**ASIC CREDIT (FLEXIBLE CREDIT COST ARRANGEMENTS) INSTRUMENT 2017/780**

**EXPLANATORY STATEMENT**

Prepared by the Australian Securities and Investments Commission

*National Consumer Credit Protection Act 2009*

The Australian Securities and Investments Commission (***ASIC***) makes *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780* under paragraph 109(3)(d) of the *National Consumer Credit Protection Act 2009* (the ***National Credit Act***).

ASIC may declare the provisions to which Part 2-6 of the National Credit Act applies (including Chapter 2 of the National Credit Act and definitions in the National Credit Act as they apply to references in that Chapter) apply in relation to a class of persons or credit activities as if the provisions were omitted, modified or varied as specified in the declaration (paragraph 109(3)(d) of the National Credit Act).

# Background

## Flex commission arrangements

'Flex commissions' refers to an arrangement whereby an intermediary (generally a car dealer) who sells a loan to a consumer earns a larger commission from the credit provider the higher the contract annual percentage rate is above a benchmark or base interest rate.

## ASIC's response to the consumer harm from flex commission arrangements in the car finance market

ASIC has undertaken detailed research on the effect of flex commission arrangements in the car finance market. This analysis is set out in detail in our Regulation Impact Statement published on 3 March 2017 (RIS), available at: http://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-279-flex-commission-arrangements-in-the-car-finance-industry/

The key findings in our RIS are that flex commissions distort pricing arrangements and are a remuneration structure that:

1. means the interest rate charged to the consumer is not related to their credit rating or the risk of default, but to their financial sophistication, degree of financial literacy and capacity to negotiate to protect their interests;
2. provides an incentive for sales intermediaries to increase the price of a credit contract in a way that does not relate to the credit risk of the particular consumer;
3. operates in a way that is not transparent for consumers or understood by them at the point of sale; and
4. can operate unfairly in any individual transaction.

ASIC has decided to prohibit flex commissions through the introduction of a legislative instrument as we consider:

1. it is the most effective way of addressing the identified consumer harm from distortions in pricing that disproportionately affect vulnerable consumers;
2. it is expected to result in a reduction in average interest rates, as a result of more visible competition through advertising (given the practical constraints on lenders being able to advertise interest rates affected by the discretion under flex commissions arrangements), more efficient pricing models, and lower losses through defaults; and
3. it provides a comprehensive and competitively neutral solution where all holders of an Australian credit licence (ACL) have to change their commission arrangements in the same way at the same time.

## Legislative context

Section 47 of the National Credit Act requires holders of an ACL to conduct their business in accordance with a number of specific obligations, including obligations:

1. Under s47(1)(a) — to do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly.
2. Under s47(1)(b) — to have in place adequate arrangements to ensure that their clients of the licensee are not disadvantaged by any conflict of interest in relation to credit activities engaged in by the licensee or its representatives.

ASIC's view is that flex commission arrangements are, by their nature, inconsistent with the expected standards of conduct of a licensee (for the reasons summarised in Part B above, and as discussed in detail in ASIC's RIS).

# Purpose of the legislative instrument

The objectives of the instrument are to:

1. Prohibit the payment of flex-commissions (that is, arrangements with adverse consequences to the consumer where the higher the cost of credit the greater the commissions earnt).
2. Provide for a limited exception to the prohibition that allows lower commissions to be paid where the price of credit reduces so that the outcome provides a benefit to the consumer.
3. Address the risk of avoidance by casting the prohibition in broad terms (including addressing conduct in relation to consumer leases and some fees and charges).

ASIC proposes to monitor the effectiveness of the legislative instrument by requiring holders of an ACL to provide ASIC with information about the annual percentage rate and the credit fees and charges under their credit contracts both before and after the commencement of the instrument (through its existing powers under the National Credit Act).

This will enable ASIC to identify practices that may seek to avoid or reduce the effectiveness of the changes introduced by the legislative instrument, and determine whether further modification of the National Credit Act is required to respond to any such conduct. If, for example, ASIC found that a significant percentage of consumers who can be characterised as financially vulnerable were being provided credit contracts with excessive annual percentage rates, that may raise questions as to whether the licensee was engaging in credit activities engaged in efficiently, honestly and fairly and whether consumers were continuing to be disadvantaged by any conflicts of interest. Licensees can reasonably expect that ASIC would investigate the reasons for such an outcome and, if necessary, introduce further obligations to address the practices driving these outcomes.

# Operation of the legislative instrument

This part of the Explanatory Statement primarily describes the operation of the legislative instrument by reference to credit contracts (to limit the extent to which there is repetition). The legislative instrument also operates in relation to certain consumer leases. Specific references to consumer leases are limited to situations where the difference in legal structure affects the way in which the provisions apply. As discussed in detail in the RIS flex commission arrangements do not currently operate in relation to consumer leases. However, extending the application of the instrument to consumer leases ensures competitive neutrality and addresses the risk of arbitrage. If the prohibition did not extend to consumer leases there is a risk that 'flex-commission' practices could migrate to this product, with intermediaries encouraging consumers to finance cars through consumer leases rather than credit contracts.

Summary of Provisions

The following provides a high level summary of key provisions. More detailed information about their operation is contained later in this Explanatory Statement.

The instrument inserts new (modified) sections 53A and 53B into the National Credit Act. The new sections create obligations on licensees and some exempt special purpose funding entities involved in providing credit contracts or consumer leases to not pay benefits, including commissions, to a person who introduces that business if that person has a discretion to influence the cost paid by the consumer and the amount of their benefit is determined by reference to that cost.

The key provisions are:

1. Section 2 of the instrument — states that the start date is 1 November 2018 (to allow a reasonable period of time for lenders and intermediaries to move to new remuneration arrangements, and for lenders to develop new pricing models).
2. Paragraph 5(a) of the instrument— modifies subsection 5(1) of the National Credit Act to contain the definitions of words and phrases used in notional sections 53A and 53B. In particular the phrase 'determines, proposes or influences' is defined to exclude a number of circumstances where the prohibition does not apply.
3. Subsection 53A(1) — describes the scope of the prohibition, both by reference to the class of persons (primarily licensees and exempt special purpose funding entities who are credit providers and lessors, referred to collectively as 'regulated persons') and the conduct that triggers the prohibition (entering into a flexible credit cost arrangement).
4. Subsection 53A(2) — introduces a prohibition on giving benefits (including commissions) under a flexible credit cost arrangement where the amount of the benefit is determined by reference to the annual percentage rate under the credit contract.
5. Subsection 53A(3) — creates exemptions to the prohibition, including where the annual percentage rate of a credit contract is reduced by a maximum of 200 basis points, or the cost of a consumer lease is reduced by a maximum of 4% of the rental charges.
6. Subsection 53A(4) — provides that the prohibition does not apply to benefits given by a regulated person either to a director or employee or a related body corporate of the regulated person, or to a director or employee of any related body corporate.
7. Subsection 53A(5) — creates an offence for a breach of the prohibition in sub-section (2).
8. Subsections 53B(1) and (2) — introduce a second prohibition, providing that if certain credit fees and charges or consumer lease fees and charges are above a maximum amount specified by a regulated person, a benefit (including fees or commissions) must not be paid or given by a regulated person to two classes of introducers: a person who is providing credit services as a representative of a credit provider or a person who is a linked supplier of the credit provider.
9. Subsections 53B(3) and (4)—create obligations on regulated persons by, first, preventing them from determining the amount of these fees and charges by reference to any revenue lost as a result of the prohibition in section 53A, and, second, requiring them to keep written records of the basis on which they determine the maximum amount that can be charged for these fees and charges.
10. Subsection 53A(5) — provides that the prohibition does not apply to benefits given by a regulated person either to a director or employee or a related body corporate of the regulated person, or to a director or employee of any related body corporate.
11. Subsection 53B(6) — creates an offence for a breach of the requirements in sub-sections (1), (3) or (4).

Key elements of the prohibition in modified sections 53A and 53B

The following part summarises key elements of the prohibition in modified sections 53A and 53B of the National Credit Act. A more detailed description of their operation is included later in this Explanatory Statement.

The instrument operates as follows:

1. Subsection 53A(1) describes the persons the prohibition applies to. These persons are referred to collectively as 'regulated persons' and are:
	1. The holder of an ACL who is a credit provider.
	2. Both parties to a servicing agreement between a special purpose funding entity and the licensee who assumes the responsibilities of a credit provider under that agreement (noting that exempt special purpose funding entities are exempt from the requirement to hold an ACL under Credit Regulation 23B of the National Consumer Credit Protection Regulations 2010 (National Credit Regulations)).
2. Subsection 53A(1) describes the circumstances for operation of the prohibition, namely that a regulated person has entered into a 'flexible credit cost arrangement' in relation to a credit contract.
3. The term 'flexible credit cost arrangement' is defined in subsection 5(1) of the National Credit Act (as modified by the instrument) as a contract, arrangement or understanding between a regulated person and another person ('the introducer'), which allows the introducer or an associated person, to determine, propose or influence the annual percentage rate under the credit contract.
4. Subsection 53A(2) prohibits a regulated person from giving the introducer or an associated person monetary or non-monetary benefits (such as commissions) where the following conditions are satisfied:
	1. the amount of the benefit is determined by reference to the annual percentage rate under the contract; and
	2. the introducer or an associated person has determined, proposed or influenced the annual percentage rate (or the cost to the consumer).
5. Subsection 53A(3) provides for an exemption to the prohibition, by allowing for variable benefits to be payable where, in summary, either:
	1. The introducer or an associated person reduces the interest rate nominated by the regulated person by a maximum of 200 basis points (so that, for example, a lower commission can be paid based on the lower interest rate under the contract, rather than the interest rate initially specified by the regulated person).
	2. The introducer or an associated person reduces the interest rate nominated by the regulated person by more than 200 basis points — but with the exemption only applying if the same benefits are given as if the contract had been written at 200 basis points below the nominated interest rate.
6. Section 53B prohibits a regulated person who is a party to a flexible credit cost arrangement giving a benefit to the introducer or an associated person in circumstances where the introducer or associated person is to receive or be paid fees and charges at a higher rate than permitted by the provision. The elements of this prohibition are:
	1. It applies to a regulated person who is a party to a flexible credit cost arrangement.
	2. It applies in relation to certain credit fees and charges.
	3. The obligation does not apply in relation to all introducers but only where the fee or charge is payable to a person who is either:
		1. providing credit services as a representative of the credit provider for the credit contract; or
		2. a linked supplier of the credit provider.
	4. No benefit may be given to the introducer or associated person by the regulated person if the amount of the fee or charge exceeds the higher of:
		1. the amount (if any) specified by a regulated person; or
		2. $0 (so that if the regulated person does not specify a fee then the introducer cannot charge any fees).
	5. The regulated person must not determine the amount of specified fees or charges by reference to the loss or potential loss of revenue by the introducer, or associated person, as a result of the prohibition in section 53A.
7. The instrument introduces penalties:
	1. A breach of the prohibition on giving benefits under subsection 53A(2) can incur a civil penalty of up to 2,000 penalty units, and a criminal penalty of a maximum of 100 penalty units, or 2 years imprisonment (or both).
	2. A breach of the prohibition on giving benefits under subsection 53B(1), and of the additional requirements in subsections 53B(3) and (4) (to not determine the amount of the fees or charges by reference to any loss of revenue and to keep written records of the basis for determining these amounts for a period of 7 years) can incur a civil penalty of up to 2,000 penalty units, and a criminal penalty of a maximum of 100 penalty units, or 2 years imprisonment (or both).

Detailed Explanation

This part of the Explanatory Statement discusses the operation of modified sections 53A and 53B in detail. In this part of the Explanatory Statement the phrase 'cost of finance' refers to:

1. in the case of a credit contract — the amount of the annual percentage rate; and
2. in the case of a consumer lease — the amount of the rental charge.

*Scope of the prohibition*

Subsection 53A(1) describes the scope of the prohibition by reference to both the persons and the type of remuneration arrangements it applies to.

The persons it applies to are referred to collectively as 'regulated persons' and are:

1. The holder of an Australian credit licence (ACL) who is a credit provider.
2. Both parties to a servicing agreement between a special purpose funding entity and the licensee who assumes the responsibilities of a credit provider under that agreement.

Paragraph 53A(1)(b) applies the prohibition to exempt special purpose funding entities and to licensees who are party to a servicing agreement with an exempt special purpose funding entity, but not themselves the credit provider or lessor. This ensures regulatory consistency in the application of the prohibition to different business models.

In general terms, an exempt special purpose funding entity is a vehicle established to raise or receive funds from investors or a securitisation entity that usually has no employees and acts through a servicing agreement with a third party who must hold an ACL and who is required to meet the obligations of a credit provider under the agreement. A special purpose funding entity therefore does not need to hold an ACL if it operates under the exemption in the National Credit Regulations.

Subsection 53A(1) also describes the circumstances for operation of the prohibition, namely that the regulated person has entered into a flexible credit cost arrangement in relation to a credit contract. The phrase 'flexible credit cost arrangement' is defined in subsection 5(1) of the National Credit Act (as modified by section 5 of the instrument). It captures current flex commission arrangements under which car dealers can nominate or select the annual percentage rate from a range agreed to with the credit provider.

The key elements of a flexible credit cost arrangement are:

1. It is a contract, arrangement or understanding — so there is no need for a formal contract or written agreement between the parties.
2. It is between a regulated person and another person, described as an introducer — the term introducer is used as it covers persons engaging in credit activities in different legal capacities (whether as a licensee in their own right, as a credit representative or as a person who is exempt under regulation 23).
3. It applies to conduct both by the introducer or by an associated person — this captures a broad range of business models where the agreement may be with one person, but the regulated conduct is undertaken or engaged in by another person.
4. The introducer or an associated person will provide credit services in relation to the credit contract — they will usually introduce the consumer to the regulated person, rather than the consumer approaching the regulated person directly.
5. The introducer (or an associated person) is able to determine, propose or influence the cost of finance to the consumer.

The definition of a flexible credit cost arrangement in section 5(1) of the National Credit Act (as modified by section 5 of the instrument) specifically excludes a servicing agreement between an exempt special purpose funding entity and the licensee also party to that agreement. The effect of this exclusion is that the prohibition will not apply to these agreements, but will extend to any 'downstream' arrangements between the licensee and its representatives.

*Operation of the prohibition*

Subsection 53A(2) prohibits a regulated person from, in summary, giving either the introducer or an associated person any monetary or non-monetary benefits (such as commissions) where both the following requirements are satisfied:

1. The amount of the benefit is determined by reference to either the annual percentage rate under a credit contract or the rental charge under a consumer lease.
2. The introducer or an associated person has determined, proposed or influenced the amount of the annual percentage rate or the rental charge.

As both requirements need to be satisfied the prohibition does not apply where:

1. the amount of any commission is determined by reference to the annual percentage rate or the rental charge, but the introducer does not have any discretion or capacity to influence this rate; or
2. the introducer is able to influence the annual percentage rate, but the amount of any commission will not be affected by any variation in the cost of finance (e.g. a flat rate of commission applies regardless of the annual percentage rate at which the contract is written).

The phrase 'monetary or non-monetary benefits' is to be given a broad interpretation and recognises that remuneration in this market can be given in a variety of different ways, apart from payments that are commonly recognised as commissions.

The phrase 'determines, proposes or influences' in defined in section 5(1) of the National Credit Act (as modified by section 5 of the instrument) to encompass current practices where introducers have the discretion to set the annual percentage rate within a range agreed between the parties. The definition contains four circumstances that do not fall within it, so that a person who only engages in conduct as described in the definition will not be a party to a flexible credit cost arrangement.

The restrictions on the meaning of 'determines, proposes or influences' are:

1. Paragraph (a) of the definition provides that an introducer or an associated person will not be seen as determining, proposing or influencing the cost of finance merely by proposing or influencing the type or identity of goods to be purchased or rented. Some credit providers may have pricing models in which the cost of finance varies according, for example, to the age or make of car. The provision ensures conduct affecting the consumer's choice in relation to the goods is not covered by the prohibition, notwithstanding that this may have an indirect effect on the cost of finance to the consumer.
2. Secondly, paragraph (b) provides that the prohibition does not apply to conduct by the introducer or an associated person in merely providing the credit provider or lessor with information about:
	1. any of the consumer’s requirements and objectives in relation to the credit contract; or consumer lease; or
	2. their financial situation.

Again, this conduct could be characterised as indirectly affecting the cost of finance where, for example, a credit provider charges a higher annual percentage rate to consumers categorised as at higher risk of default, based on their financial situation. The limitation in the definition makes it explicit that the prohibition does not apply to this conduct.

1. Paragraph (c) states that merely providing the credit provider or lessor with other factual information (that is, factual information other than in the specific circumstances specified in paragraphs paragraph 53C(2)(b) and (c)) will not amount to conduct that can be characterised as having 'determined, proposed or influenced' the cost to the consumer.
2. Finally, paragraph (d) limits the operation of the prohibition by providing that it does not apply to the introducer or an associated person determining, proposing or influencing the cost to the consumer of the transaction before there has been any contact with a prospective debtor. This means that the prohibition is limited to circumstances where the benefits payable will directly affect the cost to an individual or identified consumer. The prohibition, for example, would not apply to negotiations between the regulated person and the introducer in relation to the commission rates that the regulated person sets, including, for example, allowing for promotional periods in which credit contracts may be offered at a discounted annual percentage rate, with different commission payments applying.

*Exceptions to the prohibition — permissible reductions in cost to the consumer*

Subsection 53A(3) provides an exemptions to the prohibition, by allowing for variable benefits to be payable where the outcome operates in favour of the consumer through a reduction in the cost of finance.

Subsection 53A(3) provides, in relation to credit contracts, that the amount of the benefits can vary where the introducer or an associated person determines, proposes or influences a reduction in the annual percentage rate provided the reduction is not less than 200 basis.

In order for the regulated person to be able to rely on the exception the following requirements must be met:

1. If the annual percentage rate is not less than the rate that is 200 basis points less than the specified rate (with this rate called the 'base rate') — the regulated person can pay commissions that vary according to the rate payable under the credit contract; and
2. If the annual percentage rate is less than the base rate — the regulated person can pay commissions but they must be determined using the base rate.

The intended outcomes can be illustrated by an example in which the specified rate for a car loan is 7%, and this annual percentage rate is subsequently reduced during negotiations with the consumer:

1. If the annual percentage rate is reduced to the base rate (5%) — the regulated person can pay commissions at a lower rate, as it is a permissible reduction under subsection 53A(3); and
2. If the annual percentage rate is less than the base rate (for example, 4%) — the regulated person can only pay commissions at the rate that they would be payable if the annual percentage rate was 5%.

This outcome permits a lower commission to be paid based on a lower annual percentage rate. It therefore enables consumers to benefit from lower annual percentage rates, while still enabling introducers to receive benefits when finalising the financing of the vehicle. ASIC considers that allowing a constrained discretion structured in this way will address the harm of vulnerable consumers being charged uncompetitive rates and operate to the advantage of consumers. Further, ASIC will be undertaking monitoring to test the extent to which the relevant credit activities are being engaged in efficiently, honestly and fairly and that clients are not being disadvantaged by any conflicts of interest (including by examining whether some classes of consumers are not being offered competitive rates).

Paragraph 53A(3)(b) also allows for variable benefits to be payable in relation to consumer leases. The exception to the prohibition operates in a different way given that the cost of consumer leases is not determined by reference to an annual percentage rate.

The prohibition in relation to consumer leases in paragraph 53A(3)(b) operates by reference to the difference between the cash price of the goods and the total the rental payable under the lease, with this figure defined as the rental charge. The exception in subsection 53A(3) allows variable benefits to be paid provided there is a reduction of not less than 4% of the specified rental charge.

For example, if the consumer is leasing goods with a cash price of $15,000 and the total rental payable is $25,000 the rental charge will be $10,000. The permissible reduction will therefore be 4% of $10,000 or $400.

*Fees and charges — exceeding maximum figure allowed*

Section 53B contains a prohibition on the payment of benefits in respect of transactions where consumers have to pay fees and charges that are above a maximum figure. In summary it applies in relation to credit fees and charges payable to some introducers under a flexible credit cost arrangement and requires the regulated person to specify a maximum amount that can be charged (or, should the regulated person not nominate a specified amount, the specified maximum is taken to be $0).

The prohibition applies in relation to 'credit fees and charges' or 'consumer lease fees and charges' where the fees and charges are payable to the introducer or an associated person who is either:

1. providing credit services as a representative of the credit provider for the credit contract; or
2. a linked supplier of the credit provider.

The intended scope of the definition is illustrated by the following examples:

1. A car dealer is operating under the 'point of sale' exemption in National Credit Regulation 23 — the restriction applies in relation to credit fees and charges payable to the car dealer where either:
	1. they are engaging in credit services as a representative of the regulated person (as will usually be the case given the terms of the exemption); or
	2. they are supplying vehicles financed through credit contracts where the credit provider is a linked credit provider.
2. A car dealer holds an ACL — the restriction will only apply in relation to credit fees or charges if the credit provider is a linked credit provider in respect of the vehicle financed under the credit contract (as is typically the case in these arrangements).
3. A fee is charged by a finance broker who holds an ACL — the restriction will not apply in relation to them, as they are not supplying goods or services in relation to credit contracts where the credit provider is a linked credit provider.

Subsection 53B restricts the amount of any relevant credit fees and charges as its effect is that:

1. a regulated person may specify a maximum amount that can be charged — and that if no such amount is specified, the specified amount is taken to be $0;
2. if the relevant credit fees and charges exceed the specified amount, no benefit can be provided by the regulated person to the introducer or an associated person; and
3. the introducer or an associated person can determine, propose or influence the charging of a lower amount for the credit fees and charges (including a reduction to zero dollars).

Modified section 53B does not prescribe any maximum figure or cap on the amount of any specified fees or charges, and gives the regulated person discretion to nominate this amount. ASIC has chosen not to impose a cap itself but to introduce an indirect form of control by allowing regulated persons to do so. However, ASIC proposes to monitor the amount of these fees or charges following commencement of the prohibition (through its existing powers under the National Credit Act). This will enable it to assess whether further modifications of the National Credit Act may be required to address any excessive increases in the amounts being paid by consumers.

The instrument also introduces procedural requirements in relation to the way in which a regulated person determines the maximum amount payable for credit fees and charges.

First, paragraph 53B(3) provides that the regulated person must not determine the amount of specified fees or charges by reference to the loss or potential loss of revenue by the introducer, or associated person, as a result of the prohibition on the payment of flexible benefits. This means it cannot be set at a rate that would compensate the introducer, or any associated person, for a reduction in the significant payments earnt through higher interest charges (through the current flex-commission arrangements).

These fees were typically introduced to compensate the introducer for their time and expense in providing credit services and it is therefore expected that the maximum fee would be based on an assessment of the value of those services, which may vary from introducer to introducer given the range of business models that exist. The obligation allows a regulated person flexibility in determining this amount while preventing a transfer of costs from higher annual percentage rates to increased fees.

Secondly, subsection 53B(4) provides that the regulated person must keep records of the basis for determining the specified fees or charges for a period of seven years. This will enable ASIC to test the methodology they used in setting the maximum figure. If, for example, a regulated person changes the existing arrangements and allows introducers to charge credit fees and charges that are substantially higher ASIC will be able to scrutinise and test the underlying methodology.

Section 53B applies the same restrictions and obligations to consumer lease fees and charges that operate in the same way as to credit fees and charges (as discussed above).

*Other limitations in the scope of the prohibition*

There are three other limitations in the scope of the prohibition.

First, there is an exclusion for 'home loans' in that section 53A operates by reference to flexible credit cost arrangements that operate in relation to credit contracts other than home loans. The meaning of this term is set out in subsection 5(1) of the National Credit Act (as modified by section 5 of the instrument), and adapts the current definition of a standard home loan in section 133AA of the National Credit Act. The exclusion is introduced to avoid the application of the prohibition to white labelling and other arrangements in the home loan market where the intermediary is managing contracts on behalf of the lender. These transactions operate on a different basis, and in a market that is more transparent in price. The exemption for home loans will allow those arrangements to continue.

Further, ASIC's consultations with stakeholders did not find any evidence of systemic use of flex-commission in the home loan market where there was both a direct relationship between the annual percentage rate under a home loan and the benefits to any introducer, and that the benefits incentivised the introducer to charge a higher rate.

Secondly, the effect of subsections 53A(4) and 53B(5) is that the prohibitions do not apply to benefits given to a director or employee or a related body corporate of the regulated person, or a director or employee or a related body corporate.

Finally, the effect of section 6 is that the prohibitions in the instrument do not apply in relation to a credit activity that was engaged in, or a credit contract or a consumer lease that was entered into, before this instrument commences (on 1 November 2018).

*Commencement and transition*

Section 5 of the instrument provides that it commences on 1 November 2018. It is considered that this period of time is required as:

1. lenders will need to develop new pricing models; and
2. lenders and introducers will need to agree on new remuneration arrangements.

# Consultation

## Consultation on regulatory approach

Before making the decision to make this legislative instrument, ASIC consulted broadly with the following industry bodies on the problems raised by flex commissions, possible regulatory options, and on the form of the instrument itself:

1. the industry body for lenders in the car finance sector, the Australian Finance Conference;
2. the two industry bodies for the broader loan distribution sector:
	1. the Mortgage & Finance Association of Australia, which represents mortgage and finance brokers and other intermediaries, including mortgage management businesses, and both banks and non-bank lenders; and
	2. the Finance Brokers Association of Australia Limited, a national association representing finance and mortgage loan writers throughout Australia;
3. the industry body that advocates for Australia’s customer owned banking sector, the Customer Owned Banking Association, which represents mutual banks, credit unions and building societies;
4. the national body for commercial equipment finance brokers, the Commercial Asset Finance Brokers Association of Australia Limited;
5. the principal industry body representing franchised new car dealers, the Australian Automotive Dealer Association; and
6. the Motor Trades Association of Australia Limited, which represents the motor traders associations operating in each State and Territory whose membership includes both new and used car dealerships.

ASIC also consulted with:

1. lenders who provide car finance, including authorised deposit-taking institutions (ADIs) and non-ADIs, lenders who specialise in this market, and lenders who offer a broad range of credit products, including car loans;
2. a number of individual car dealers or dealer groups; and
3. consumer advocates.

These consultations were primarily conducted through:

1. consultation with targeted stakeholders on whether ASIC should take action in relation to flex commissions and the advantages and disadvantages of different regulatory options in December 2015 and May 2016;
2. consideration of written responses based on these consultations; and
3. meetings with representatives of some of the consulted groups.

In these consultations, there was broad (but not unanimous) agreement on three issues:

1. It was accepted that flex commissions caused harm, although there was disagreement about the extent of this harm, particularly as to whether it only applied to ‘outlier’ transactions with the highest annual percentage rates or more broadly.
2. It was accepted that it was desirable to have a collective and competitively neutral response to address the ‘first mover’ problem, and ensure that there was a smooth transition by lenders.
3. It was accepted that if ASIC did prohibit flex commissions, there was a substitution risk, in that car dealers may seek to recoup lost revenue by charging higher dealer fees.

## Consultation on terms of the instrument

Following the decision to proceed with making this legislative instrument, ASIC engaged in further consultation with both industry bodies and other stakeholders on a draft instrument, to ensure that it would operate as intended. This was primarily undertaken through Consultation Paper 279 Flex commission arrangements in the car finance industry (released in March 2017).

**Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

 *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780*

This legislative instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Overview of the legislative instrument**

This legislative instrument modifies the *National Consumer Credit Protection Act 2009* (***National Credit Act***) by inserting a new provision that prohibits certain conduct.

The objectives of the instrument are to:

1. Prohibit the payment of 'flex-commissions' (that is, arrangements with adverse consequences to the consumer where the higher the cost of credit the greater the commissions earnt).
2. Provide for a limited exception to the prohibition that operates in favour of the consumer (for example, allowing lower commissions to be paid where the price of credit reduces).
3. Address the risk of avoidance by casting the prohibition in broad terms.

It is expected the introduction of the prohibition will:

1. encourage lenders to develop more accurate pricing for risk models, in which the cost of credit will be more closely linked to the consumer’s financial circumstances and background; and
2. produce better outcomes for consumers, including more transparency in the pricing of credit, more efficient pricing models, a reduction in average interest rates as a result of more visible competition through advertising and lower losses through defaults.

**Human rights implications**

This instrument does not engage any of the applicable rights or freedoms.

**Conclusion**

This instrument is compatible with human rights as it does not raise any human rights issues.