The application for an Australian Credit Licence will need to be made by 31 December 2010.

Provided the vendor financier is a registered credit participant by 30 June 2010, then from 1 July 2010 they may engage in a credit activity until an Australian Credit Licence is granted. After the application is made,

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they may engage in credit activities after 31 December 2010 until the grant (or refusal) of an Australian Credit Licence.

Even though it is not required, an application for the Australian Credit Licence may be made by a person who only seeks to administer 'carried over instruments'. If so, it will be treated as a streamlined application and be granted on condition to restrict the licence to these activities.

The form of application for an Australian Credit Licence is very detailed and the assistance of a professional will be necessary to provide the information asked for. A summary is –

- You and your business – you will be asked questions about who you are and the types of credit activities you propose to engage in under the credit licence.
- Compliance with your obligations – you will be asked to identify each of the people who are involved in the management of your credit business, your compliance arrangements, your representatives, the adequacy of your resources and the dispute resolution, risk management and compensation systems that you have in place.
- Supporting information – you and each of the people involved must show that they are 'fit and proper' people, in terms of past conduct, experience and qualifications and what your credit business will involve and how it will be operated.
- Statements and declarations – you must make a statement about your and your peoples' past conduct, and you must declare you will comply with your obligations as a credit licensee.

The Australian Credit Licence will be issued with conditions, which will restrict the licence to certain credit activities consistent with the experience and qualifications of the Applicant. In particular, mortgage broking will be restricted to appropriately qualified people because it involves recommending loans. ASIC may impose a 'key person' condition, that the specified person must remain involved with the business.

Holders of an Australian Credit Licence will be given a licence number to display on their advertising, websites, letterheads, etc.

The fee will be \$450 for online applications for an Australian Credit Licence. There will be an annual renewal statement and a fee payable.

ASIC's Regulatory Guide 204 deals with Applying for and varying a credit licence. The form is ASIC Form CS02.

Comply with the National Credit Code (the "NCC")

The NCC is an updated version of the former Uniform Consumer Credit Code (the "UCCC").

The NCC must be complied with from 1 July 2010 regardless of whether or not the person providing the credit is the holder of an Australian Credit Licence or not.

These provisions of the NCC are particularly relevant to vendor financiers –

- Section 10 – makes it clear that the NCC applies to Instalment Contracts – these are defined as contracts where payments are made towards the price (other than towards the deposit) and the payments are not rent payments, and the purchaser takes possession and makes payments before the title is transferred.
- Section 16 – requires a Credit Code disclosure statement to be provided before the credit contract is entered into – the disclosure statement must contain the information set out in Section 17 and the prescribed Forms of Information Statement and Disclosure. Section 17 contains key requirements, which can lead to court penalties and well as unenforceability of interest charges if they are not complied with. Sections 56 & 57 contain similar requirements for guarantees.
- Section 33 – requires Statements of Account to be provided to the debtor no longer than each 6 months after the Contract Date. Section 34 sets out what must be contained in the Statements of Account. Section 36 requires Statements of Account to be provided at other times within 14 days of request.

- Section 64 – allows a change to be made to an interest rate, according to a change in the reference rate, by giving 20 days notice.
- Section 72 – allows a debtor to apply to the credit provider for hardship relief in the form of a change in the credit contract if because of illness, unemployment or other reasonable cause, they are unable to meet their obligations under the credit contract. The change could be reducing the amounts of the payments and extending the term, postponing the payments or both (with no change to the interest rate). Unlike the UCCC which provided for the postponement of obligations for a period of up to 2 months, there is no period specified in the NCC. Section 72 applies to credit contracts of a value of up to \$500,000.
- Section 76 – provides that the court may reopen and re-write the credit contract if the contract was entered into in unjust circumstances, such as in circumstances where there was no negotiation; where the contract contains conditions that are unreasonably difficult to comply with; where it is in the interests of the debtor to do so according to his or her age or physical or mental condition; whether independent legal advice was obtained; the extent the contract was explained accurately; whether the interest rate charge is excessive compared with comparable contracts; and whether the payments can be made without substantial hardship.
- Section 82 – allows the debtor to pay out the credit contract at any time, subject to the payment of early repayment charges.
- Section 87 – requires a direct debit default notice (in the prescribed Form) to be given within 10 business days of the first default occurring under a direct debit arrangement.
- Section 88 – states that a default notice (and the prescribed Form of Information about debtor's rights after default) must allow the debtor at least 30 days to remedy the default and must be given before enforcement proceedings are commenced under a credit contract.
- Section 150 – requires that advertising in which the amount of the repayments is stated must contain the annual percentage rate. There is no definition of 'advertising'. However, it does include advertising in newspapers, journals and websites; and probably includes signs.
- Notes – The National Credit Code is Schedule 1 to the National Consumer Credit Protection Act 2009. The new forms will apply as from 1 July 2010 to existing and new credit contracts, but can be phased in until 30 June 2011. The forms are found at the end of the National Consumer Credit Protection Regulation 2010. Go to www.comlaw.gov.au

What will my obligations be as the holder of an Australian Credit Licence?

General conduct obligations

The general conduct obligations of credit licensees will need to be demonstrated in the Application for the Australian Credit Licence and subsequently. They are:

- Broad compliance obligations consisting of engaging in credit activities efficiently, honestly and fairly; complying with the conditions on the licence; and complying with credit legislation and relevant laws.

All persons involved in the business must be 'problem-free'. This means background checks consisting of a clean criminal history check, a bankruptcy check and a credit history check of directors and senior employees must be carried out and the reports attached to the Application.

- Having risk management systems in place; arrangements to avoid conflicts of interest to consumers; internal dispute resolution systems and membership of an approved external dispute resolution scheme.

It is a requirement in an Application for licence that there be membership of an ASIC-approved external dispute resolution scheme – which is either the Financial Ombudsman Service or the Credit Ombudsman Service Ltd.

It will be necessary to show these general conduct arrangements are in place to ensure compliance when applying for a licence. As a general rule, the smaller and simpler the business, the smaller and simpler the measures and arrangements need be. Very small businesses can meet their obligations by having a checklist.

- Ensuring the representatives comply with credit legislation; adequate training and individual competence; and ongoing organisational competence.

Until 30 June 2014, at least two years 'problem-free experience' will be required for those providing credit assistance and at least five years 'problem-free experience' will be required for those entering into credit contracts. After that date, credit industry qualifications will also be required (at least to a Certificate IV in Financial Services or tertiary equivalent).

In addition, maintaining organisational competence will involve undertaking at least 10 hours of continuing professional development per year. The exact requirement will be a condition on the licence. The activities which may be counted will include preparation for presentations and attendances at relevant professional seminars or conferences, viewing DVDs of recent professional seminars and completion of online tutorials or quizzes on recent developments.

ASIC advises that in 'a small micro lending business that has only two or three representatives, it may be sufficient for your responsible managers to set aside a few days a year to personally train your representatives about your credit products and about the legal obligations that apply to your business'.

- Having adequate financial, technological and human resources to engage in the credit activities authorised by the licence; adequate compensation arrangements; and arrangements and systems to ensure compliance with the general conduct obligations.

To satisfy the financial resources requirement, satisfactory financial accounts showing sufficient working capital will be needed, and to satisfy adequate compensation arrangements, professional indemnity insurance may be required.

Credit licensees will be required to lodge a compliance certificate annually to demonstrate compliance with these obligations. To comply, records of monitoring and reporting will need to be kept, and the qualifications and experience of the people in the business will need to be sufficient to make them 'fit and proper' to engage in the credit activities competently, and financial resource requirements will need to be satisfied.

ASIC's Regulatory Guide 205 deals with Credit Licensing: General Conduct Obligations.

ASIC's Regulatory Guide 206 deals with Credit Licensing: Competence and Training

ASIC's Regulatory Guide 207 deals with Credit Licensing: Financial Requirements

ASIC's Information Sheet 97 on Guidance for small credit businesses deals with how small businesses may comply with general conduct obligations.

Credit contract obligations

The obligations will differ slightly depending upon whether the licensee is the credit provider or simply providing credit assistance in relation to credit contracts. The obligations prior to entering into a credit contract are:

- A credit guide to be given to a consumer containing information about the licensee and some of the licensee's obligations under the Act.
- A quote / offer of credit for the credit.
- Making a preliminary assessment as to whether the contract will be suitable for the consumer. To do so, the licensee must make inquiries and verifications about the consumer's requirements, objectives and financial situation.
- The appropriate Financial Information Statement and Disclosure in accordance with the prescribed forms is to be given to the consumer.

There is a transition period for compliance with these requirements between 1 July 2010 and 30 June 2011.

ASIC's Regulatory Guide 208 deals with How ASIC charges fees for credit relief applications

ASIC's Regulatory Guide 209 deals with Credit licensing: Responsible lending conduct

Conclusion

- The new National Credit Act will mean that only the competent and the responsible credit providers and providers of credit assistance will remain in the industry.
- Vendor Financiers who have existing Instalment Contracts or Second Mortgages or who have websites advertising credit assistance should register with ASIC as a credit participant between 1 April 2010 and 30 June 2010 if they wish to carry on business after 1 July 2010.
- Vendor Financiers who have registered and desire to continue Instalment Contracts or Second Mortgages or continue to maintain websites advertising credit assistance after 31 December 2010 must apply for an Australian Credit Licence before that date to carry on business after 31 December 2010.
- Vendor Financiers must introduce new forms for Information Statements, Disclosures, Notices of Default and Direct Debit Default Notices in the period from 1 July 2010 to 30 June 2011 to comply with the new National Credit Code.
- Joint Venturers must hold an Australian Credit Licence to provide credit assistance to residential property owners or investors in the form of assuming loan liabilities or selling a residential property using an Instalment Contract or Mortgage. Owners who sell in this way as a one-off transaction need not hold an Australian Credit Licence to do so.
- The use of Leases and Options for vendor finance is *not* affected by the new National Credit Act.

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Disclaimer –

This guide is prepared for information purposes only and does not constitute legal advice.

It provides a general outline without taking into account any specific circumstances.

We encourage you to seek your own professional advice to find out how the National Credit Act and other legislation apply to you, as it is your responsibility to determine your obligations.

Liability is limited by a scheme approved under Professional Standards Legislation (NSW).

This guide is issued on 12 March 2010 and is based on legislation and ASIC information available at that date.