AUSTRALIAN COLLECTORS & DEBT BUYERS ASSOCIATION

28 February 2020

Manager
Financial Services Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: FSRCconsultations@treasury.gov.au

Dear Sir/Madam,

Submission in response to exposure draft legislation:
Implementing Royal Commission Recommendations 1.6, 2.7, 2.8, 2.9 & 7.2
Strengthening breach reporting

The Australian Collectors & Debt Buyers Association is pleased to provide the attached Submission in response to Treasury's consultation for the above exposure draft legislation.

Please do not hesitate to contact the writer to discuss any aspect of the Submission.

Yours sincerely
AUSTRALIAN COLLECTORS & DEBT BUYERS ASSOCIATION

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Submission to Treasury

Implementing Royal Commission Recommendations 1.6, 2.7, 2.8, 2.9 & 7.2

Strengthening breach reporting

February 2020

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Introduction

Australian Collectors & Debt Buyers Association (ACDBA) welcomes this opportunity to comment on the draft exposure legislation *Implementing Royal Commission Recommendations 1.6, 2.7, 2.8, 2.9 & 7.2 - Strengthening breach reporting* released for consultation by Treasury on 31 January 2020.

ACDBA was established in 2009 for the benefit of companies who collect, buy and/or sell debt - our members (refer Appendix 1) represent the majority of the collection market in Australia.

The core business of our members within the financial services industry is in the credit impaired consumer segment, whether as collectors or debt purchasers, working with consumers who for various reasons, have found themselves in default of their credit obligations.

ACDBA members purchasing debt, each hold an Australian Credit Licence and are members of the Australian Financial Complaints Authority (AFCA). Our members do not provide financial advice.

Debt purchasing

Accounts assigned to debt purchasers typically involve debts where an acceleration clause in the financial agreement has been triggered by the customer's default in making repayments.

Many customers with accelerated debts are in hardship giving rise to complex, contested and unresolved issues. Debt purchasers are specialists in dealing with and managing hardship as they almost exclusively interact with customers in some form of financial difficulty.

An expanded explanation of how debt purchasing operates in Australia is included at Appendix 2.

Observations

Further to the *Stakeholder Roundtable – Credit* convened by Treasury on 20 February 2020 in which ACDBA participated, we provide some additional observations in relation to the proposed exposure draft legislation, specifically in response to matters canvassed within Chapter 2 of the Exposure Draft Explanatory Materials.

The proposed amendments introduce breach reporting obligations for all Australian Credit Licensees. ACDBA generally supports the policy intent and the Government's commitment to strengthening the breach reporting regime. However, the proposed expansive definition of 'Reportable Situation' will in our view result in a significant additional burden to industry, increasing compliance costs which will ultimately be passed on to consumers in the form of higher costs for accessing credit.

Reports based on such an expansive definition will not effectively support ASIC's regulatory activities and will result in significant reporting noise, taking ASIC's focus away from more serious matters which may cause consumer harm and require prompt enforcement action or other intervention.

Appreciating the intention is to create a more objective reporting standard, we submit the breach reporting obligations should be limited to matters which involve significant consumer harm. This limitation avoids the unnecessary cost impost on industry, whilst ensuring that the reports from licensees provide quality, actionable information, best supporting ASIC's oversight of industry and regulatory enforcement activities to reduce consumer harm.

Determining what amounts to significant consumer harm involves a subjective assessment and as such warrants careful definition and regulatory guidance to ensure all credit licensees adopt and are held to a consistent methodology in terms of assessing which matters are reported and the timeframes for reporting.

Reportable situations

The proposed amendments to the National Consumer Credit Protection Act 2009 (NCCP) provide in respect to credit licensees, there is a 'reportable situation' if:

> *"50A*
> *(1) (a)*
> *(iii) the licensee has commenced an investigation into whether the licensee or a representative of the licensee has breached a core obligation; and*
> *(b) the breach or likely breach is significant."*

What is intended to be meant by 'investigation'?

In the absence of a considered and focused definition of the term 'investigation', the obligation to report any investigation into a breach of a core obligation will impose compliance burdens on credit licensees which are likely to be excessive and unreasonable.

Any definition of 'investigation' must have regard to scale. Additionally, whether an investigation is significant and therefore reportable must take into consideration the likely consumer harm.

Reporting an investigation of a breach or likely breach which is potentially systemic or complex is appropriate, whereas with other investigations of which there are typically far more, the burden of reporting and the resources needed to comply with the obligation will vastly outweigh any potential benefit from ASIC analysing such reported data.

Consider for example, the situation of 'investigations' undertaken by credit licensees in connection with their established internal Quality Assurance processes (QA).

A financial firm in adopting and maintaining a QA system for its business operations commits to routinely undertaking investigations to confirm its ongoing work processes and outcomes align with its adopted QA standards and comply with the National Credit Code (NCC).

Investigations and audits are an integral feature of testing and maintaining QA systems and advancing compliance and business improvement initiatives. Under the proposed legislation, undertaking these activities, whether on a routine or random basis, would amount to an investigation in relation to a breach of a core obligation and accordingly, each individual QA review would trigger the obligation to report - this cannot be the intention.

Reporting such activities, except where a systemic or complex breach is involved, would inevitably lead to over-reporting, thereby skewing the data provided to ASIC and undermining the usefulness of the reporting framework itself.

Financial firms commit to adopting and maintaining best practice through QA to deliver a better financial service to consumers. Excessive reporting obligations of investigations and breaches identified from those investigations will deter credit licensees from undertaking substantial proactive reviews where there is a risk that all such investigations and investigation outcomes will be reportable.

Without modification, the proposed legislation creates an incentive for credit licensees to limit their control, review and improvement activities aimed at delivering a better financial service to consumers, to only those areas where no breach reporting is required. Under the proposed legislation few such areas exist.

There is an imperative to appropriately narrow the reporting obligation otherwise compliant industry participants will incur a disproportionate increase in costs and suffer greater reputational harm through ASIC's public reporting of breaches than less compliant credit licensees indifferent to their obligations, or less heavily invested in resources or technology and therefore less efficient at identifying issues within their business.

Unchanged, the proposed legislation hands a competitive advantage to those less forensic or improvement focused participants who will bear less costs, be exposed to less enforcement and will weather less adverse publicity - this is a contrary and counterproductive outcome.

Determining if a breach is 'significant'

The triggers proposed for a significant breach of a core obligation fail to include scalability as a consideration. We submit, it is appropriate and reasonable that whether a breach is significant and reportable, must take into account the actual or potential harm to the consumer.

A materiality threshold as to a consumer's harm should be introduced to provide an objective consideration for the triggers. The current proposed trigger to report any matter which constitutes a contravention of a civil penalty provision without having regard to actual or potential consumer harm will result in significant over-reporting.

It is also relevant to consider whether the licensee, upon identifying a breach or likely breach, has acted promptly to rectify the breach, including any remediation activities to address any consumer harm. If the breach or likely breach was not systemic, but rather an isolated issue and the credit licensee has already acted to remediate any consumer harm, then such a consideration should be taken into account when determining whether the breach is reportable.

Reporting isolated breaches to ASIC which have already been subject to remediation would be redundant and serve no useful purpose.

We note a similar approach has been adopted by the Office of the Australian Information Commissioner (OAIC) under the Notifiable Data Breach legislation, where the obligation to report includes these essential considerations:

- there is unauthorised access to or unauthorised disclosure of personal information, or a loss of personal information, that an organisation or agency holds;
- this is likely to result in serious harm to one or more individuals; and
- the organisation or agency hasn't been able to prevent the likely risk of serious harm with remedial action.

The OAIC approach means there is no need to report a breach after remediation - on the rationale the breach was not systemic, there was no risk of ongoing serious harm and/or it had been adequately remediated. A similar approach should be adopted by ASIC.

Further, ASIC's guidance to financial service licensees under RG 78 potentially provides the basis for a framework for a materiality threshold in relation to the 'significant' breach reporting obligations of credit licensees.

ASIC guidance should be similarly provided to credit licensees on breach reporting and specifically include consideration of any actual or potential financial losses of consumers arising from the breach of a core obligation in determining if the breach is 'significant' and therefore reportable.

All these matters impacting on whether a breach of a core obligation should be considered 'significant' warrant further consultation with industry to inform the development of any regulatory guidance.

Practical considerations

To illustrate the above points, we raise as an example the situation of a licensee sending a Credit Guide (as required under the NCC) to the consumer's previous address rather than to the consumer's updated address. This incorrect mailing is identified by the licensee using an automated quality control system and an exception is flagged. The exception is investigated and the notice manually reissued to the current address for the consumer within twenty-four hours.

Under the proposed legislation, this example presents two reportable situations, both the investigation of the 'significant breach' and the 'significant breach' itself.

We respectfully submit that the obligations to report these events, which only arises as a direct result of the licensee having invested in robust control systems to flag and address exceptions, means ASIC would receive two reports about something that is so plainly trivial it wastes time and resources for both the licensee and ASIC.

A reasonable and logical conclusion for a licensee facing such an onerous reporting obligation is that it would be better to turn that control system off, avoiding the reporting obligation and any brand or reputational damage arising from its inclusion in ASIC's published data.

ASIC's publication of breach report data

The publication by ASIC of breach reporting data as proposed will not be useful to consumers as they will be unable to reconcile the number of reported breaches against the size of the financial firm. The published data is also unlikely to help consumers to make informed consumer choices as more compliant organisations will appear worse than less compliant ones given the relative commitment to reporting breaches.

The underlying problem is the volume and quality of data is entirely dependent upon the attitude and control framework of each credit licensee and without this context published data will mislead consumers and capital market stakeholders such as funders and investors.

Reporting subjective data is inappropriate when there is a better and available source of objective data which more usefully serves the objective of consumer protection: the Australian Financial Complaints Authority's publication of complaint statistics, named determinations and named systemic issues is completely objective and provides a better indication of the strength of the control framework and attitude of credit licensees to compliance, positive consumer outcomes and remediation of issues.

ASIC should be required to adopt as a principle, to only publish those significant breaches reported by credit licensees which resulted or are likely to result in serious harm to affected consumers and/or are in the public's interest to know.

In the alternative, we submit that any proposed ASIC publication of breach reporting data requires reference to scale to ensure published data is reasonable, informative and useful as a public metric of a financial firm's performance. All published data should be expressed relevant to the following:

- Data at firm level should be clearly contrasted to the scale of the financial firm's operations for example comparing to the total number of accounts under management or the total number of contacts made.
- Aggregate data should be similarly referenced to such information as the total number of accounts under management or the total number of contacts made by the particular segment of the financial services industry.

Concluding comments

The proposed amendments to introduce breach reporting obligations for all credit licensees are generally supported by ACDBA however further consultation and consideration is warranted to ensure the regime is reasonable and practical for implementation and any publication of breach data be informative and useful as a metric for consumers and stakeholders.

Without regard to scale and consumer harm, the proposed breach reporting obligations will impose excessive and unreasonable compliance burdens on credit licensees.

Breaches which are potentially systemic or complex in nature should be reported, but other reporting obligations should be limited to those breaches involving significant un-remediated consumer harm, otherwise the burden of reporting and the resources needed to comply with the obligation will outweigh the potential benefit of the reported data.

We have flagged the issue that compliant credit licensees bearing the cost of meeting the obligations will be at a competitive disadvantage to any licensees which adopt a less forensic or improvement focussed approach to the proposed breach obligations.

Additionally, firms adopting a comprehensive regime of investigating and reporting breaches will be significantly disadvantaged in any public reporting, if compared with other firms who are indifferent to their reporting obligations, or who invest less resources in identifying breaches within their organisation.

These are counterproductive outcomes in terms of improving the delivery of financial services to best meet the objective of improved consumer protection.

Contact

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Appendix 1 - Members of Australian Collectors & Debt Buyers Association

- Axess Australia Pty Ltd
- Baycorp (Aust) Pty Ltd
- CCC Financial Solutions Pty Ltd
- CFMG Pty Ltd
- Charter Mercantile Pty Ltd
- CollectAU Pty Ltd
- Collection House Limited (ASX: CLH)
- Complete Credit Solutions Pty Ltd
- Credit Collection Services Group Pty Ltd
- Credit Corp Group Limited (ASX: CCP)
- Credit Four Pty Ltd
- illion Australia Pty Ltd
- Lyndon Peak Pty Ltd t/as Access Mercantile Services
- PF Australia Pty Ltd
- Prushka Fast Debt Recovery Pty Ltd
- Shield Mercantile Pty Ltd

Appendix 2 - Debt Purchasing explained

Debt sale contracts exhibit the features of outsourced service provision rather than asset divestment - the contracts contain substantial ongoing conduct obligations and restrictions imposed on the purchaser, which are supported by warranties, indemnities and other potential penalties. The conduct obligations deal with matters such as ongoing compliance with laws, codes, guidelines, data security, principles of fairness and policy directives of the seller.

These contractual requirements are supported by ongoing reporting obligations for matters including breaches, complaints and the identification of customers in sensitive circumstances. There are provisions for extensive auditing, on-site visits and regular review meetings to share emerging issues. Sellers retain substantial discretion to recall individual customer accounts at any time.

The contractual elements create an outsourcing relationship granting the seller substantial control over the ongoing conduct of the purchaser and the experience of individual consumers.

It is appropriate to note ASIC as the regulator for the financial services industry provides guidance in respect to conduct relating to a debt[1]:

> *A creditor may also remain liable for conduct regarding a debt despite having sold or assigned the debt. Liability will generally remain for misconduct occurring before the sale or assignment of the debt.*

Accounts assigned to debt purchasers by original credit providers typically involve debts where an acceleration clause in the financial agreement has been triggered by the consumer's default in making repayments. Once a debt has been accelerated, the amount owing is immediately due and payable.

Many, if not most consumers with accelerated debts are likely to be in hardship giving rise to complex, contested and unresolved issues.

Debt purchasers are specialists in dealing with and managing hardship as they almost exclusively interact with customers in some form of financial difficulty.

Debt purchasers do not establish separate hardship teams and do not need to implement protocols and systems to identify hardship. Rather, they proceed on the basis that every customer is in hardship. This means that every customer receives an empathetic and understanding experience designed to reach mutual agreement on a sustainable repayment arrangement.

The debt purchase business model includes two key features being:

a. The model is uniquely suited to the promotion of affordable and flexible long-term payment arrangements which most effectively respond to individual customer circumstances

b. Debt purchasing involves the assignment of permanent tenure to defaulted loans at prices which represent a substantial discount to the face value outstanding

The benefit of these two features is allowing debt purchasers to agree to longer-term payment arrangements with lower and more affordable repayments for the customer in hardship and to take a patient approach to understanding and accommodating individual customer circumstances.

[1] Equifax Default Information Guide version 23.0 - February 2019

Each year ACDBA members participate in a data survey to provide industry wide demographics. Reviewing the data survey for FY2019 reveals there were 2.38 million accounts with a total face value of $12.7 billion under collection that had been purchased from originating credit providers.

These aggregated figures reveal across ACDBA members a low average value per account of only $5,336.

Members handle a range of debt values in their portfolios from lesser amounts in respect to telecommunication debts through to larger amounts for higher value credit card and other banking product debts.

ACDBA members in FY2019, reported collecting $2.2 billion of defaulted consumer credit obligations restructured into sustainable repayment arrangements together with $1 billion in hardship arrangements and waiving a further $18.6 million owed by vulnerable customers in financial hardship.