Australian Treasurer announces proposed responsible lending reforms

By: Samantha O'Brien | Dylan Burke | Ann-Marie Coleman

On 25 September 2020 the Treasurer announced the Government's plan to, in effect, remove the current responsible lending obligations from the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**), other than for certain higher-risk products. [1]

In this update, we explore the key aspects of the proposed responsible lending reforms and the likely impact for lenders and other key players in the consumer credit industry.

Current state of play

The NCCPA sets out responsible lending obligations that apply to consumer credit. The aim of these obligations is to ensure lenders do not provide unsuitable loans to consumers.

These obligations require lenders to:

1. make reasonable inquiries about the consumer's financial situation, requirements and objectives;
2. take reasonable steps to verify the consumer's financial situation; and
3. make an assessment that the credit contract is 'not unsuitable' for the consumer.

What is proposed?

The Government's view is that, in 2020, the principles which underpin responsible lending obligations are being implemented in a way that is no longer fit for purpose.

In response, the Government plans to remove the current responsible lending obligations from the NCCPA and introduce a new regime, with the exception of small amount credit contracts and consumer leases where enhanced responsible lending obligations will be introduced (details of which are yet to be confirmed).

Particularly in the current economic landscape, the reforms are intended to remove barriers to the flow of credit to households and businesses. Currently, lenders have a high bar to meet when deciding whether to provide a loan, with the onus being on the lender to verify borrower information. As noted in the fact sheet released by the Government, this has resulted in lenders often applying a 'one-size fits all' approach, irrespective of the circumstances of the consumer.

Interestingly, the Financial Services Royal Commission Final Report recommended that the responsible lending obligations in the NCCPA, and particularly the 'not unsuitable' test, should remain unchanged and stated that, to the extent any deficiencies in the law were identified, steps should be taken to 'fill in that gap'.[2] Rather than 'fill the gap', the Government is proposing to overhaul the responsible lending regime completely (subject to limited exceptions).

Relevantly, it appears that ADI lenders will not be subject to the new NCCPA regime given they are already required to comply with APRA standards. This means the new regime will only apply to non-ADIs (and the Government intends to bring across key elements of the APRA standards into the NCCPA, to ensure consistency).

The exact nature of the obligations that will replace the NCCPA responsible lending regime remains to be seen, but a key feature of the reforms will be allowing lenders to rely on the information provided by borrowers, unless there are 'reasonable grounds' to suspect the information is unreliable. What will amount to reasonable grounds' (and what inquiries a lender will be expected to make in this respect) is not yet clear.

In turn, borrowers will be made more accountable for providing accurate information to inform lending decisions, effectively shifting a significant amount of responsibility from the lender to the borrower.

It appears that mortgage brokers will also no longer be subject to the responsible lending obligations (though a new best interests duty for mortgage brokers is commencing on 1 January 2021).

What does this mean for lenders and other key players in the consumer credit industry?

It is clear that the intention of the reforms is to make it easier for lenders to provide loans. This should mean that lenders will be able to simplify their credit assessment process and likely reduce the time needed to assess and extend credit.

The extent to which lenders will be able to 'relax' their current procedures will ultimately depend on how the obligations are framed in the legislation. A draft of this is yet to be released but, as the Government intends for the reforms to commence on 1 March 2021, it is expected this will be released soon. The Government's fact sheet indicates that obligations on the lender will be 'proportionate with the risk' associated with the type of loan product or borrower.

Small business lending will also be simpler because, as part of the reforms, the Government intends to remove small business lending from the NCCPA regime. Where a proportion of application for credit is for a business purpose (irrespective of the proportion), the new regime will not apply (this is instead of the current 'predominant purpose' test).

As well as potentially making life easier for existing lenders, the reforms may incentivise neo-banks and other fintechs looking to disrupt consumer credit to enter the consumer lending space where previously they may have been dissuaded by the prescriptive obligations (and the resources, procedures and expertise required to meet these). With new regulatory sandbox relief having commenced on 1 September 2020[3] (which allows certain credit providers to provide credit activities for 24 months without an Australian credit licence)[4], it is arguably easier than ever before for fintechs to compete in the consumer credit space.

The reduced regulatory burden should make it easier for customers to apply for loans (including to switch credit providers), and encourage competition in the market.

Increased competition in the market is a theme that we anticipate will be likely to persist over the short to medium term, and beyond. Whether reforms in the area of responsible lending will accelerate this trend is still yet to be seen. However, in any event we expect that many industry players will continue to take a conservative approach, despite the proposed reforms described above. In particular, some industry participants already take the approach that even where a responsible lending policy and practices are not required by law, implementing these will assist with credit and reputation management (if done well). Responsible lending also becomes particularly important to consider to the extent that lending decisions are automated, and in those circumstances, again we expect a more conservative approach to be taken.

As the Government has identified, a 'one-size fits all' approach is not appropriate when it comes to a responsible lending policy, and it does require some critical thinking to be implemented. While there is some precedent for automation in this space, there is no settled view, and it is likely that a lender will need to undertake some sort of manual verification/interrogation in terms of forming a view on an applicant's spending habits and requirements (regardless of whether the proposed reforms shift the onus of establishing a potential borrower's suitability for lending).

Again, despite any proposed reforms in this space, lenders will also need to strike an appropriate balance between lending in a responsible and appropriate way (even if not required by law to do so), and not incurring credit risk unnecessarily. As such, despite the reforms, we expect that many lenders will (at least for the short term) continue to lend in such a way that ensures avoiding unnecessarily incurring (or increasing) credit risk.

Other issues to consider

Of course, responsible lending obligations are only one aspect of the regulatory landscape and lenders will still need to comply with other obligations (and bear these in mind before amending existing procedures). These include:

- the general conduct obligations in the NCCPA, including the obligation to do all things necessary to ensure credit activities authorised by the licence are engaged in efficiently, honestly and fairly;
- the upcoming design and distribution obligations (these apply to financial products including credit products). The new obligations commence on 5 October 2021 and will require product issuers to determine the target market for a product and distributors to take reasonable steps to ensure they only distribute to customers within that target market (subject to certain exemptions);
- the Banking Code of Practice, which requires signatory banks to 'exercise the care and skill of a diligent and prudent banker' when considering whether to provide, or increase the limit of, a loan; and
- for APRA authorised ADIs, the APRA prudential standards (including the residential mortgage lending standard).

The Government will consult publicly with stakeholders before finalising any legislation required to implement the reforms in the area of responsible lending. For any lenders in the consumer credit space, or those thinking about entering the market, this is certainly one to keep a close eye on. If you would like to further understand the likely impact for your business, please contact our team.

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[1] Australian Treasury, 'Simplifying access to credit for consumers and small business' (Joint Media Release with The Hon Michael Sukkar MP, 25 September 2020) <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/simplifying-access-credit-consumers-and-small>.

[2] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (2019) vol 1, p 59-60.

[3] *National Consumer Credit Protection (Fintech Sandbox Credit Licence Exemption) Regulations 2020* (Cth)

[4] Relevantly, this relief does not apply to reverse mortgages, small amount credit contracts or where part of the credit is secured by a lien over the consumer's household property. The credit limit of the contract must also be between $2,000 and $25,000 and have a term of no more than 4 years.
