



Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

Request for Information Reforms to Consumer Lending

Background Paper 5

This paper was prepared by the Treasury in response to a request made by the Royal Commission.



Australian Government

The Treasury

FINANCIAL SERVICES ROYAL COMMISSION

**REQUEST FOR INFORMATION
REFORMS TO CONSUMER LENDING**

OVERVIEW OF THE KEY REFORMS IN CONSUMER LENDING SINCE 2007

Introduction

The regulation of consumer lending in Australia has undergone significant reform since 2007. It has seen the introduction of a national regime to regulate the provision of consumer credit and a shift away from a consumer protection framework anchored in disclosure and conduct obligations to a more interventionist approach targeting specific credit lending practices and credit product features. At the same time, reforms are being introduced to improve the efficiency and level of competition in consumer lending, with a goal of driving better pricing, enhanced access to finance and new products and services.

The introduction of the national regime, which was agreed to by the Council of Australian Governments (COAG) in 2008, was designed to ensure that consumers were better protected in their dealings with credit products and credit providers and to extinguish the gaps and conflicts which existed under the state and territory regimes.

To make the transition to a national regime as smooth as possible, it was introduced in two phases:

- phase one introduced a Commonwealth statutory framework for the regulation of lenders and brokers through the *National Consumer Credit Protection Act 2009* (NCCP Act); and
- phase two primarily targeted the regulation of specific classes of credit products.

Subsequent to this, specific reforms have been made to the NCCP Act, including in relation to credit cards and small amount credit contracts (SACCs). Reforms have also been introduced outside of the NCCP Act, but which nevertheless impact on consumer lending, for example, legislation which voids unfair contract terms in standard form consumer contracts and the proposed power for the Australian Securities and Investments Commission (ASIC) to intervene in respect of products that risk consumer harm.

While the key reforms to consumer lending since 2007 have occurred through legislation, reforms have also occurred through legislative instruments and regulatory guidance issued by ASIC and the Australian Prudential Regulation Authority (APRA).

In addition to these reforms, which focus on credit provision and credit products, reforms have also been introduced which impact how consumers engage with credit services and products. These include the raising of professional standards for financial advisers and the establishment of the Australian Financial Complaints Authority. Reforms have also been introduced to promote competition, for example, removing restrictions on the use of the term 'bank'. These reforms have not been included in this information note.

The introduction of a national regime

COAG's decision to introduce a national regime to regulate the provision of credit was put into effect by the 2009 National Credit Law Agreement (NCL Agreement). The NCL Agreement required the national regime to be introduced in two phases.

Phase one began on 1 July 2010 with the commencement of the NCCP Act. The main features of the phase one reforms included:

- a comprehensive licensing regime for all providers of consumer credit, including brokers and intermediaries;
- responsible lending requirements on all licensees so that they do not provide credit products and services that are unsuitable for consumers;
- expanded redress for consumer protection through, for example, universal external dispute resolution membership for licensees;
- improved sanctions and powers for ASIC; and
- a largely replicated version of the Uniform Consumer Credit Code as the National Credit Code.

In relation to the phase two reforms, given the broad spectrum of issues to be considered, it was agreed that these reforms would be delivered in two parts, with those issues requiring more in-depth industry consultation considered in part two.

The first part of the phase two reforms occurred through the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011 (Home Loans and Credit Cards Act) and the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Enhancements Act).

The Home Loans and Credit Cards Act introduced:

- a requirement to provide a Key Facts Sheet for standard home loans and credit card contracts;
- restrictions on using credit cards above the card's credit limit;
- an allocation hierarchy for payments made under credit card contracts; and
- restrictions on making unsolicited invitations to borrowers to increase their credit limit.

The Enhancements Act had as its main features:

- a new regime to regulate SACCs;
- product-specific obligations for reverse mortgages;
- caps on charges for SACCs and other credit contracts; and
- provisions for dealing with consumer hardship.

The second part of the phase two reforms has not been completed. A draft bill containing the remainder of the reforms was released for consultation in December 2012 – *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* – however, it was not introduced to the Parliament before Parliament was prorogued in August 2013.

The key components of this Bill were to introduce reforms in relation to:

- small business lending;
- credit provided for investment purposes;
- some forms of private lending;
- short-term and indefinite term consumer leases; and
- the regulation of practices which seek to avoid the operation of the national credit law.

Other legislative reforms to consumer lending

In addition to the reforms introduced through the national credit regime, in recent years, there have been a number of specific legislative reforms to consumer lending; there also reforms which are currently being progressed. These are summarised below.

Credit cards

The *Treasury Laws Amendment (Banking Measures No. 1) Act 2018* received Royal Assent on

5 March 2018. The specific matters targeted in these reforms include:

- the tightening of responsible lending obligations for credit cards;
- prohibiting unsolicited credit limit offers in any form;
- preventing interest charges being retrospectively imposed on balances which have had the benefit of an interest-free period; and
- allowing consumers to request a reduction in their credit limit or terminate their credit card, including through an online means.

These reforms respond to concerns about the competitive dynamics of credit card interest rates and how consumers engage with credit card products.

Reflecting the concern about the impacts that behavioural biases can have on how consumers engage with credit cards, the Australian Government's Behavioural Economics Team (BETA) is undertaking a project on the impact that timely reminders can have on credit card repayment behaviour. The trial is due to finish in mid-2018, after which BETA will prepare a report outlining the trial's findings.

Small amount credit contracts

In addition to the reforms made to SACCs through the Enhancements Act, changes were made through the *National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014*. The Regulation addressed avoidance practices and clarified the boundaries between small amount and medium amount credit contracts.

Additional reforms to the consumer lending laws dealing with SACCs and consumer leases are currently being progressed by the Australian Government. These reforms are in response to the *Review of the small amount credit contract laws*, which was released by the Government in 2016.

Exposure draft legislation was released for consultation from 23 October 2017 - 3 November 2017. The draft legislation is being considered in light of feedback received during consultation.

Note: SACC providers and lessors who provide consumer leases hold credit licences. Credit licensees are not within the definition of financial services entities contained in the Letters Patent.

Unfair contract terms

The Productivity Commission in its 2008 report, *Review of Australia's Consumer Policy Framework*, found that the capacity for businesses to use one-sided contract terms could sometimes unfairly and inefficiently cause detriment to consumers. As a result, it recommended that unfair contract terms should be addressed by national regulation.

In response, the Australian Government, through the *Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010*, introduced protections against unfair contract terms, including in relation to credit products. Under these laws, where a term is found to be unfair, it is void, and therefore not binding on the parties.

Product intervention power

In response to a recommendation made in the 2014 *Financial System Inquiry*, legislation is currently being developed to provide ASIC with a product intervention power to help reduce the risk of harm to consumers. This power will allow ASIC to take direct action to intervene in the sale of products, including credit products, where it identifies a risk of significant consumer detriment. (Note, the related design and distribution obligations do not apply to credit products. A key principle in determining the appropriate coverage for these obligations was that it should not apply where there is an equivalent regime already in place. In the case of credit products, the equivalent regime is the responsible lending obligation.)

Exposure draft legislation was released for consultation from 21 December 2017 – 9 February 2018. The draft legislation is being considered in light of feedback received during consultation.

Mandatory comprehensive credit reporting

The Government announced in the 2017-18 Budget that it would legislate to make participation in comprehensive credit reporting compulsory if 40 per cent of credit accounts were not being reported by the end of 2017. This followed recommendations from the 2014 *Financial System Inquiry* and the Productivity Commission's (PC) *Inquiry into Data Availability and Use*.

The purpose of these reforms is to improve how lenders meet their responsible lending obligations and give lenders access to data that will encourage competition for small business and retail customers with positive credit histories.

On 2 November 2017, the Government announced that it would legislate to require the four major banks to share comprehensive credit information with credit reporting bodies by 1 July 2018. Exposure draft legislation was released for consultation from 8 February 2018 – 23 February 2018. The draft legislation is being considered in light of feedback received during consultation.

Open Banking

In 2017, the Australian Government commissioned the *Review into open banking in Australia*. Open Banking is intended to give customers greater access to and control over their own banking data. It enables the customer to direct that they, or third parties chosen by them, be provided with their banking data in a secure environment and in a prescribed way.

The Review provided its report to the Government at the end of 2017 and made recommendations on how to best implement Open Banking in Australia, recognising that Open Banking will be implemented as part of the Government's commitment to expand consumers' access to data more broadly, which it announced in response to a recommendation of the PC's *Inquiry into Data Availability and Use*.

The Government is currently consulting on the Review's recommendations before making final decisions on implementation. Consultation closes on 23 March 2018.

Consumer lending reforms made by ASIC and APRA

While the key reforms to consumer lending have occurred through legislation, reforms have also occurred through legislative instruments and regulatory guidance issued by ASIC and APRA.

Key consumer lending reforms made by ASIC

As the consumer credit regulator, ASIC provides regulatory guidance explaining how it will exercise specific powers and interpret the law. Relevant regulatory guidance is included in Attachment C.

ASIC also has powers which allow it to directly regulate consumer lending through issuing legislative instruments which modify the NCCP Act. A reform introduced using this power is contained in *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780*. Through this instrument, ASIC formally banned flex commissions in the car finance market. Flex commissions are paid by lenders to car finance brokers (typically car dealers), which allow the dealers to set the interest rate on the car loan. Under these arrangements, the higher the interest rate charged to consumers, the larger the commission earned by the dealer.

Key consumer lending reforms made by APRA

Although ASIC is the responsible regulator for consumer credit, APRA prudentially supervises authorised deposit-taking institutions (ADIs). This includes practices in relation to lending, including mortgage lending, from the perspective of the risks that lending practices may pose to ADIs' soundness.

The key reforms implemented by APRA in relation to consumer lending are contained in APRA's Prudential Practice Guide *APG223 – Residential Mortgage Lending*, which was most recently issued in February 2017 (APG223). APG223 outlines what APRA considers to be prudent practices in the management of risks which arise from lending which is secured by mortgages over residential property. It sets out APRA's views in relation to:

- sound loan origination criteria, including quantitative serviceability parameters;
- appropriate security valuation practices; and
- stress testing and the management of problem loans.

Additionally, APRA has also intensified its scrutiny of housing lending in recent years. In December 2014, APRA wrote to all ADIs outlining further measures to reinforce sound residential mortgage lending practices, which included a focus on investor lending growth and serviceability assessments.

In March 2017, APRA again wrote to all ADIs outlining the additional steps which ADIs should take to address risks which APRA had identified as continuing to build within the mortgage lending markets. These additional steps include:

- placing a quantitative benchmark on the flow of new interest-only lending to 30 per cent of new residential mortgage lending; and
- continuing to restrain lending growth in higher risk segments.

ATTACHMENT A – CONSUMER LENDING REFORMS MADE THROUGH LEGISLATION SINCE 2007

DATE OF ROYAL ASSENT	TITLE	DESCRIPTION
15 December 2009	National Consumer Credit Protection Act 2009	Introduced a comprehensive licensing regime, responsible lending conduct requirements, expanded access to redress for consumers, improved sanctions and enforcement powers for ASIC and a National Credit Code.
15 December 2009	National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009	Provided transitional and consequential arrangements to support the transfer of credit regulation to the Commonwealth.
10 March 2010	National Consumer Credit Protection Regulations 2010	The Regulations make arrangements in relation to a number of issues, including licensing, responsible lending, and compliance and enforcement.
14 April 2010	Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010	Introduced unfair contract terms protections, including for credit products, into the Australia Securities and Investments Commission Act 2001.
25 July 2011	National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011	Required home loan lenders to provide a Key Facts Sheet to consumers for comparison purposes. It also introduced: mandatory disclosure of credit card annual interest rates; prohibitions on unsolicited credit limit increase invitations; limitations on lending above credit limits; and prioritisation of repayment of balances attracting the highest interest rates.

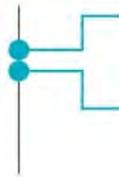
DATE OF ROYAL ASSENT	TITLE	DESCRIPTION
17 September 2012	Consumer Credit Legislation Amendment (Enhancements) Act 2012	Introduced a new regime to regulate small amount credit contracts (SACCs), caps on charges for SACCs and other credit contracts, product-specific obligations for reverse mortgages and hardship provisions.
12 June 2014	National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014	The Regulations, relevantly, clarify the boundaries between small amount and medium amount credit contracts and address avoidance practices.
5 March 2018	Treasury Laws Amendment (Banking Measures No.1) Act 2018	Introduced a number of reforms to credit cards, including: tightening responsible lending obligations; prohibiting unsolicited credit limit offers in any form; preventing interest charges being retrospectively applied to balance that have had the benefit of an interest-free period; and allowing consumers to reduce their credit limit or cancel their credit contract, including through an online means.
Bill has not been introduced into Parliament	National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017	The Bill seeks to strengthen lending conduct and consumer protections for SACCs and consumer leases.
Bill has not yet been introduced into Parliament	Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017	Under the Bill, ASIC will be able to take direct action to intervene in the sale of products, including credit products, where it identifies a risk of significant consumer detriment.
Bill has not yet been introduced into Parliament	National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018	The Bill requires the four major banks to provide comprehensive credit information on consumer credit accounts to certain credit reporting bodies. It also expands ASIC's power so it can monitor compliance with the mandatory regime and imposes additional requirements on where data which is held can be stored.

Consumer lending reforms made through legislation since 2007

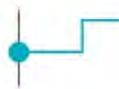
2009

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- 15 December 2009**
National Consumer Credit Protection Act 2009
 - 15 December 2009**
National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009

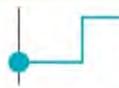
2010

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- 10 March 2010**
National Consumer Credit Protection Regulations 2010
 - 14 April 2010**
Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010

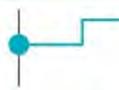
2011

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- 25 July 2011**
National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Act 2011

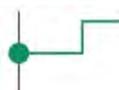
2012

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- 17 September 2012**
Consumer Credit Legislation Amendment (Enhancements) Act 2012

2014

- 
- 12 June 2014**
National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014

2018

- 
- 5 March 2018**
Treasury Laws Amendment (Banking Measures No.1) Act 2018

Bill has not yet been introduced into Parliament

National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017

Bill has not yet been introduced into Parliament

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017

Bill has not yet been introduced into Parliament

National Consumer Credit Protection Amendment (Mandatory Comprehensive Credit Reporting) Bill 2018

ATTACHMENT B – AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION CONSUMER LENDING REFORMS SINCE 2007

DATE	TITLE	DESCRIPTION
REGULATORY GUIDANCE		
29 March 2010	RG 210 Compensation and insurance arrangements for credit licensees	Outlines how licensees can satisfy the requirement to have adequate compensation arrangements.
25 June 2010	RG 205 Credit licensing: General conduct obligations	Outlines key compliance concepts that apply to all of the general conduct obligations and describes what ASIC looks for when assessing compliance.
25 June 2010	RG 207 Credit licensing – Financial requirements	Sets out ASIC’s minimum expectations for demonstrating adequate financial resources.
15 July 2010	RG 201 Unsolicited credit cards and debit cards	Sets out ASIC’s position on the prohibition of unsolicited sending of credit cards and debit cards.
10 November 2010	RG 219 Non-standard margin lending facilities: Disclosure to investors	Sets out ASIC’s expectations for improved disclosure to ensure investors can understand these products.
25 November 2010	RG 218 Licensing: Administrative action against persons engaging in credit activities	Describes the administrative powers available to ASIC to enforce the <i>National Consumer Credit Protection Act 2009</i> .
31 August 2011	RG 220 Early termination fees for residential loans: Unconscionable fees and unfair contract terms	Gives general guidance on when an early termination fee for a residential loan may be unconscionable or unfair.
18 February 2013	RG 204 Applying for and varying a credit licence	Explains how to make an application for a credit licence using the online application and how to apply for a variation of a credit licence.

DATE	TITLE	DESCRIPTION
5 November 2014	RG 209 Credit licensing: Responsible lending conduct	Sets out ASIC's expectations for meeting responsible lending requirements (expected to be reviewed in 2018).
26 February 2016	RG 96 Debt collection guideline: For collectors and creditors	The Guideline is designed to help debt collectors and creditors who use external collection agencies understand how the Commonwealth consumer protection laws apply.
REGULATORY GUIDANCE (CONTINUED)		
December 2016	RG 206 Credit licensing – Competence and training	Sets out ASIC's minimum expectations for demonstrating organisational competence.
23 August 2017	RG 257 Testing fintech products and services without holding an AFS or credit licence	Provides guidance for fintech businesses seeking to test products and services before they obtain an Australian financial services licence or Australian credit licence.
12 October 2017	RG 203 Do I need a credit licence?	Provides guidance to help people decide whether they need to obtain an Australian credit licence.
16 November 2017	RG 263 Financial Services and Credit Panel	Sets out the principles and processes of the Financial Services and Credit Panel, which sits alongside ASIC's administrative processes and assists in making administrative decisions.
14 February 2018	RG 165 Licensing: Internal and external dispute resolution	Explains what parties must do to have a dispute resolution system in place to meet ASIC's requirements.
LEGISLATIVE INSTRUMENTS		
1 April 2010	[CO 10/249] External dispute resolution schemes	The Class Order provides the names of the External Dispute Resolution Schemes ASIC has approved for credit.
2 May 2010	[CO 10/250] Internal dispute resolution	The Class Order provides for ASIC's Internal Dispute Resolution requirements for credit.

DATE	TITLE	DESCRIPTION
1 January 2011	[CO 10/1230] Clarification of credit disclosure obligations – including commencement	The Class Order gives effect to certain disclosure obligations of the <i>National Consumer Credit Protection Regulations 2010</i> .
12 July 2013	[CO 13/18] Funded representative proceedings and funded proof of debt arrangements exclusion from the National Credit Code	The Class Order enables the temporary operation of a litigation funding arrangement and a proof of debt funding arrangement without compliance with the <i>National Consumer Credit Protection Act 2009</i> and <i>National Credit Code</i> . The Class Order has been remade, and relief extended, a further three times with the most recent instrument granting relief until 12 July 2019. (The Class Order is not applicable to financial services entities as defined by the Letters Patent).
14 December 2016	ASIC Credit (Concept Validation Licensing Exemption) Instrument 2016/1176	Exemption to allow concept validation of a business model without holding a licence in certain circumstances (regulatory sandbox).
6 September 2017	ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780	Through this instrument, ASIC formally banned flex commissions in the car finance market.
22 September 2017	ASIC Credit (Financial Counselling Agencies) Instrument 2017/793	Provides relief for financial counselling agencies to remain exempt from the requirement to hold a credit licence when providing credit assistance in certain circumstances. (This instrument is not applicable to financial services entities as defined by the Letters Patent).
Upcoming	Determination on the credit limit on a credit card	Determination of the period for repayment of the credit limit on a credit card – under new s160F of the <i>National Consumer Credit Protection Act 2009</i> .

* ASIC also issues information sheets on consumer lending and provides individual relief from regulatory requirements.

ATTACHMENT C – AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY CONSUMER LENDING REFORMS SINCE 2007

DATE	NAME	DESCRIPTION
2008 3 December 2014 (most recent update)	Prudential standard APS220 - credit quality	APS 220 requires an Authorised Deposit-taking Institution (ADI) to control credit risk by adopting prudent credit risk management policies and procedures. Apra expects to commence consultation on revisions to APS 220 during 2018; this will include addressing prudential expectations for loan underwriting standards.
9 December 2014 February 2017 (most recent update)	Letter to all Authorised Deposit-taking Institutions: Further measures to reinforce sound residential mortgage lending practices	In this letter, APRA advised that it considered that it was necessary to further increase the level of supervisory intensity in the area of housing lending, to reinforce sound lending practices, with a particular focus on some specific areas of prudential concern. APRA indicated that it considers a benchmark of 10 per cent annual growth in investor lending to be an indicator of heightened supervisory concern.
November 2014/February 2017	Prudential Practice Guide: APG 223 – Residential Mortgage Lending	This Prudential Practice Guide outlines prudent practices in the management of risks arising from lending secured by mortgages over residential properties, including owner-occupied and investment properties. The February 2017 update includes prudent measures to assess borrower serviceability, including the application of quantitative interest-rate buffers.
31 March 2017	Letter to all Authorised Deposit-taking Institutions: Further measures to reinforce sound residential mortgage lending practices	In this letter, APRA advised that additional measures to address the risks within the mortgage lending market, including a 30 per cent benchmark on the share of new interest-only lending by ADIs.
May 2017	ARF 223.0 Residential Mortgage Lending	ARF 223 will provide APRA with more granularity in ADI's reporting on residential mortgage lending.