SUBMISSION

Financial Services Royal Commission

16 April 2018

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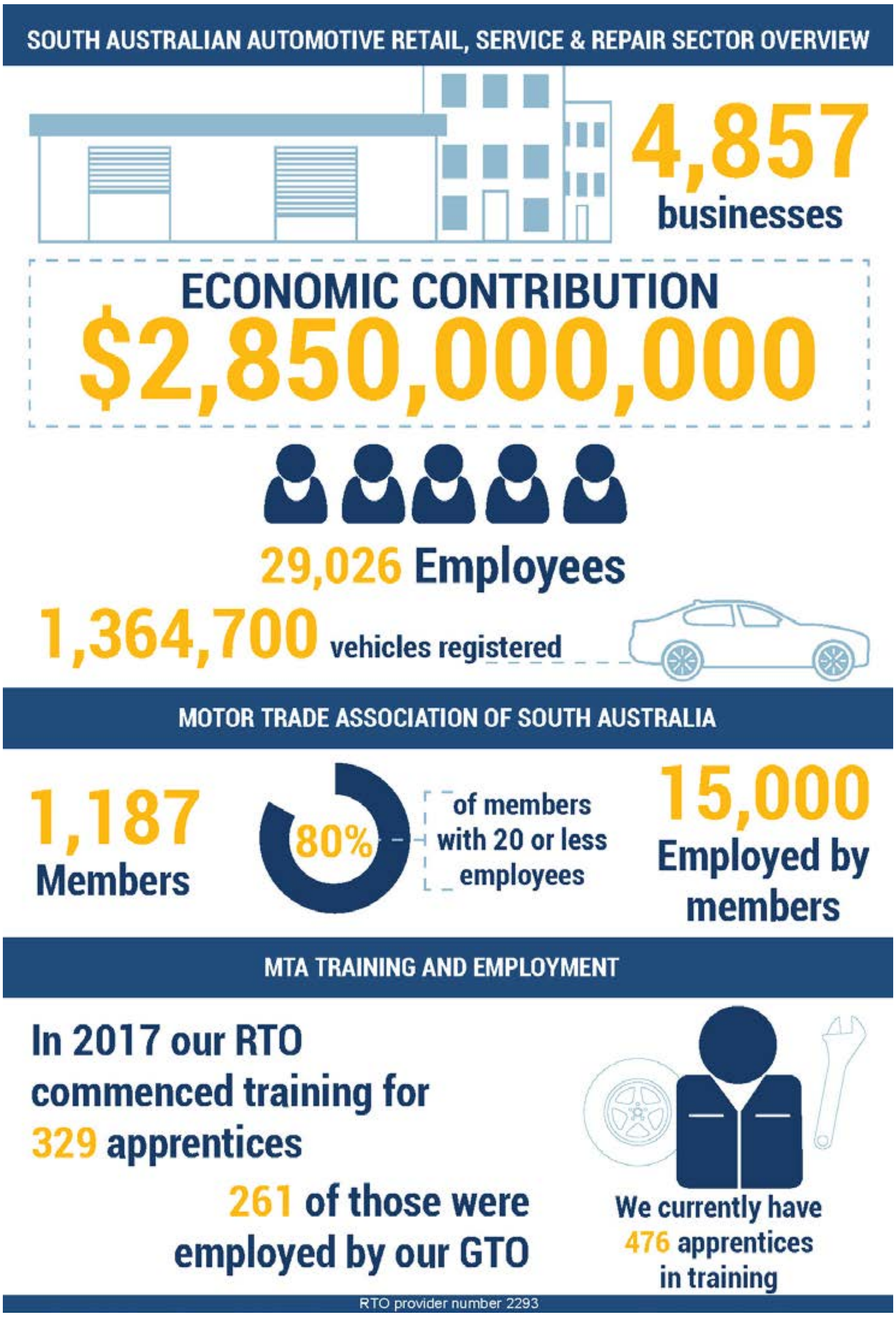
2. About Us

The Motor Trade Association of South Australia is the only employer organisation representing the interests of the automotive retail, service and repair businesses in the state.

MTA Automotive Training and Employment services are the provider of choice for the industry and are comprised of both our Registered Training and Group Training Organisations.



DIVISIONS

- AUSTRALIA AUTOMOBILE DEALERS ASSOCIATION (SA) DIVISION
- AUTO REPAIR AND ENGINEERING DIVISION
- AUTOMOTIVE DISMANTLERS DIVISION
- BODY REPAIR SPECIALISTS DIVISION
- COMMERCIAL VEHICLE INDUSTRY ASSOCIATION (SA) DIVISION
- FARM AND INDUSTRIAL MACHINERY DEALERS ASSOCIATION (SA) DIVISION
- LICENSED VEHICLE DEALERS DIVISION
- MOTORCYCLE INDUSTRY ASSOCIATION OF SA DIVISION
- VEHICLE RENTAL DIVISION
- TYRE DEALERS DIVISION
- SERVICE STATION DIVISION
- TOWING SERVICES DIVISION

3. Glossary

ASIC	Australian Securities and Investment Commission
MTA	The Motor Trade Association of South Australia

4. Industry Consultation

This submission summarises the views of the MTA’s members. In developing this submission, the MTA has consulted with members in the following divisions:

MTA
MOTOR TRADE ASSOCIATION
AUSTRALIA AUTOMOBILE DEALERS ASSOCIATION (SA) DIVISION

5. Executive Summary

Submissions made to the Financial Services Royal Commission have made a number of sweeping and unsubstantiated claims in relation to the car finance market, particularly in relation to those dealerships acting as brokers on behalf of lenders. These claims imply a culture of systemic fraud and reckless lending which is without foundation and needlessly damage the reputations of many family owned businesses that operate with the highest integrity.

The MTA has previously made a number of submissions on behalf of its members to the ASIC review of the car finance market to highlight the important benefits consumers can derive from dealer financing arrangements.

In particular, consumers are afforded greater levels of competition for loan rates, increased access to finance sources and lower vehicle purchasing costs through the services offered at dealerships.

Some submissions to the Royal Commission have highlighted the enforcement action taken by ASIC to claim there is a systemic failure of the regulatory environment.

However, the evidence actually demonstrates that there are relatively low levels of non-compliance with the previous regulatory framework and that the framework provided a viable mechanism for enforcement action.

It is also critical that the Royal Commission recognise the lengthy review process undertaken by ASIC, which involved all stakeholders.

The findings of the ASIC review have led, appropriately, to new arrangements that place the onus on lenders, rather than dealerships, for the quality and administration of their product offerings.

These arrangements have only been in place since September 2017, with the transition period due to expire in November 2018. It would be highly disruptive to businesses which have acted in good faith and begun to adjust their business models to comply with the new regulations to then be required to make a further series of changes that could be recommended by the Royal Commission.

This is exacerbated by the fact that the efficacy of the new arrangements in addressing some of the issues raised through the ASIC review and by submissions to the Royal Commission has not yet been fully implemented let alone tested.

The MTA recommends that the Royal Commission defer to the reform package proposed by ASIC and make no further recommendation in relation to this matter.

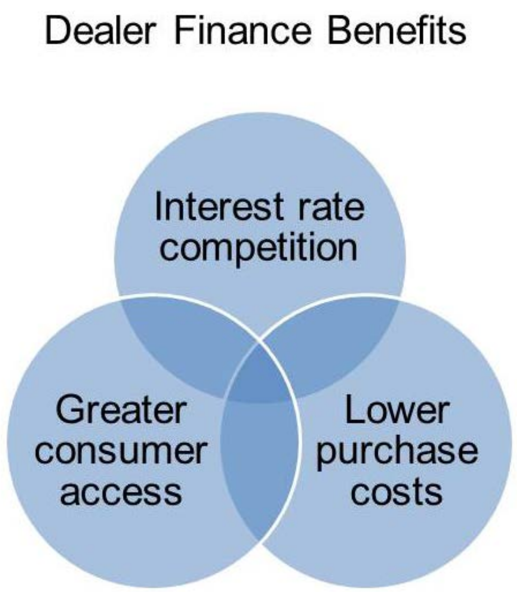
6. Dealer finance

Dealer finance improves access to finance arrangements for a cohort of borrowers that would otherwise have limited options to obtain loans for the purpose of purchasing a vehicle. These arrangements provide better overall value to the consumer than if these arrangements were absent or compared to banks.

The MTA considers that submissions to the Royal Commission have incorrectly isolated a single element of the value chain to make their case, rather than considering the overall benefit to consumers that dealer finance provides.

Better overall value is delivered in three principle ways:

1. Interest rate competition
2. Greater consumer access
3. Lower purchase costs



7. Interest rate competition

Lending rates through dealer finance channels are demonstrably lower than those of deposit taking institutions. This in itself increases the attractiveness and availability of loans to people on fixed incomes.

ASIC has previously said it is concerned about the prevalence of so called 'outliers'. The MTA understands that 'outliers' have been construed by ASIC as to mean variances from the base rate of greater than five per cent.

The MTA considers that further regulation would seek to govern for the exception rather than the rule by seeking to eliminate 'outliers', rather than using its enforcement powers to ensure that where consumer harm has occurred, in breach of the Consumer and Competition Act, it is accordingly penalised.

Submissions to the Royal Commission have not acknowledged the pricing of risk as an explanation for this variance. This indicates a lack of appreciation of the dealership business model. Whereas banks rely on a financial product as their primary saleable item, dealerships rely upon vehicle sales. The finance mechanism is fundamental to the facilitation of the vehicle sale.

A bank will provide differing interest rates to staggered cohorts of borrower or refuse to lend depending on the risk profile of the potential borrower. In this way it offsets its risk for each cohort and can afford to turn away potential borrowers to manage its financial risk. This reduces the base rate variance for banks because they can concentrate on the cohort most likely to repay.

A dealership must not only factor in these same considerations, but must also price additional risk factors such as inventory and floor space while maintain volume of vehicle sales in a highly competitive market for both vehicles and finance.

This means dealerships take on customers that would not comply with the risk assessment employed by banks and other lending institutions. This additional risk can result in access to, rather than denial of, higher rates for higher risk borrowers, counter balanced by lower rates for lower risk customers to maintain price competition.

Other factors must also be considered such as the productivity and transactional costs of effectively forcing customers to use non dealer finance to facilitate their purchase. To date, this cost has not been quantified.

Higher productivity costs and reduced interest rate competition would constitute consumer harm.

Table 1

Financial Institution - Competitor Comparison (June 30 2016)

Bank/Credit Union	Establishment Fee	Monthly Fee	Headline Rate	Comparison Rate	Key Criteria	Loan Conditions	Headline Rate Variance
Westpac	$250	$10	8.49%	9.54%	$10k - $100k	Secured loan	6.20%
	$250	$10	14.69%	na	Flexi loan	unsecured	
	$250	$10	12.99%	14.01%		Personal Loan	
CBA	$250	$10	12.99%	14.01%	car 1 - 5 years, $10k min	*"Your interest rate will be based on a number of factors, including the information you provide and our assessment of your application. We will confirm your actual interest rate in your loan offer document"*	6.45%
	$250	$10	7.45%	8.54%	-		
	$250	$10	13.90%	14.77%	$5k - $50k flexi option		
NAB	-	-	13.90%	14.77%	$5k to $50k secured	-	0.29%
	-	-	13.69%	14.56%	secured	-	
	-	-	14.19%	15.06%	secured	Have a unsecured option 17.75%	
ANZ	$350	$5	6.80%	7.65%	Car less than 6yo min $7500	1 - 7 year term, online rate only, different if via Branch	7.89%
	$350	$10	13.95%	14.01%	Says 13.95 to 16.95%	Depending upon credit criteria (not disclosed)	
	$350	$10	14.69%	15.55%	Says 14.69% to 17.69%		
Police Credit Union	-	-	5.99%	5.99%	Min $15k, max term 5 years	Must be a member	0.94%
	-	-	6.93%	7.20%	Min $15k, max term 5 years	Subject to credit criteria (strong credit risks only)	
	-	-	-	-	-	-	
Bank SA	-	-	12.74%	13.62%	1-7 years, variable, $3k-$80k	Car max 12yo at term end. Rate depends on Loan to Value ratio	5.86%
	-	-	8.49%	9.39%	1-5yrs fixed,	Car max 12yo at term end. Rate depends on Loan to Value ratio	
	-	-	14.35%	15.22%	Unsecured	*"The actual interest rate applicable to the loan will be based on the information you provide at the time of your application and our credit assessment. The rates available range from 10.99% p.a. to 19.99% p.a."*	
People's Choice Credit Union	$250	-	5.64%	5.99%	New cars only, min $20k	Rate fixed for 5 years, then reversed to 11.55%. Must be member.	8.35%
	$250	-	7.99%	8.35%	older cars, $10k min	Note additional 0.15% rate lock to guarantee rate	
	$250	-	11.99%	13.76%	Secured	Note publicly available records show written 1,400 car loans, but >13,000 personal loans	
	-	-	13.99%	15.78%	Unsecured		
Money 3	-	-	28%	-	Secured car loans $2000 - $35000 .	Commonly 25% to 35%, aimed at sub-prime. Terms for 48 Months	Up to 10%
	-	-	-	-	Terms 4 yrs max	Also have "micro loans" higher rates again	
Liberty	$395 + 2%+	$5	6.69%	9.18%	From <Rate>. Other rates undisclosed.	Tier customers into risk profiles AA, A, B, C, D. Advertised rates are for low risk profiles. C & D risk rates 18% - 28%	Up to 21%
	FPA $845	-	-	-	-		

Table 1 shows the results of a survey taken by the MTA of available lending rates and criteria.

The table demonstrates that dealer finance is actually significantly more competitive than what consumers can source from these other lenders.

While finance companies, unlike banks, are more willing to take on higher risk consumers, they also charge significantly higher rates than either banks or dealers.

Increasing the market penetration of these companies by limiting competition from dealer finance would constitute consumer harm.

8. Greater consumer access

Separate to rate competition, lending criteria for dealer finance lowers the barriers of entry for potential borrowers who would not otherwise meet the criteria set by banks and other lending institutions.

This additional risk is factored into the cost to borrow and often borne by the dealership if the loan defaults.

This difference should not be taken to be predatory. It simply captures a segment of the borrowing market that has good credit history but does not meet the criteria set by a bank. This does not necessarily make a potential borrower high risk.

Removal of this market segment would perversely impact upon vehicle sales without justification and harm consumers unnecessarily by denying them access to loans and vehicles.

High risk borrowers still face stringent criteria and credit checks in order to obtain loans and typically the credit risk pricing is such that they are priced out of the market anyway.

Proposals to limit or abolish incentives will have the effect of denying access to finance for significant numbers of consumers. This would constitute consumer harm.

9. Lower purchase costs

Car dealership viability is fundamentally driven by throughput or volume of sales in order to meet demand and protect market share.

A consequence of this business model is that price competition is highly competitive and margins are low.

Deloitte's dealer profitability report shows that the YTD Net Profit to Sales ratio is 2.3%.[1] This is compared to 1.9% in 2014.[2]

BDO found that specialty retailers recorded net profit margins of 4.3% and international retailers recorded 5.3% in the same period.[3]

This reliance on sales volume to ensure sustainability drives price competition for vehicles. Incentive payments serve to help drive this price competition and sales volumes.

Regulatory changes which impact upon the ability of dealerships to deliver this price competition will therefore obviously result in higher prices for consumers on the capital cost of vehicles.

Higher prices will impact sales volumes, further reducing profitability in a very tight market which will require cost reductions in dealerships, principally on income and workforce levels. Reducing employment and wage growth is not currently Australian Government policy.

Regulatory changes will also have consequential effects on the composition of the Australian vehicle fleet.

Higher pricing will shift consumer preferences to older, less reliable and less safe vehicles which are available within their price range. Given respective State and Commonwealth Governments have placed a long term heavy emphasis on reducing Australia's road toll, pricing consumers out of the market for safer vehicles would be inconsistent with objective. This would constitute consumer harm.

If the Royal Commission decided to expand its scope to include the cost impacts to consumers of dealer finance it cannot look at one element in isolation, it must take a holistic view of the total consequences of its actions.

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[1] *December 2015 Dealer Profitability Report*, Deloitte, https://www.eprofitfocus.com/market-intelligence/monthly-dealer-profitability/december-2015-dealer-profitability
[2] Ibid
[3] *2015 Spend Trend Report*, BDO, https://www.bdo.com.au/en-au/news/media-releases/retailers-gear-up-for-strong-2016-with-marketing-d

10. ASIC Reforms

As the result of a two year review by ASIC into the car finance market, a number of reforms were instituted in September 2017.

These reforms operate so that:

- The lender, not the car dealer, has responsibility for determining the interest rate that applies to a particular loan. The car dealer cannot suggest a different rate that earns them more commissions.
- Car dealers will have a limited capacity to discount the interest rate and receive lower commissions, leading to lower costs for credit.

Lenders and dealerships have until November 2018 to update their business models, and implement new commission arrangements that comply with the new law.

Given that the transition period for these reforms still has nine months to run, it is premature for the Royal Commission to offer any recommendations that would unwind or add additional complexity to this market.

All stakeholders have participated in good faith in the review process conducted by ASIC. Attempts to re-litigate the proposed solutions through the Royal Commission are disingenuous and potentially dangerous given the short time frame it has to consider the vast range of complex financial matters before it.

As a result of these reforms, there are already examples of improved practices including:

- Tightening of lending criteria to require higher levels of substantiation of expenses.
- Strict and consistent assessment criteria for individuals with an adverse credit history.

11. Next Steps

The MTA is available to provide further information in relation to this submission and to clarify any aspect of it.

This includes meeting with agency representatives and facilitating further consultations with industry on proposed changes.

12. Submission Contact

For further information relating to this submission please contact:

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