



# Consumer credit reforms

The Government is simplifying Australia's credit framework to ensure consumers and small businesses can get timely access to credit, particularly as the economy recovers following the COVID crisis. Through a suite of changes to Australian credit laws, the Government will enable the more efficient flow of credit to consumers and small businesses while maintaining strong consumer protections. Improving the flow of credit is a key element of the Government's JobMaker plan, supporting business investment and creating jobs to build a stronger, more resilient and more competitive economy.

## Taking action to reduce barriers to credit

The importance of credit to households and businesses makes access to credit vital to Australia's economic success. Economic studies have consistently demonstrated a positive relationship between credit growth and economic growth, with the cost and availability of credit a strong determinant of credit growth.

Credit underpins the Australian dream of home ownership, with more than \$13 billion dollars on average in new credit extended each month to help Australian families purchase their own home. Credit also allows investors and businesses to invest, grow and create jobs, including around \$5 billion per month in new credit to housing investors.

Now, more than ever, it is important that there are no unnecessary barriers to the flow of credit to households and business, especially small and medium sized businesses, as the economy recovers.

The *National Consumer Credit Protection Act 2009* (Credit Act) was put in place more than 10 years ago. The Credit Act introduced principles aimed at ensuring lenders do not provide unsuitable loans to consumers. Fast forward to 2020, and the principles which underpin responsible lending obligations (RLOs) have been implemented in a way that is no longer fit for purpose and which risks slowing our economic recovery.

The prescriptive approach in RLO guidance and internal lenders' systems developed to comply with the guidance leaves borrowers and lenders facing a 'one-size-fits-all' approach. This means lenders are required to adopt a similar approach to credit assessment for most consumers and credit products, irrespective of their circumstances. Lenders face prescriptive obligations, with close to 100 pages of guidance advising how they should meet their obligations under RLOs. The guidance puts the onus on lenders to verify information provided by borrowers, with borrowers bearing limited responsibility for providing incorrect or misleading information to lenders. In response, many lenders have put in place detailed and lengthy credit approval processes aimed solely at meeting these requirements, but without necessarily improving a lender's ability to understand if the loan is suitable for the customer.

As a result, obtaining credit has become more burdensome for borrowers, irrespective of the risks they face, and significantly increased the time needed to gain credit approvals. As the Governor of the Reserve Bank of Australia observed recently, what began as responsible lending principles has translated into a practice that has become imbalanced between a lender and its customer, leading to the undesirable consequence of unduly restricting lending.

Since the introduction of RLOs, the Government has introduced a number of significant changes in other areas of the law that have strengthened consumer protection in the credit system, including:

- provided the Australian Securities and Investments Commission (ASIC) with a product intervention power that allows ASIC to ban, or amend, a credit product where that product has resulted, or is likely to result, in significant consumer detriment;
- introduced a design and distribution obligation which will require product issuers to identify and distribute their products to appropriate consumers to reduce the risk of consumers acquiring or being mis-sold products that do not meet their needs;
- introduced a best interests duty for mortgage brokers which will ensure mortgage brokers act in the best interests of consumers when providing credit assistance;
- more than doubled the maximum corporate and financial sector civil and criminal penalties under the Credit Act;
- enhanced protections for credit card customers by banning unsolicited offers of credit limit increases, simplifying how interest is calculated and requiring online options be available for consumers to cancel cards or reduce their limits; and
- established the Australian Financial Complaints Authority (AFCA), increasing access for borrowers to external dispute resolution.

The Australian Prudential Regulation Authority (APRA) has also updated its standards for Authorised Deposit-taking Institutions (ADIs) to ensure lenders have appropriate settings for managing risk. APRA's standards, which govern over 90 per cent of all credit extended to Australian borrowers, sets out standards for credit risk management that ADIs are expected to meet. These standards include expectations of sound lending practices. At present, ADIs are subject to the RLOs while also needing to comply with APRA's requirements in respect of the same lending activity.

The 'one-size-fits-all' and prescriptive nature of RLOs is imposing burdensome and unnecessary processes on both lenders and borrowers, leading to delays in credit approvals and increasing borrowing costs. Existing mortgage holders face avoidable delays in refinancing existing loans even if they have a strong credit record, and sophisticated borrowers are often subject to the same stringent obligations as a high-risk borrower applying for a payday loan. To the extent that small business owners use their home as security for personal and business investment, delays in credit processing times also delay investment and business growth.

### Example - 'One-size-fits-all' framework

Lisa is a retiree who recently lost her husband. They had a \$3,000 credit card account in both their names, but upon her husband's death the bank closed the account as he was the main cardholder. During the last two years, Lisa was the only person using and paying for the card, but was informed by the bank that she could not obtain a credit card in her own name as it could put her in 'severe financial distress'.

Despite Lisa having \$430,000 in her accounts, including her husband's Refundable Accommodation Deposit being repaid to his estate, the bank notified Lisa that it was not able to consider her assets in her credit evaluation, but only the actual income she received each month.

Following the proposed changes, the lender would instead be able to consider Lisa's financial circumstances, including that she has sufficient available assets to meet the total amount of outstanding credit and make their own assessment regarding whether to extend the product.

## Government reforms – improving the flow of credit

The Government will simplify the law through changes to the Credit Act to reduce the time and cost of credit assessments for consumers and businesses, reduce red tape for consumers seeking a credit product, improve competition by making it easier for consumers to switch lenders, and enhance access to credit for small businesses.

The Government will achieve this by:

- ensuring that ADIs continue to comply with APRA's lending standards;
- appropriately adopting key elements of APRA's ADI lending standards and applying them to non-ADIs; and
- for higher-risk products, being small amount credit contracts (SACCs) and consumer leases, RLOs will remain and the obligations on all lenders of these products strengthened.

APRA will continue to regulate ADIs in relation to existing standards and ASIC will continue to regulate non-ADIs in relation to the new standards that are introduced. Appropriately adopting APRA's expectations of sound ADI lending practices for non-ADIs will ensure there is consistency between the standards applied for ADIs and non-ADIs.

A key feature of the new obligations will be allowing lenders to rely on the information provided by borrowers, unless there are reasonable grounds to suspect it is unreliable. Borrowers will be made more accountable for providing accurate information to inform lending decisions, replacing the current practice of 'lender beware' with a 'borrower responsibility' principle. This change will help address the excessive risk aversion which has progressively entered the system, restricting the flow of credit.

The changes will remove the 'one-size-fits-all' approach to lending, and ensure credit assessment is attuned to the needs of the borrower and the credit product. For example, lenders at present are required to obtain and verify extensive information about borrowers' expenses, irrespective of the type of loan product or the borrower. Following the changes, the obligations on the lender will be proportionate with the risk. As a result, credit providers will be able to simplify their credit assessment process and extend credit in a more timely and efficient manner. The Government expects that lenders will pass on the benefits of the reduced regulatory burden to consumers over time.

#### **Example - Risk-averse lender**

Marc put down a deposit to buy his first home after receiving pre-approval from the bank, following a suitability assessment. Prior to settlement, Marc received a promotion at work that changed his role and increased his salary (he had been with the company for a year). He notified his bank before the loan was finalised. The bank's response was that the promotion constituted a change in circumstance, and therefore the loan suitability process would need to be run again to determine how much he could borrow. However, this process was delayed because Marc no longer had a past history of income at the level to rely on. Understandably, this caused Marc concern as settlement on the house was imminent, and this was an unnecessary delay in the final approval of funds.

Following the proposed changes, the bank would instead be able to assess that the change in circumstance did not negatively affect borrowing capacity.

The changes to the Credit Act will streamline consumers' engagement with lenders. As lenders can rely on the information provided by borrowers, the need for extensive verification procedures, which can often account for half the loan application process, will diminish. This will significantly simplify the loan application process for borrowers as they will no longer need to hand over superfluous amounts of information to lenders. Reducing the burden faced by borrowers when seeking loans will also reduce barriers to switching between credit providers, encouraging consumers to seek out better terms or a lower interest rate.

Where a proportion of an application for credit is for a business purpose, irrespective of the proportion, the new framework will not apply. Small business lending was never intended to be captured by the Credit Act, but the recent prescriptive interpretation of the obligations as well as the excessive risk aversion of lenders has meant that some small businesses have struggled to access credit, particularly where it is difficult to separate their business from their household, such as primary producers. Borrowers will have more confidence to approach lenders to access credit for business purposes knowing that the process to obtain approval is simpler and less intrusive. Importantly, small business lending will continue to be covered by the ASIC approved Banking Code of Practice, which will be strengthened following the implementation of the financial services Royal Commission, to include enforceable code provisions, regulated by ASIC. Small business lending also continues to be subject to AFCA's small business jurisdiction, where the lender is an AFCA member, providing free and timely access to redress.

Consumers more broadly will continue to have access to protections via existing frameworks for borrowers. Credit providers will still be obliged to be members of AFCA and comply with their existing licensing obligations to act efficiently, honestly and fairly. Further, the duty under the Banking Code of

Practice for signatory banks to exercise the care and skill of a diligent and prudent banker will still apply.

To ensure there is no misalignment between the obligations of mortgage brokers and lenders, following the changes, mortgage brokers will no longer be subject to RLOs; however, consumers will continue to be protected when accessing services by mortgage brokers through the recently introduced best interest duty for mortgage brokers commencing 1 January 2021.

The reforms will be implemented through changes to the Credit Act and will commence, subject to the passing of legislation, from 1 March 2021.

## **Ensuring high cost forms of borrowing are protected – Small Amount Credit Contracts and Consumer Leases**

The Government will also implement reforms to enhance financial inclusion and ensure Australian consumers accessing small amount credit contracts (SACCs) and consumer leases are better protected.

SACCs and consumer leases are high cost forms of borrowing, and are more typically accessed by some of Australia's most vulnerable consumers. While these products can be useful for consumers as an emergency source of funding, repeat borrowing can lead to repayments consuming a greater portion of income, becoming increasingly unaffordable.

The Government's reforms are designed to limit consumer harm while maintaining access to SACCs and consumer leases.

### **Imposing a cap on the total payments that can be made under a consumer lease**

The permitted cap on costs will be equal to the sum of the base price of the goods hired under the lease, permitted delivery fees and permitted installation fees multiplied by 4 per cent per month (up to a maximum of 48 months). Lessors will additionally be able to charge a one-off establishment fee of 20 per cent of the good's base price.

### **Introducing new 'protected earnings amounts' for SACCs and consumer leases**

SACC providers and consumer lessors will be prohibited from providing a SACC or lease that would result in:

- A person who receives 50 per cent or more of their net income from Centrelink from devoting more than 20 per cent of their net income to SACC and consumer lease repayments, with no more than 10 per cent of this being allocated toward SACC repayments.
- A person who receives less than 50 per cent of their net income from Centrelink from devoting more than 20 per cent of their net income to SACCs or consumer leases (these are separate caps).

These 'protected earnings amounts' will maintain access to credit while ensuring enhanced protection for the most vulnerable consumers.

The reforms will be implemented through changes to the Credit Act and will take effect 6 months following passage of legislation.

## **Protecting consumers from the predatory practices of debt management firms**

The Government will support consumers engaged in financial disputes by introducing licensing obligations for debt management firms representing consumers in disputes with financial services firms.

Consumers turning to debt management firms for representation in disputes with credit providers are often vulnerable and confused by unfamiliar formalised processes. As it currently stands, the piecemeal regulatory regime for these firms means that, where difficulties arise between consumers and these paid representatives, affordable and accessible forms of redress are unavailable.

To address this, the Government's reforms will require debt management firms representing consumers in internal and external dispute resolution processes to hold an Australian credit licence and meet the ongoing obligations imposed on credit licensees. These obligations include a requirement to meet the 'fit and proper person' test, and to undertake their activities 'efficiently, honestly and fairly'.

Importantly, the Government's reforms will allow those consumers involved in a dispute with a debt management firm representative to have disputes determined efficiently and fairly by the Australian Financial Complaints Authority.

This reform will be implemented through a change to the Credit Regulations and will commence from 1 April 2021.

## **Next Steps**

The Government will consult publicly with stakeholders before finalising any legislation required to implement the reforms.