

**EXPLANATORY STATEMENT for
ASIC Credit (Amendment) Instrument 2018/706**

Prepared by the Australian Securities and Investments Commission

National Consumer Credit Protection Act 2009

The Australian Securities and Investments Commission (ASIC) makes *ASIC Credit (Amendment) Instrument 2018/706* under paragraph 109(3)(d) of the *National Consumer Credit Protection Act 2009* (the **National Credit Act**). Paragraph 109(3)(d) provides that 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.

This legislative instrument amends the *ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780* (the **primary instrument**). Under subsection 33(3) of the *Acts Interpretations Act 1901*, where an Act confers a power to make, grant or issue any instrument (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend or vary any such instrument.

1. Background

'Flex commission arrangements' are arrangements 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. Following analysis on the effect of these arrangements in the car finance market, ASIC made findings that these pricing arrangements are a remuneration structure that:

- (a) 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;
- (b) 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;
- (c) operates in a way that is not transparent for consumers or understood by them at the point of sale; and
- (d) can operate unfairly in any individual transaction.

On 5 September 2017, ASIC made the primary instrument to:

- (a) 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 earned);
- (b) 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; and

- (c) 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).

The primary instrument commences on 1 November 2018.

ASIC consulted on the draft terms of the primary instrument before it was executed and registered. However, following registration of the instrument, industry stakeholders raised three issues that require minor changes to the terms of the instrument. These issues are explained below.

Definition of 'home loan'

When ASIC made the primary instrument, it exempted home loans from the operation of the prohibition as the operation of commissions in this market has not been identified as having the same adverse impacts on consumers.

The definition of **home loan** in section 4 of the primary instrument reflects a definition currently used in the legislation. However, some stakeholders have raised a concern that this definition is narrower than the range of residential property related loans that are regulated under the National Credit Act (as provided by section 5 of the National Credit Code). Stakeholders were concerned that the carve out would not cover loans where the credit provided is:

- (a) predominantly used to purchase residential property, but some funds are used for other purposes;
- (b) predominantly used to refinance loans wholly or predominantly used to purchase residential property, but some funds are used for other purposes;
- (c) used to renovate or improve residential property; or
- (d) used to refinance loans made to renovate or improve residential property.

Exclusion of certain agreements from the prohibition

The primary instrument operates to exclude from the prohibition a 'servicing agreement', and remuneration paid under such an agreement, between a licensee and an exempt special purpose funding entity. This carve out is achieved by excluding such agreements from the definition of a **flexible credit cost arrangement**.

Under servicing agreements, the licensee performs obligations or exercises rights of a credit provider on behalf of the exempt entity. A licensee acting under a servicing agreement will often have day to day control over the entry into contracts by the exempt entity. It is expected that licensees acting on behalf of an exempt special purpose funding entity will be involved in day-to-day management that includes determining or influencing the terms of the contract entered by the exempt entity.

Some stakeholders have raised a concern that similar arrangements with licensees are commonly used by special purpose funding entities that hold a licence (rather than acting as exempt entities), and that this situation should also not be covered by the prohibition.

Application to 'in-flight' offers

The prohibition contained in the primary instrument applies to a credit activity that is engaged in, or a credit contract or a consumer lease that is entered into, from commencement of the instrument on 1 November 2018. One stakeholder indicated that it anticipates that as at 1 November 2018 it may have some offers (in-flight offers) that have been given to consumers prior to that date and that are capable

of acceptance by the consumer after that date. Credit activities may be engaged in in relation to the finalisation of contracts resulting from those in-flight offers after 1 November 2018. The stakeholder requested a change to the transition arrangement for the primary instrument to allow for entry into a credit contract or consumer lease pursuant to the acceptance by a consumer, on or after 1 November 2018, of an in-flight offer.

2. Purpose of this instrument

ASIC Credit (Amendment) Instrument 2018/706 is intended to address the above issues raised by stakeholders.

3. Operation of the instrument

The instrument makes the following amendments.

Definition of 'home loan'

The instrument amends the notional definition of **home loan** in paragraph 5(a) of the primary instrument to be consistent with the broader range of purposes relating to residential property that result in a contract being regulated by the National Credit Act. The amended definition will have the effect of excluding from the prohibition:

“a credit contract under which a licensee or an exempt special purpose funding entity provides credit wholly or predominantly:

- (a) to purchase, renovate or improve residential property; or
- (b) to refinance credit that has been provided wholly or predominantly to purchase, renovate or improve residential property”.

Exclusion of management agreements

The instrument:

- (a) amends the notional definition of **flexible credit cost arrangement** in paragraph 5(a) of the primary instrument to exclude a ‘management agreement’; and
- (b) inserts a notional definition of **management agreement** in paragraph 5(a) of the primary instrument to cover written agreements referred to in regulation 26 of the *National Consumer Credit Protection Regulation 2010*.

These amendments have the effect of excluding from the prohibition benefits that are paid to a person acting in the capacity of a mortgage manager as defined in regulation 26. Regulation 26 defines a **mortgage manager** as:

“a licensee who has a written agreement with:

- (a) a credit provider or lessor; or
- (b) a third party who is authorised to act for a credit provider or lessor (under a written agreement with the credit provider or lessor); and

under the terms of which:

- (c) the licensee is required to manage the relationship with the consumer on a day-to-day basis for the credit provider or lessor in accordance with the credit provider's, lessor's or third party's policies and procedures; and
- (d) the credit contracts, consumer leases and associated documentation used by the licensee are branded or co-branded with the name of the licensee".

Application to 'in-flight' offers

The instrument amends the application provision in section 6 of the primary instrument to provide (in addition to the existing limitations) that the primary instrument does not apply in relation to a credit contract or consumer lease that was entered into:

- (a) before the instrument commences; or
- (b) before 1 February 2019 as a result of either an offer that was made by the credit provider or lessor before the instrument commences, or an acceptance before 1 February 2019 by the credit provider or lessor of an offer made by the consumer before the instrument commences.

Given the different offer and acceptance models that may be used for entering credit contracts and consumer leases, the additional transition provision minimises disruption to stakeholders.

4. Consultation

ASIC provided initial drafts of the proposed amendments to the stakeholders who raised the issues noted above, who confirmed that the amendments would address those issues. ASIC also provided the draft proposed amendments to a broader group of stakeholders who had engaged in the consultation for, and provided comments on drafts of, the primary instrument. We received responses from lenders, industry representative bodies and consumer representative bodies. All stakeholders who responded were supportive of the draft amendments. Some stakeholders suggested technical changes to the draft wording, which have been incorporated. Though there have been some changes to the final wording of the amendments in this instrument, the amendments have the same substantive effect as the drafts provided for consultation.

Statement of Compatibility with Human Rights

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

ASIC Credit (Amendment) Instrument 2018/706

ASIC Credit (Amendment) Instrument 2018/706 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

ASIC Credit (Amendment) Instrument 2018/706 amends ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780 to:

- (a) ensure that the definition of **home loan** used in the primary instrument is consistent with the broader range of purposes relating to residential property that are treated as regulated credit contracts, and is effective to exclude these credit contracts from the prohibition contained in the primary instrument;
- (b) ensure that the definition of **flexible credit cost arrangement** used in the primary instrument excludes a management agreement, which is defined to cover written agreements referred to in regulation 26 of the *National Consumer Credit Protection Regulation 2010*; and
- (c) ensure that the application provision will have the effect that the primary instrument does not apply to a credit contract or consumer lease that was entered into on or after 1 November 2018 (but before 1 February 2019) as a result of either an offer that was made by the credit provider or lessor before 1 November 2018 or acceptance by the credit provider or lessor of an offer made by the consumer before 1 November 2018.

Human rights implications

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

Conclusion

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

Australian Securities and Investments Commission