Submission to Senate Economics Legislation Committee on the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020

Submission date: 3 February 2021

Submitted by: The following members of the Australasian Consumer Law Roundtable:

- Professor Elise Bant, Professor of Private Law and Commercial Regulation, University of Western Australia Law School (https://www.uwa.edu.au/profile/able/elise-bant)
- Dr Vivien Chen, Lecturer, Department of Business Law and Taxation**,** Monash Business School, Monash University (https://research.monash.edu/en/persons/vivien-chen)
- Dr Karen Fairweather, Senior Lecturer, Faculty of Law, University of Auckland (https://unidirectory.auckland.ac.nz/profile/k-fairweather)
- Ms Nicola Howell, Senior Lecturer, Faculty of Business and Law, Queensland University of Technology (https://staff.qut.edu.au/staff/nicola.howell)
- Professor Justin Malbon, Adjunct Professor, Griffith Law School, Griffith University (https://scholar.google.com/citations?user=bWIDJXkAAAAJ&hl=en)
- Professor Luke Nottage, Professor of Comparative and Transnational Business Law, Sydney Law School, University of Sydney (https://www.sydney.edu.au/law/about/our-people/academic-staff/luke-nottage.html)
- Professor Jeannie Paterson, Professor of Law (Consumer and Credit Protection and New Technology), Melbourne Law School, University of Melbourne (https://law.unimelb.edu.au/about/staff/jeannie-paterson)
- Professor Gail Pearson, Discipline of Business Law, University of Sydney (https://www.sydney.edu.au/business/about/our-people/academic-staff/gail-pearson.html)
- Dr Andy Schmulow, Senior Lecturer, School of Law, Faculty of Business and Law, University of Wollongong (https://scholars.uow.edu.au/display/andy_schmulow)
- Professor Eileen Webb, Professor of Law and Ageing, School of Law, University of South Australia (https://people.unisa.edu.au/eileen.webb)
- Associate Professor Therese Wilson, Dean of Law and Head of School, Griffith Law School, Griffith University (https://experts.griffith.edu.au/7389-therese-wilson)

Thank you for the opportunity to provide a submission to this inquiry into the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020. This submission is made by law academics who are members of the Australasian Consumer Law Roundtable group and who teach and research consumer law and policy.

We previously contributed to a submission on the exposure draft legislation, released in November 2020. In this earlier submission, we explained our strong concerns about the proposal to remove the responsible lending obligations for most consumer credit products, and we recommended that, with one exception (on the expansion of the best interests duty) the proposed amendments not be proceeded with.

Our concerns about the exposure draft legislation, for the most part, remain and have not been adequately addressed in the Bill as tabled in December 2020. We therefore have attached the text of our earlier submission as an Appendix below, with some annotations to reflect changes or clarification since the exposure draft material was released, and we ask that this material be considered part of our submission to this inquiry.

Having regard to the text of the Bill and Explanatory Memorandum as tabled, we also make the following additional points:

- One of the main concerns as identified in the Explanatory Memorandum is the prescriptive nature of the ASIC guidance on the RLOs. This suggest the reform attention should be paid to the scope and content of the regulatory guide (which does not have the force of law) rather than to the text of the RLOs in the legislation, which are principles-based and allow for flexible application to different circumstances. For example, the Chairman of ASIC has noted that the law "still provides enough flexibility for lenders to exercise their good judgment – their professional judgment – in order to make the correct decisions".[1]

- For the non-ADI standards, the Bill and explanatory material clarifies that a single instance of non-compliance with the non-ADI standards will amount to a contravention of the relevant section and could therefore be relevant in a dispute made to AFCA. However, unless it the non-compliance is repeated, the lender will not contravene a civil penalty provision, and therefore an individual consumer will have no right to seek compensation under NCCPA s 178.

- The reliance on APRA standards for lending by ADIs also means that a failure to comply with an APRA standard will not be a contravention of a civil penalty provision in the NCCPA, and an affected consumer will not have a right to seek compensation under NCCPA s 178.

- As a consequence of effective removal of the RLOs from the NCCPA, and lack of opportunity for legal action, there will be no opportunity to use litigation to clarify the scope of the expectations of lenders. The fact that the vast majority of disputes at AFCA are resolved by negotiation also results in a lack of transparency about the expectations of lenders, which in turn makes it difficult for consumers to know whether standards are below what is required.

[1] James Eyers and James Frost (2020) 'ASIC gives banks a break on responsible lending', *Australian Financial Review* 21 May 2020 (https://www.afr.com/companies/financial-services/asic-gives-banks-a-reprieve-on-responsible-lending-20200521-p54v6e).

- The Explanatory Memorandum suggests that small business lending has been hindered because of the ambiguity in the application of the law to mixed-use lending, and that the Bill will remove this ambiguity because fewer inquiries will need to be made as to loan purpose (pp 50-51). However, other obligations in the NCCPA will continue to apply to loans that are predominantly for personal, domestic or household purposes, and the amendments proposed to the RLOs will not relieve the lender of the need to ascertain the respective proportion of the personal and business purposes of a proposed loan.

- The Explanatory Memorandum indicates concern about the need to facilitate increased access to credit, however, we note that a December 2020 report from NAB that mortgage lending for first home buyers was at record levels,[2] and statistics from the Australian Bureau of Statistics showing that new loan commitments for housing reached record highs in December 2020.[3]

We therefore strongly recommend that the provisions that remove the RLOs from application in all credit products except for low limit credit contracts and consumer leases be deleted from the Bill.

We note that the Bill also contains provisions to:

- Extend the best interests duty to a wider group of credit assistance providers;

- Implement many of the recommendations of the Review of Small Amount Credit Contracts and Consumer Leases; and

- Introduce anti-avoidance measures.

We are supportive of the intent of these proposals, but due to the time constraints for making this submission, are not able to provide specific comments on the detail of these provisions in the Bill.

Contact for further information:

Nicola Howell, QUT Faculty of Business and Law

Email: nicola.howell@qut.edu.au

Tel: (07) 3138 2006

[2] New data from National Australia Bank says mortgage lending for first-home buyers at record levels (theaustralian.com.au) (G Cockburn, *The Australian*, 15 December 2020).
[3] Australian Bureau of Statistics, *Lending Indicators* (December 2020), at https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release.

Appendix: Text of submission to Treasury on the Exposure Draft National Consumer Credit Protection (Supporting Economic Recovery) Bill 2020 and related measures

The text below replicates a submission made by Consumer Law Academics in Australia and New Zealand. The submission was provided to Commonwealth Treasury on 23 November 2020. Annotations to the submission were made on 3 February 2021.

Introduction and summary

Thank you for the opportunity to provide feedback on the exposure draft material designed to implement the Government's proposals announced on 25 September 2020 (including the NCCP (Supporting Economic Recovery) Bill 2020, the NCCP (A new regulatory framework for the provision of consumer credit) Regulations 2020, the Non-ADI Credit Standards, and the accompanying explanatory material). This submission has been prepared and submitted by several members of the Australasian Consumer Law Roundtable.[4] This informal group of academics comes together annually to present and debate consumer law research and policy at the Australasian Consumer Law Roundtable workshop.

Our submission sets out our concerns with the proposal to repeal the responsible lending obligations for most Australian Credit Licence holders. Given the short time frame for consultation, we have focused on the broad policy positions that would be implemented if the exposure draft material became law, rather than technical drafting issues.

Our concerns include that the proposals will detract significantly from necessary protections offered by consumer credit laws; encourage instances of irresponsible lending; remove access to the Courts and the possibility of a clear remedy; and the result may be avoidable harm and distress for many individuals and families in Australia. We acknowledge that the government's expectation is that the proposal will improve the flow of credit to consumers and small businesses. However, we have seen no evidence that the responsible lending obligations unreasonably stifle credit access, and their removal is likely to have limited effect on this policy goal.

Even if equivalent standards are included in prudential standards and the proposed Non-ADI standards, these standards focus on systemic issues. Their aim is to ensure stability in the banking system, not redress harm to individuals. For this reason, they provide limited, if any, enforcement or remedial options for consumers when there is non-compliance with the relevant standards. In any case, there is little history of active enforcement practices by APRA to date, and limited enforcement mechanisms where action is taken. As a result, there

[4] The lead author of the submission is Nicola Howell. Therese Wilson, Gill North, Elise Bant, Jeannie Paterson, Vivien Chen and Gail Pearson also contributed to the final text of the submission.

is likely to be a lack of real deterrence for inappropriate conduct, especially in circumstances where irresponsible lending may be financially rewarding to the institution concerned.

Individual instances of irresponsible lending can cause considerable emotional and financial harm to individuals, households, and families. More widespread cycles of irresponsible lending, as have happened in the past, leave consumers over-indebted and vulnerable if a sudden and steep economic downturn occurs, such a downturn arising from a global pandemic.[5] The broader economic and community impacts are typically vast and long-lasting.

Our concerns about the proposed changes are set out in more detail below, and we strongly recommend that the proposed amendments to the RLOs in the NCCPA and related measures not be proceeded with. Instead, any concerns about scope and complexity could be most usefully addressed through expanding the scope of the current Australian Law Reform Commission (ALRC) reference on financial services regulation to include consumer credit regulation *or* to commission a subsequent reference or review following the conclusion of the ALRC's financial services review.

The original policy rationale for the RLOs is still relevant

As flagged in the Government's announcement on 25 September, if the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020 becomes law, the responsible lending obligations (RLOs) in the NCCPA will apply only to 'low limit credit contracts' (defined in Schedule 1, item 1 to include only small amount credit contracts and similar contracts offered by ADIs). For all other consumer credit contracts, credit providers and credit assistance providers will no longer be required to comply with the responsible lending obligations in the NCCPA.[6] Instead, it is suggested that appropriate lending conduct will be ensured by compliance with APRA prudential standards for ADI lenders and equivalent standards for non-ADI lenders, and by the best interests' duty for credit assistance providers.

However, our primary submission is that the policy rationale for the original implementation of RLOs for all credit providers and credit assistance providers remains equally valid today, and there is nothing arising from the COVID-19 pandemic that suggests a need to reject this original policy rationale.

The current responsible lending provisions in Australia are only 11 years old. They were introduced following a long period of discussion and consultation about the failure of the predecessor regulation, the Uniform Consumer Credit Code, to protect consumers from poor lending practices of some lenders and brokers. Specific responsible lending provisions were ultimately deemed necessary because existing measures, including prudential

[5] See Andy Schmulow (2020) 'ASIC's loss to Westpac is terrible for everyone' (https://www.regulationasia.com/asics-loss-to-westpac-is-terrible-for-everyone/).

[6] We note also that the RLOs will continue to apply to consumer leases, as the Bill does not propose any changes to Parts 3-3 and 3-4 of the NCCPA.

standards, disclosure obligations, remedies for unjust credit contracts, and provisions in industry codes that required banks to exercise the care and skill of a diligent and prudent lender, were considered insufficient. Higher standards were warranted. As noted by Middleton J in the 2018 case of *ASIC v ANZ Bank*:

> Chapter 3 [of the National Consumer Credit Protection Act 2009 (Cth)] has a specific purpose to create and enforce a new norm of conduct for credit providers and brokers when entering into credit contracts.

Importantly, the RLOs apply to all consumer credit contracts, and are not limited to particular types of contracts, ensuring uniformity in the basic conduct standards for all products and all provider types.[7]

The National Consumer Credit Protection Act was passed with the support of Liberal and National Party members in the Australian Parliament. No subsequent consideration of the legislation recommended or suggested a need to wind back the overall approach in the responsible lending provisions. The responsible lending provisions have been considered directly or tangentially in several reviews since their introduction, including Parliamentary Committee inquiries on proposed amendments, the 2016 Review of the Small Amount Credit Contract Laws, and ASIC reports on lending and other practices in relation to credit cards (REP604, REP580), reverse mortgages (REP586), small amount credit contracts (REP426), low doc home loans (REP410), and the practices of credit assistance providers (REP358) and mortgage brokers (REP628).

Residential mortgage lending has been an area of concern in recent years, and APRA and ASIC have played a complementary role in this area. In the build-up of risk in this sector through the 2010s ASIC and APRA worked cooperatively in their respective spheres of prudential supervision and conduct regulation, APRA focusing on serviceability and ASIC on lack of suitability.[8] Concerns about a deterioration in lending standards in the home mortgage market were specifically raised by APRA in late 2017,[9] with the Chair of APRA also explaining in 2018, that he '[has] been … engaged in … a tug of war with the [banking] industry to try to improve standards [in the mortgage lending industry]'.[10] These concerns were raised despite the existence of prudential standards for ADI lenders.

Less than two years ago, the Financial Services Royal Commission rejected the proposition that responsible lending measures taken by the regulators had impacted on tightened credit; instead other factors were at play.[11] The FSRC explicitly recommended *against*

---

[7] *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2018] FCA 155 [25].

[8] Gail Pearson (2020) 'Twin Peaks and boiling frogs: consumer protection in one or two ponds? In Andrew Godwin and Andrew Schmulow *The Cambridge Handbook of Twin Peaks Regulation* (in press).

[9] Cited in Gill North and Therese Wilson (2020) 'Has the Australian Prudential Regulatory Authority done enough to meet its legislative objectives and prepare Australia for the next financial crisis'? 43(2) UNSW Law Journal 552, 572.

[10] Ibid.

[11] Financial Services Royal Commission, Final Report (vol 1), 59.

changing the NCCP Act obligation to assess unsuitability (Recommendation 1.1). The Government's response to this recommendation was supportive, stating:

> The Government **agrees** to this recommendation and the Commissioner's findings that 'not unsuitable' remains the appropriate standard for responsible lending obligations within the *National Consumer Credit Protection Act 2009* (NCCP Act).[12]

While the COVID-19 pandemic has had significant health and economic implications, it has not fundamentally changed the parameters of the consumer credit market, and does not warrant a rejection of a standard of conduct that was agreed as appropriate and necessary at the time, and that was supported by, among others, Commissioner Hayne and the Government, less than 2 years ago.

In contrast to the extensive discussion and consultation leading up to the introduction of the responsible lending provisions, and in various reviews and forums since the provisions have been in operation, there has been hardly any public discussion of the need for the changes proposed by the government. In addition, the very short period of consultation on the exposure draft documents (just over two weeks), and the government's stated intention for the changes to commence by March 2021, mean that it will not be possible to have a thorough and considered consultation on the proposals, despite the fact that they will amount to a radical departure from the existing requirements.

RLOs will not apply to most consumer credit products, including product types where concerns about irresponsible lending have previously been identified

If the Bill is passed, RLOs will be retained only for 'low limit credit contracts', where the definition encompasses small amount credit contracts and similar contracts provided by ADIs. As was identified in the 2015 SACC review, many of the consumers using small amount credit contracts are vulnerable or disadvantaged, and the general RLOs have therefore been supplemented with additional protections.

Retaining the RLOs for this group of credit products is very important, and we discuss this further below.

However, SACC consumers are not the only consumers at risk of irresponsible lending. For example, responsible lending was the third most common issue in banking and finance complaints received by AFCA in 2019/2020, and most complaints to AFCA involve home loans and credit cards.[13] And in an analysis of ASIC enforcement action between January 2014 and June 2017, North and Wilson reported that the enforcement actions involved car

[12] The Australian Government the Treasury (2019) *Restoring Trust in Australia's Financial System: The Government response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 6.
[13] Australian Financial Complaints Authority (2020) *Annual Review 2019-20*, 29.

loans, home loans, overdraft facilities and credit cards, as well as small amount credit contracts.[14]

Some of ASIC's more recent enforcement action on responsible lending also involves credit products other than SACCs. For example, the Commonwealth Bank was recently ordered to pay a penalty for contravening the responsible lending obligations when offering a credit limit increase on a credit card product to a problem gambler.[15]

ASIC reports have also identified concerns about overcommitment, irresponsible lending and/or product suitability in relation to credit cards (REP604, REP580), reverse mortgages (REP586), small amount credit contracts (REP426), low doc home loans (REP410), and the practices of credit assistance providers (REP358) and mortgage brokers (REP628).

In many cases, these concerns have arisen despite the applicability of prudential standards, the availability of review through AFCA or its predecessors, and/or the application of industry codes such as the Code of Banking Practice.

We also draw your attention to the recent 'Shonky Award' given by CHOICE to Harvey Norman and Latitude Finance in relation to the selling of expensive credit cards, [16] and to a speech made this month by ASIC's Acting Chair, Karen Chester, where she noted that ASIC will focus its enforcement work on conduct that seeks to exploit the pandemic environment, including predatory lending conduct.[17] Predatory lending conduct is not confined to small amount loans.

The above examples show that if the Bill comes into force, a consumer taking out a loan in similar circumstances to those identified in the case law, ASIC's enforcement work and reports, and other commentary will have much reduced protection from irresponsible lending. If a lender or broker (other than where a SACC is involved) engages in irresponsible lending, an affected consumer will have no remedy through the courts, and ASIC will have no jurisdiction to seek a penalty from the institution or individual concerned. The types of products that will no longer be governed by the NCCPA RLOs include home loans (whether for residential or investment purposes), credit cards, secured personal loans, unsecured personal loans above $2,000, car loans, medium amount credit contracts, and reverse mortgages, and the amount of credit provided through these products far exceeds the amount of credit provided through SACCs.

The Bill will also likely make it more difficult to address overcommitment issues in future products that may fall outside current regulatory frameworks. For example, ASIC has reported that some consumers using Buy Now Pay Later products are at risk of overcommitment.[18] Removing responsible lending obligations for almost all of the

[14] Gill North and Therese Wilson (2018) 'Supervision of the responsible lending regimes: Evidence, theory, analysis and reforms' 46 Federal Law Review 193, 201.
[15] *ASIC v Commonwealth Bank of Australia* [2020] FCA 1543.
[16] See https://www.choice.com.au/shonky-awards/hall-of-shame/shonkys-2020/harvey-norman.
[17] 'Getting on with it' Keynote address by Karen Chester, Acting Chair, ASIC AFR Banking & Wealth Summit Wednesday 18 November 2020 (https://asic.gov.au/about-asic/news-centre/speeches/getting-on-with-it/).
[18] Australian Securities and Investments Commission (2018) *Review of buy now pay later arrangements* (Report 600), 12.

consumer credit market will make it more difficult to develop solutions and political will for addressing overcommitment issues in the Buy Now Pay Later market.

RLOs are critical in the SACC market

We agree that the RLOs are important for the SACC market, and we applaud the retention of the RLOs for these contracts, given the risk of detriment to borrowers and the high use by vulnerable and disadvantaged borrowers. In light of the particular issues in this market, additional responsible lending protections are included for SACCs, and these should continue to apply. Provisions such as the protected earnings rule are aimed at ensuring that SACC borrowers are able to afford their daily necessities. At the same time, RLOs mitigate the risk of increasing indebtedness from repeated use of high-cost loans and debt spirals. The detrimental consequences of being caught in a debt spiral are underscored in the Revised Explanatory Memorandum to the Enhancements Bill. These include severely diminished capacities to channel credit to improve their standards of living, which may in turn adversely affect their health and wellbeing.[19] The significant risks of detriment to consumers are reflected in recent statistics that indicate that 'over a 5-year period around 15% of payday borrowers will get into a debt spiral which leads to events such as bankruptcy … A larger number fall into family or relationship issues'.[20] Statistics from the 2015 review of SACCs indicate high levels of repeat borrowing. An average of 3.64 SACCs was taken out by consumers during a 12-month period to 20 July 2015, and '30 per cent of households with a SACC consumer had more than one SACC concurrently'.[21]

SACC Review recommended expanding, not weakening, protections

The SACC review noted the importance of safeguards aimed at protecting SACC borrowers from harm caused by debt spirals. Provisions such as the protected earnings rule are aimed at ensuring that SACC borrowers are able to afford their daily necessities, and in light of the increasing use of online loans, the Panel recommended that safeguards such as the protected earnings rule should be extended to a broader range of consumers.[22] A reduction of RLOs for all but SACCs and equivalent products from ADIs is at odds with the Panel's views that more safeguards are required for other consumers to lower the risks of harm from indebtedness.

[19] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 54.
[20] Digital Finance Analytics, *The Costs of Inaction in Payday Lending* (Report, 18 June 2018) 3 <https://policy.consumeraction.org.au/wp-content/uploads/sites/13/2018/06/180605-DFA-PayDay-Impact.pdf>.
[21] Ibid 13.
[22] The Australian Government The Treasury (2016) *Review of the Small Amount Credit Contract Laws*, 11 (recommendation 1).

Risks of regulatory arbitrage, particularly for borrowers of Medium Amount Credit Contracts

The removal of the RLOs for all credit contracts other than 'low limit credit contracts' is likely to create the potential for arbitrage, where consumers may be encouraged to borrow more than they are seeking so that the licensee can avoid the application of the RLOs in the NCCPA.

The consumer credit sector has had a long history of avoidance activities, where credit providers and credit assistance providers artificially structure transactions so as to avoid the application of the credit laws, or particular aspects of the credit laws.[23] Creating a regulatory divergence between types of credit contracts in terms of the application of RLOs is likely to exacerbate that trend, particularly when a one-off instance of non-compliance with the RLOs in the NCCPA can lead to the imposition of significant penalties and/or compensation orders, while, as discussed below, the potential penalties or enforcement options for a one-off failure to comply with the lending standards in APS220 or the proposed Non-ADI standards are much more limited, and there is no option for individual consumer remedies. Such an approach is also inconsistent with principles of functional neutrality that was a key principle behind the recommendations in the Wallis Financial System Inquiry.

Further, even without explicit or implicit encouragement, potential borrowers may also decide to take out larger loans than they had originally intended if these loans are more accessible.

If the Bill passes, borrowers of amounts of more than $2000 will not be protected by RLOs. However, medium amount credit contracts and other loans are marketed on the same internet platforms as SACCs and consumers are exposed to advertising which emphasises the positive aspects of such loans while the risk of harm from debt spirals are often obscured.[24] Lenders' websites and social media sites commonly offer tips on living well on a budget while advertising their loans in the midst of advice on good financial management, at times encouraging consumers to take out loans for expenses such as holidays. There are no mandatory warnings for loans above $2000 nor requirements that lenders should signpost consumers to cheaper alternatives for managing debt. RLOs are an important safeguard against consumers taking out loans that are unaffordable and detrimental.

[Annotation 3/2/21: We note the introduction of anti-avoidance provisions in the Bill as tabled in Parliament. However, these provisions will not address the issue of lenders providing MACCs instead of SACCs.]

[23] Eg, ibid 95.

[24] Vivien Chen, 'Online Payday Lenders: Trusted Friends or Debt Traps' (2020) 43 *University of New South Wales Law Journal* 674.

Credit assistance providers should also be subject to responsible lending obligations

The proposed Bill would result in credit assistance providers, including mortgage and finance brokers, no longer being subject to the RLOs. Instead, it is proposed that consumers will be protected through the new best interests' duty.

We strongly support the introduction of the best interests' duty for mortgage brokers, and the proposal in the Bill to extend its application to all credit assistance providers (proposed new ss 158L(1), 158LD). However, the best interests' duty complements, rather than obviates the need for, direct responsible lending obligations. Neither the Financial Services Royal Commission nor the Productivity Commission suggested that the introduction of a best interests' duty for brokers would be a reason to remove the responsible lending obligations. Further, the best interests' duty is untested, and it is premature to remove the RLOs without first confirming that the best interests' duty operates as expected.

In addition, the recommendation of the FSRC in relation to conflicted remuneration for brokers has not been fully implemented.[25] Commissioner Hayne explained at length how the existing conflicted remuneration models seriously undermine brokers' ability, or incentives, to act in their customers' best interests. Rather, brokers' interests are aligned with the banks whose products they recommend. While legislation has recently been passed to prohibit conflicted remuneration, separate regulations provide a backdoor route to permit the most harmful forms of conflicted commissions. Section 158NB of the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures)) Act 2020 (Cth) amends the National Consumer Credit Protection Act 2009 to introduce a requirement that brokers 'must not accept conflicted remuneration'. This appears to align with the FSRC recommendations. However, separate Regulations carve out certain kinds of commission from the prohibition.[26] Under the Regulations, volume[27] and campaign-based[28] commissions would be banned but not upfront and trail commissions, despite being criticised by the FSRC.[29] This is contrary not only to Commissioner Hayne's recommendations, which fully reflect the reality of the situation, but centuries of established equity jurisprudence. The harmful ramifications for consumers who rely on mortgage brokers for guidance and assistance in what has only become a more complex and volatile financial environment are clear.

[25] See further Jeannie Paterson and Elise Bant, 'Mortgage Broking, Regulatory Failure and Statutory Design' (2020) 31 *Journal of Banking and Finance Law and Practice* 7.
[26] Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers) (Mortgage Brokers) Regulations 2020-reg 28VA.
[27] Ibid sub-reg 28VA(3)(b).
[28] Ibid sub-reg 28VA(3)(c).
[29] ABC News Online 'Banking royal commission calls for compensation, crackdowns and an overhaul of financial relators' (4 February 2019) (https://www.abc.net.au/news/2019-02-04/banking-royal-commission-report-at-a-glance/10777188).

Complexity continues

The announcement by the Treasurer suggested that credit law has become overly complex. However, while being promoted as reducing some aspects of complexity, the proposed changes to the Act and Regulations also add new elements of complexity, including with the introduction of another new type of credit contract, the 'low limit credit contract'. This 'low limit credit contract' is defined to include small amount credit contracts and similar products offered by ADIs. However, not all low limit credit contracts will be regulated in the same way. RLOs will apply to all low limit credit contracts. However, the additional protections for small loans in the 2012 Enhancements Act (including disclosure warnings, a price cap, and the protected earnings rule) will only apply to small amount credit contracts. As a result, a consumer who is borrowing $1500 from a non-ADI lender will have the benefit of the RLOs, as well as additional disclosure warnings, the protected earnings regime, and a price cap. A consumer who is borrowing $1500 from an ADI lender will only have the protection of the RLOs.[30]

The complexity created by differential treatment of small loans will sit alongside the existing complexities created by additional rules for other credit contracts, including reverse mortgages, standard home loans, credit card contracts, and medium amount credit contracts. Further complexity will also be built into the regulatory framework by introducing new standards for non-ADIs, where those standards are different to those applicable to ADIs, and by having different regulators (APRA for ADIs, ASIC for non-ADIs) responsible for monitoring and enforcing lending standards. Giving the existing complexity, and the introduction of additional complexity through the proposed changes, removing the RLOs for most consumer credit products is likely to have a minimal impact on the overall complexity of the regulatory framework for consumer credit.

In any case, complexity in consumer regulation is not unusual, and a similar level of complexity is found in the broader financial services regulatory regime. Concerns about complexity are, however, best addressed through considered review of the regulatory framework as a whole, rather than through a rushed proposal to remove a key plank of that framework. This also risks unintended consequences in related legislation, for example, credit reporting requirements. As we argue below, addressing complexities is best done as part of the ALRC's review of financial services regulation, a related review, taking into account the findings of the ALRC Review.

APRA prudential standards are not sufficient regulation for consumer protection purposes

In the case of the vast majority of credit products where the responsible lending obligations will no longer apply, the Government has asserted that APRA prudential standards will be sufficient to guide credit providers to appropriate conduct.

[30] The 48% price cap for credit contracts that are not SACCs does not apply to credit provided by an ADI lender: NCC s 32A(4).

Under the Banking Act, APRA can make prudential standards, and, with some exceptions, these standards are legislative instruments.[31] Most relevant for responsible lending is APRA's Credit Risk Management Standard (APS220), which has recently been revised and is due to come into force in January 2021. APS220 include principles specific to lending to natural persons that mirror some of the language in the current RLOs. For example, lenders are required to establish sound credit assessment and approval criteria that include consideration of the borrower's purpose and risk profile, identified by making reasonable inquires and taking reasonable steps to verify income or cash flows, commitments and total indebtedness, and the borrower's expenses. The explanatory material for the Non-ADI Credit Standards Determination also indicates (on p 2) that APS220 will be further amended to require an ADI to assess an individual's capacity to repay credit without substantial hardship, further borrowing from the language in the current RLOs. We note, however, that it is not clear that APS220 will be amended to also include current presumptions of substantial hardship (eg, in relation to credit cards (s 131(3AA)) NCCPA and loans secured by the debtor's primary residence (s 131(3) NCCPA).

ADIs are required to comply with prudential standards, including APS220.[32] However, there is no direct penalty for non-compliance. Instead, in the event of non-compliance, APRA can issue a direction, and it is only if there is non-compliance with that direction that a criminal offence has been committed and a criminal penalty can be imposed.[33]

Also, in the past, APRA has only rarely issued a direction or used its other coercive powers and has instead relied on more informal and private action to encourage change.[34] Its enforcement approach has been criticised by the FSRC and the Enforcement Review, and by other commentators. For example, North and Wilson have recently argued that in relation to mortgage lending:

> APRA has failed to proactively monitor compliance with its prudential standards and written guidance and failed to utilise most of its forensic and enforcement powers when the governance, risk management and lending practices of ADIs and other lenders within its mandate were substandard or non-compliant. Poor governance and risk management processes, lax, imprudent and irresponsible home lending standards, and actual or possible breaches of the law, should have attracted immediate and stronger responses by APRA.[35]

[31] Banking Act 1959 (Cth), ss 11AF(1), 11AF(7B)).
[32] Ibid s 11AG.
[33] Ibid s 11CG.
[34] See APRA (2019) Enforcement Strategy Review, Final Report which shows that in the period 2013 – 2018, APRA issued two formal directions, accepted 7 enforceable undertakings and imposed licence conditions on 2 occasions (at 14).
[35] Gill North and Therese Wilson (2020) 'Has the Australian Prudential Regulatory Authority done enough to meet its legislative objectives and prepare Australia for the next financial crisis'? 43(2) UNSW Law Journal 552, 572, 578-9. See also Andy Schmulow, Karen Fairweather and John Tarrant (2019) 'Restoring confidence in consumer financial protection regulation in Australia: A Sisyphean task? 47(1) *Federal Law Review* 91.

We acknowledge that APRA has accepted recommendations that it increase its appetite for enforcement action,[36] so there may be some change in approach in the future. However, it seems premature to rely on APRA as the sole regulator of responsible lending conduct for ADIs without evidence of a sustained change in regulatory approach.

In any case, APRA is a prudential regulator, not a conduct or consumer protection regulator. Its own *Enforcement Approach* document makes it clear that APRA's work focuses on the ability of entities to meet their financial promises, and that it can use its enforcement powers 'to prevent and address serious prudential risks'.[37] As noted in the FSRC Final Report, APRA is more aligned to stability threats than consumer outcomes,[38] and APRA's role is directed to system stability issues, rather than personal financial stability. An individual instance of irresponsible lending is unlikely to have prudential implications, and it seems highly unlikely that APRA will have (or could legitimately assume) any role in addressing individual consumer concerns of irresponsible lending unless they have a bearing on system stability.

In addition, consumers do not have any right to enforce APRA's prudential standards and cannot take legal action for an institution's failure to comply with those standards. This contrasts with the current RLOs, where non-compliance gives rise to the right of a consumer who has suffered loss or damage to seek compensation orders or other remedies, and/or for ASIC to seek compensation orders on behalf of one or more affected consumer (eg s 178 NCCPA).

As a result, even if there is compliance with APRA's lending standards from a systems perspective, there are no remedies or other recourse for consumers who have suffered from individual instances of non-compliance with those standards, and no penalties that are applicable in individual instances of non-compliance.

Non-ADI standards similarly have limited options for consumer protection enforcement

The explanatory material for the exposure draft bill indicates that non-ADI lenders will be also be subject to system level obligations, implemented through a Ministerial Determination (the draft National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020). The Minister's power to make standards is set out in the proposed new s 133EA of the NCCPA.

As with APS220, the proposed standards mirror some of the language used in the RLOs.

Also, again aligning with APS220, the Bill makes explicit that any enforcement focus is largely on the extent to which non-ADI credit providers document and implement appropriate systems overall, rather than on addressing individual instances of irresponsible lending. As is set out in the explanatory material (para 1.20), 'These requirements will be

[36] APRA (2019) *APRA releases new enforcement approach* (Media release 15 April 2019).
[37] APRA (2019) *APRA's Enforcement Approach*, 4.
[38] Financial Services Royal Commission, Final Report (vol 1), 453.

system-level obligations rather than focusing on individual loans engaged in by licensees.' Non-ADI lenders are required to establish and document systems, policies and processes for credit conduct that comply with the relevant standards (proposed s 133EB), not repeatedly fail to implement their systems, policies and processes (proposed s 133EC), and give to consumers any document required by the standards (proposed s 133ED). A civil penalty of up to 5000 penalty units can be imposed for non-compliance with these obligations. ASIC will have jurisdiction to take enforcement action in the event of non-compliance with these civil penalty provisions. Individual consumers may also be able to take action to seek compensation for loss or damage suffered for any contraventions under s 178 NCCPA. However, in practice, this option is likely to be of limited use for consumers. Once appropriate systems policies and processes are established, failure to implement those systems, policies and processes will only be actionable if the failure is repeated. Occasional failures will not be at risk of enforcement action, even though occasional failures may cause significant harm to an individual borrower. And an individual consumer is unlikely to be able to have access to information that would prove a repeated failure.

[Annotation 3/2/21: We acknowledge the clarification in the Explanatory Memorandum (as tabled in December) that consumers will retain the option of lodging a dispute with AFCA. However, we remain concerned that the option of seeking compensation through s 178 NCCPA will no longer be an option for individual instances of non-compliance.]

Exemption for small business credit weakens consumer protection

The proposed non-ADI standards will not apply for any credit that is for both personal and small business purposes, as long as those small business purposes are genuine, and not merely minor or incidental (proposed reg 6(2)). The Consumer Credit Fact Sheet states that 'Small business lending was never intended to be captured by the Credit Act', however, we suggest that where the small business purposes form less than half of the purposes, it has always been intended that the consumer credit protections apply. We note that the predominant purpose test was also included in the predecessor regulation, the Uniform Consumer Credit Code.

There are considerable risks in weakening consumer protections in the case of credit that has only a small component of a business purpose. Lenders who operate at the margins and who target vulnerable consumers may take advantage of this change.

There is no definition of 'genuine' or 'merely minor' or 'incidental', however, the proposed non-ADI standards may mean that a loan that is only 10% or 20% for business purposes, and 90% or 80% for consumer purposes will not be subject to *any* responsible lending standards. In contrast, under the current NCCPA, the RLOs apply as long as the credit is wholly or predominantly for personal, domestic, or household purposes. For combined personal and business purposes, the predominant purpose is defined as:

(a) The purpose for which more than half of the credit is intended to be used; or

(b) If the credit is intended to be used to obtain goods or services for use for different purpose, the purpose for which the goods or services are intended to be most used (NCC s 5(4)).

Under the current law, the RLOs will therefore apply to credit that is provided 51% for personal, domestic, or household purposes, and 49% for small business purposes. Where the majority of the credit is being provided for personal purposes, it is appropriate for that protections for consumer credit to apply.

In addition, other obligations in the NCCPA and NCC will apply where the loan is wholly or predominantly for personal, domestic, or household purposes, including the requirements for pre-contract disclosure in the NCCPA and NCC. The proposed reforms therefore produce greater complexity and incoherence in the law's regulation of financial services in this space. Even if the non-ADI lending standards are made, lenders will need to assess the purpose of the loan in order to determine whether these other NCCPA and NCC obligations apply. If the business purposes are assessed as less than 50%, lenders will also have to make an assessment of whether the business purpose is 'genuine' and not 'merely minor' or 'incidental' before determining whether the non-ADI standards apply to the credit assessment process. Presumably, this will involve collection and assessment of relevant information from the prospective borrower that would be needed for a responsible lending assessment in any case.

Lack of Parliamentary scrutiny

If the proposed Bill is passed by the Parliament, the effect will be a transfer of the authority for imposing responsible lending standards from the Parliament to APRA (for ADI lenders) and the Minister (for non-ADI lenders). We acknowledge that there are usually consultation processes in place for developing and revising prudential standards and Ministerial directions, and that there is also the possibility for the Parliament to disallow these legislative instruments. However, the provision for disallowance is not equivalent to the level of transparency, scrutiny, discussion, and debate that is available for standards imposed through legislation. In a 2011 article discussing ASIC's rule making power under the Corporations Act 2001 (Cth), Professor Stephen Bottomley argued that:

> The default principle that underlies these first four propositions is that legislative change should be done by and through Parliament. This is not because Parliament is necessarily gifted with unique insights and skills, especially in the area of corporate and financial markets law reform. It is because the parliamentary processes are open to wide public input - they are visible and publicly accountable. It is true that those processes can sometimes be flawed, but the flaws are also visible. As with all default positions, there must be exceptions, but they should be treated as such, not as an alternative or parallel system of rule-making.[39]

[39] Stephen Bottomley (2011) 'The notional legislator: The Australian Securities and Investments Commission's role as a law-maker' 39 Federal Law Review 1, 30.

We believe that a similar argument can be made in respect of the use of Ministerial directions and other legislative instruments in relation to regulating lending conduct, that is, that key responsible lending standards for consumer credit licensees should be imposed through legislation rather than legislative instruments, as is proposed.

Other protections do not reduce the need for RLOs

The Treasurer's announcement on 25 September 2020 also noted various other protections for consumers that would continue to operate even once the RLOs are removed in relation to most credit contracts. However, while these protections are important, they do not replace the need for continuing the application of the RLOs to all consumer credit contracts.

Jurisdiction of AFCA to resolve consumer disputes

The Australian Financial Complaints Authority (AFCA) (which replaced the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal) was established in 2018. ADI lenders have long been required to belong to an ASIC approved EDR scheme (such as FOS). The introduction of the NCPPA ensured that non-ADI lenders were also required to join an EDR scheme. The establishment of AFCA has resulted in an increase in the monetary jurisdiction of the available schemes. However, AFCA's decision-making criteria includes legal principles.[40] If the standards required of lenders by the NCCPA are reduced, including through an emphasis on borrower responsibility, and a lack of obligation on lenders to verify information provided by borrowers, this is highly likely to have a flow-on effect to AFCA's decision making and expectations about the inquiry and verification standards that are required of lenders.

In addition, AFCA's role is to resolve individual disputes, and most are resolved by negotiation, where the outcomes are not disclosed. AFCA has a more limited role in addressing the public interests in deterring and punishing inappropriate conduct and giving an authoritative statement of the meaning and scope of standards imposed by law.[41]

Industry codes of conduct

Many ADIs belong to a detailed industry code that includes some provisions around responsible lending. For example, the Code of Banking Practice states that when subscribers are considering providing a new loan, or increase a loan limit, subscribers "will exercise the care and skill of a diligent and prudent banker" (para 49). An obligation in similar terms existed before the NCCPA and responsible lending obligations, and it was not seen as sufficiently rigorous to obviate the need for the responsible lending provisions. This is because a diligent and prudent banker owes its duty to the bank, not to its customers. The focus is on taking prudent steps to ensure that its lending practices are secure, not fair. This

[40] AFCA Rules, para A.14.2(a).

[41] See generally Nicola J Howell (2019) 'Shutting the courts out: Developing consumer credit law in the shadow of alternative dispute resolution and the new Australian Financial Complaints Authority' 30(2) *Journal of Banking and Finance Law and Practice* 57-78.

means, for example, that there may be asset-based lending where the bank's loan to a vulnerable consumer is wholly secured against the borrower's home.[42] Asset-based lending, and the devastation it wrought on consumers, was one of the key drivers behind the introduction of the RLOs.

In addition, if the responsible lending provisions are repealed, this clause will have no practical effect on consumer lending in its current form. Paragraph 50 says "If you are an individual customer, that is not a business, we will do this *by complying with the law*" (emphasis added). This means that if the legislative standards are removed or diluted (as is proposed), the standards required by the Banking Code of Practice will be removed or diluted to the same extent.

Finally, the industry codes are voluntary codes, there is no obligation on lenders to subscribe to an industry code, and there is no industry code for non-ADIs that has a robust compliance framework and imposes similar responsible lending obligations.

New ASIC powers

In recent years, ASIC has been granted additional powers in the regulation of credit promotion and lending practices, including the new Design and Distribution obligation (due to commence on 5 October 2021), and the Product Intervention Power (already in force since 2019). However, these powers have different purposes compared to the responsible lending obligations and are focused on consumer markets (or particular groups of consumers) in general. Their aim is to ensure that products are appropriately designed for the target consumer group. They will have little application in situations where a product is harmful or inappropriate in relation to a particular consumer because of their individual circumstances, but where it might be suitable for others in the relevant class. Both preventative and responsive enforcement options, and class and individual responses are needed to address consumer protection issues in the consumer credit sector.

The need for change has not been demonstrated

We have not seen evidence of unreasonable denial of credit due to RLOs. If there is such evidence held by the RBA or by Treasury, this should be made public to inform debate.

It is alleged that removal of RLOs will decrease processing times for loan approval. This is a highly automated process. With improvements in automated processes and the benefits of access to consumer data enabled under the Consumer Data Right/open banking, credit providers are likely to be able to make individual responsible lending assessments with increased effectiveness and efficiency. If there is modelling on the impact of the proposal on loan processing times, this should be made publicly available to inform debate.

The media release announcing the RLO changes stated that the current regime is 'overly prescriptive, complex and unnecessarily onerous on consumers'. However, the claims of

[42] JM Paterson, 'Knowledge and Neglect in Asset Based Lending: When is it Unconscionable or Unjust to Lend to a Borrower Who Cannot Repay' (2009) 20 *Journal of Banking and Finance Law and Practice* 18.

over-prescription, leading to reduced credit access, are not consistent with the experience of key regulators and policy makers. For example, earlier this year, ASIC's Chairman stated, in relation to the responsible lending law, that:

> "There has always been enough inherent discretion and flexibility in those largely principle-based obligations for lenders to apply their discretion to different circumstances."

And that the law:

> "still provides enough flexibility for lenders to exercise their good judgment – their professional judgment – in order to make the correct decisions".[43]

And although the RBA Governor recently criticised the level of prescription in the guidance on the responsible lending obligations, he also confirmed that the principles in the legislation are sound.[44] In the same discussion, Governor Lowe also said:

> I would have to say, though, that in the past three or four months I've heard fewer concerns from the banks about the responsible lending laws. ASIC introduced new guidance. Institutions are gradually coming to grips with those.[45]

None of these comments suggest that removal of responsible lending obligations is warranted. Also relevant is the fact that more recent guidance on the scope of the responsible lending obligations has been in favour of credit provider practices, with the Full Federal Court of Australia rejecting ASIC's appeal in the 'Wagyu and Shiraz' case.[46]

There is also little support for the claim that the responsible lending obligations have adversely affected the flow of credit. In its response to the Hayne Royal Commission's Interim Report, Treasury stated that:

> '[t]here is little evidence to suggest that the recent tightening in credit standards, including through APRA's prudential measures or the actions taken by ASIC in respect of [responsible lending obligations], has materially affected the overall availability of credit'.[47]

Of course, this comment was made before COVID-19 and its impacts. However, more recent observations include the Australian Banking Association's report that approval rates for small business loans had remained high throughout the pandemic, and that banks had approved loans worth more than $9 billion to SMEs and sole traders in the six weeks to

[43] James Eyers and James Frost (2020) 'ASIC gives banks a break on responsible lending', *Australian Financial Review* 21 May 2020 (https://www.afr.com/companies/financial-services/asic-gives-banks-a-reprieve-on-responsible-lending-20200521-p54v6e).
[44] House of Representatives Economics Committee, Hansard 14 August 2020, p 20.
[45] House of Representatives Economics Committee, Hansard 14 August 2020, p 20.
[46] *ASIC v Westpac Banking Corporation* [2020] FCAFC 111.
[47] FSRC Final Report, vol 1, 58.

October 7),[48] and UBS's conclusion that removing the responsible lending obligations will have limited effect on credit demand, especially in housing.[49]

In addition, there is a considerable risk that loosening the reins for credit access will likely lead to higher levels of over-indebtedness and consequent hardship for many consumers. Australians already have very high levels of private debt, and the economic impacts of COVID-19 are likely to continue for many months, if not years. This includes high levels of unemployment and reduced financial support in terms of unemployment benefits and support for businesses as current measures are wound down. Reducing a key plank of the consumer protection regime for consumer credit at this time is therefore likely to lead to the re-emergence of many of the problems that precipitated the introduction of responsible lending laws, and result in very poor outcomes for many individuals and families in Australia. The policy case for removing the RLOs from the NCCPA for most lending has not been made out.

An alternative approach: Coordinate with the current ALRC review of financial services regulation

We acknowledge industry has raised concerns about complexity in the regulatory framework for consumer credit. However, these concerns, including concerns about the certainty or otherwise of the scope of the obligations, are best addressed through considered review and amendment, rather than removing responsible lending obligations altogether.

We note that the ALRC has very recently been given a reference to review the regulatory framework for financial services regulation, with a focus on simplification. Concerns about the complexity of consumer credit laws will be best addressed following the findings of this review. Making substantial changes to consumer credit regulation, without the benefit of the ALRC's review, may either lead to the need for further changes to respond to the ALRC review, or the risk of considerable misalignment in regulatory approaches in the different parts of the consumer financial services sector.

An alternative approach would be to include consumer credit in the scope of the ALRC's current review, or establish a parallel review examining the consumer credit regulatory framework.

We strongly recommend that the proposed amendments (other than the changes to Part 3.5A) are not proceeded with, and that instead the government address any genuine concerns about levels of prescription and complexity through an appropriate review process, and/or in line with findings and recommendations from the ALRC review.

[48] See Australian Bankers' Association (2020) 'Flow of credit to small business remains strong' (Media Release, 20 October 2020) (https://www.ausbanking.org.au/flow-of-credit-to-small-business-remains-strong/).
[49] See Australian Financial Review 'Lending backflip won't boost banks' (21 October 2020).

Conclusion

The RLOs were introduced for a purpose – to prevent over-indebtedness and individual harm and the potential systemic instability that can result from widespread instances of this. The RLOs are a central plank for consumer protection in Australia. They have been important in exposing and remedying instances of irresponsible lending across both the ADI and non-ADI sector, and have repeatedly been assessed by government and banks alike as having had limited impact on access to credit. Non-compliance with the RLOs exposes a licensee to the prospect of informal and formal enforcement action by ASIC, often widely publicised, and affected consumers can seek remedies through litigation, again with the results made publicly available. The broad, system-level obligations and lending standards in place for prudential purposes will not protect individual consumers and have strictly limited enforcement and remedial options. The removal of RLOs will therefore inevitably result in an increase in instances of irresponsible lending, and consequent harms for many individuals and families in Australia.

We do not recommend that the exposure draft Bill, Regulations and Ministerial Direction be proceeded with in their current form. Instead, we recommend only that the proposed amendments to extend the application of Part 3-5A to all credit assistance providers be introduced.

Contact for further information

Nicola Howell (nicola.howell@qut.edu.au, tel (07 3138 2006)