

EXPOSURE DRAFT EXPLANATORY MATERIAL

Issued by authority of the Treasurer

National Consumer Credit Protection Act 2009

National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020

Section 133EA of the *National Consumer Credit Protection Act 2009* (the Act) will be inserted into the Act by the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020. Section 133EA will provide that the Minister may, by legislative instrument, determine non-ADI credit standards specifying requirements for a credit licensee's systems, policies and processes relating to non-ADI credit conduct.

Non-ADI credit conduct relates to credit contracts where the contract is not a small amount credit contract, and where the credit provider is not an authorised deposit-taking institution (ADI). In relation to these contracts, non-ADI credit conduct consists of entering into a credit contract, or increasing the credit limit under a credit contract, or making an unconditional representation to a consumer that the licensee will do either of those things.

Small amount credit contracts are instead subject to the provisions in Division 2 of Part 3-2 of the Act, while in providing credit, ADIs are subject to prudential standards made by the Australian Prudential Regulation Authority (APRA) under the *Banking Act 1959*.

The purpose of the *National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020* (the Standard) is to ensure non-ADI credit providers establish, maintain and implement systems, policies and processes directed toward credit being provided where the licensee has assessed that a borrower will have the capacity to repay any credit provided without substantial hardship.

The Standard requires licensees to implement adequate systems, policies and processes relating to non-ADI credit conduct, rather than impose individual conduct-level obligations. This enables credit assessment to move away from a prescriptive framework for lenders and borrowers, and will support risk-based lending that is attuned to the needs and circumstances of the borrower and credit product.

On 25 September 2020, the Government announced it would reform the responsible lending obligations in the Act to improve the flow of credit by increasing timely access to credit for consumers and small businesses, and improve competition between lenders to allow consumers to more easily switch lenders if they choose.

The Government stated that this will be achieved through appropriately adopting key elements of APRA's prudential lending standards for ADIs and applying them to non-ADI credit providers.

In particular, the Standard is similar to key provisions to APRA's forthcoming prudential standard APS 220 Credit Risk Management, which are related to an institution's lending standards and ensuring borrowers' capacity to repay. Over the coming month, APRA plans to consult on a minor amendment to APS 220. Subject to finalisation of the Standard, APRA plans to add a sentence to APS 220 that would require an ADI to assess an individual's capacity to repay credit without substantial hardship.

The Standard imposes obligations on credit licensees to implement systems, policies and processes to be used for assessing and approving whether to undertake non-ADI credit conduct. The Act requires these systems, policies and processes to be established by the licensee prior to engaging in any non-ADI credit conduct, being activities related to the provision of credit or increasing a credit limit. These systems, policies and processes will ultimately provide for the licensee to assess a borrowers' capacity to repay credit without substantial hardship. A licensee will contravene the Act if the licensee repeatedly fails to give effect to the systems, policies and processes.

A licensee will be required by the Standard to give a copy of an assessment conducted to the consumer upon request up to seven years after the credit contract was entered into or the credit limit was increased. A licensee will contravene the Act if the licensee fails to do so.

Details of the Instrument are set out in [Attachment A](#).

The Instrument will commence on the later of the day after it is registered on the Federal Register of Legislation and immediately after the commencement of Schedule 1 to the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020.

Details of the *National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020*

Part 1—Preliminary

Section 1—Name of the Standard

This section provides that the name of the instrument is the *National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020* (the Standard).

Section 2—Commencement

The Standard will commence on the later of the day after the instrument is registered on the Federal Register of Legislation, and immediately after the commencement of Schedule 1 to the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020. That Bill will insert the power to make the Standard into the *National Consumer Credit Protection Act 2009*.

Section 3—Authority

The Standard will be made under the *National Consumer Credit Protection Act 2009* (the Act).

Section 4—Definitions

This section defines expressions used in the Standard.

A ***non-ADI credit contract*** is defined as a credit contract where the contract is not a small amount credit contract, and where the credit provider is not an authorised deposit-taking institution (ADI). This mirrors subsection 133EA(5) of the Act, and are the credit contracts regulated by the Standard (except where the contract is exempted for having a small business purpose).

Small amount credit contracts are instead subject to the provisions in Division 2 of Part 3-2 of the Act, and the provision of credit by ADIs is instead regulated by prudential standards made by APRA under the *Banking Act 1959*.

The expression ***small business*** has the same meaning as in the *Australian Small Business and Family Enterprise Ombudsman Act 2015*.

Terms defined in the Act that are used in the Standard will have the same meaning as in the Act, due to paragraph 13(1)(b) of the *Legislation Act 2003*. This includes the expression ***non-ADI credit conduct***.

Part 2—Standards relating to systems etc.

Section 5—Simplified outline

This section sets out a simplified outline of the operation of the substantive provisions of Part 2 of the Standard. A simplified outline is a guide intended to assist

readers. This outline is not intended to be comprehensive, and readers should rely on the substantive provisions of Part 2 of the Standard.

Section 6—Requirements for systems, policies and processes relating to conduct

This section sets out the application of the Standard. In particular, it provides that the licensee's systems, policies and processes relating to non-ADI credit conduct must comply with the requirements set out in Part 2 of the Standard (see, in particular, sections 7, 8 and 10).

The requirements set out in Part 2 of the Standard are directed toward credit being provided where the licensee has assessed that a borrower will have the capacity to repay any credit provided without substantial hardship.

Non-ADI credit conduct includes entering into a non-ADI credit contract, or increasing the credit limit under a non-ADI credit contract, or making an unconditional representation to a consumer that the licensee will do either of those things.

The Standard requires licensees to implement adequate systems, policies and processes relating to non-ADI credit conduct, rather than impose individual conduct-level obligations. This reflects the need to move away from a prescriptive framework for lenders and borrowers, towards one that encourages risk-based lending that is attuned to the needs and circumstances of the borrower and credit product.

As set out in section 11, the adequacy of these systems, policies and processes in complying with these requirements will be determined taking into account the nature, scale and complexity of the non-ADI credit conduct engaged in by the licensee. This ensures that a licensee will be required to have systems, policies and processes that are commensurate with the relevant credit business carried on by the licensee.

This section also provides that the Standard does not apply in relation to credit provided genuinely for a small business purpose, where that purpose is not minor or incidental to the overall purpose of the credit. The Act does not apply where lending is predominantly for a small business purpose. However, it can be time consuming for lenders to assess the predominant purpose of a loan when lending is for a mixed-use, particularly where it is difficult to separate the business from the household, such as primary producers. Clarifying that the Standard does not apply to lending for a small business purpose will ensure that the obligations being imposed do not impede the timely flow of credit to small business. Licensees will still be required to determine the purpose of credit for compliance with other provisions of the Act and the *National Credit Code*.

Section 7—Credit assessment criteria

This section requires the licensee's systems, policies and processes to include credit assessment criteria that will be considered by the licensee when assessing whether to engage in a non-ADI credit activity where the debtor under the non-ADI credit contract is, or will be, a consumer.

These criteria must enable the licensee to assess whether the consumer will be able to repay the credit without facing substantial hardship. Additionally, the credit assessment criteria must require consideration of factors listed in the Standard. These factors are based on APRA's prudential standard APS 220 Credit Risk Management.

In adopting principles from the forthcoming APS 220 Credit Risk Management, a key focus has been on minimising inconsistencies in requirements between ADIs and non-ADIs. The Standard has closely followed APRA's expectation of serviceability assessment standards, outlined in APRA's prudential standard APS 220 Credit Risk Management. Since APRA has a focus on protecting retail depositors, ADIs are subject to a broader prudential framework. APS 220 Credit Risk Management also covers minimum standards of governance, risk management and financial resources for prudent lending.

APS 220 Credit Risk Management requires ADIs to have established sound credit assessment and approval criteria that consider the borrower's capacity to repay. APS 220 also sets out a range of criteria that ADIs should consider as part of their credit assessments. Over the coming month, APRA plans to consult on a minor amendment to APS 220. Subject to finalisation of the Standard, APRA plans to add a sentence to APS 220 that would require an ADI to assess an individual's capacity to repay credit without substantial hardship.

The criteria must also allow for the assessment to be proportionate to the nature, type and size of the credit. This is intended to ensure lenders have the flexibility to scale their credit assessments according to the characteristics of the borrower and credit product, while reflecting the relative risk involved.

Section 8—Credit assessment

This section requires the licensee's systems, policies and processes to provide for the licensee to make an assessment before engaging in non-ADI credit activities. This assessment would include assessing whether the consumer will be able to repay the credit without substantial hardship. This provides a clear standard that will govern the overall outcome non-ADIs are aiming to achieve when conducting their assessments.

The assessment must be made against the criteria established by the licensee in accordance with section 7.

The licensee's systems, policies and processes for making the assessment must provide that the credit could only be repaid with substantial hardship if any of the circumstances set out in section 9 would exist. The circumstances set out in section 9 do not limit the circumstances in which the consumer would only be able to repay the credit with substantial hardship.

The licensee's credit assessment must also comply with information requirements set out in this section. This includes making reasonable inquiries, and taking reasonable steps, to verify the income and indebtedness of the consumer. This also includes making reasonable inquiries of the consumer's reasonably foreseeable expenses, and the licensee may also rely on reasonable estimates of those expenses. The basis of a reasonable estimate would need to be consistent with the consumer's particular circumstances.

Subject to those requirements, the licensee may choose to rely on the information provided by the consumer unless there are reasonable grounds to believe the information provided is unreliable. A licensee may have reasonable grounds to believe that the information was unreliable due to the content of the information provided, or due to the circumstances or manner in which the information was provided. For example, information may be assumed to be unreliable if the lender had instructed the borrower to provide certain information in order to secure a more favourable loan for the borrower.

Where information is provided by a third party, the licensee must take reasonable steps to verify the accuracy and completeness of the information provided.

Section 9—When the assessment must be that the consumer could not repay without substantial hardship

This section sets out non-exhaustive circumstances in which the licensee's systems, policies and processes for conducting credit assessments must provide for the licensee's assessment to be that the credit could only be repaid with substantial hardship. As noted above, these circumstances do not limit the circumstances in which the consumer would only be able to repay the credit with substantial hardship.

This section applies to circumstances:

- where the consumer could only repay the credit by selling the consumer's principal place of residence, and the consumer does not intend to sell the residence at the time of the assessment;
- where the consumer could only repay the credit by failing to meet rental payments on the consumer's principal place of residence; or
- where the credit contract is a credit card and the consumer could not repay the credit limit on the credit card within three years.

Section 10—Approval must be consistent with assessment

This section requires the licensee's systems, policies and processes for approving the engagement in non-ADI credit activities to meet certain requirements.

Firstly, the approval must be in accordance with the assessment made by the licensee. Secondly, the licensee must not approve engaging in the non-ADI credit conduct if the assessment was that the consumer could not repay the credit without substantial hardship.

Section 11—Adequacy of systems, policies and processes

This section provides that in considering whether systems, policies and processes established by a licensee are adequate, the nature, scale and complexity of the non-ADI credit conduct engaged in by the licensee must be taken into account. This ensures that a licensee will be required to have systems, policies and processes that are commensurate with the relevant credit business carried on by the licensee.

Part 3—Standards relating to documents

Section 12—Simplified outline

This section sets out a simplified outline of the operation of the substantive provisions of Part 3 of the Standard. A simplified outline is a guide intended to assist readers. This outline is not intended to be comprehensive, and readers should rely on the substantive provisions of Part 3 of the Standard.

Section 13—Giving the consumer the assessment

This section requires the licensee to provide a consumer with a written copy of a credit assessment upon request by the consumer. This request may be made before entering a credit contract or increasing the credit limit of a contract, or up to seven years after that time.

The timeframe for compliance depends on when the request was made. The licensee must give the consumer the copy:

- if the request was made before the credit contract is entered into or the credit limit is increased—before entering the contract or increasing the limit;
- if the request was made within two years of the credit day—within seven business days of receiving the request;
- otherwise—within 21 business days of receiving the request.

If the credit provider assigns their rights to another licensee, the timeframes for compliance are extended to 15 and 25 business days respectively.