

**Senate Standing Committee on Economics**

**ANSWERS TO QUESTIONS ON NOTICE**

**Treasury Portfolio**

Additional Estimates

10 – 11 February 2010

**Question: aet 112**

**Topic: Consumer Credit Reform**

**Hansard Page: E84 (11/02/2010)**

**Senator PRATT asked:**

**Senator PRATT**—The committee is well up to speed with progress so far on consumer credit reform. We are about to move into our next phase. I understand that recently there have been consultations that have put forward some further changes and enhancements and that we are consulting on those changes. One of those is regulations to accommodate difference practices in the way interest may be calculated or charged by lenders in respect of the provision of credit for residential investments. Is this the way we currently regulate interest in relation to residential investments or is it new? And what is the significance of that particular change?

**Mr Murphy**—I think it would be best if—

**Ms Rowbotham**—I put that one on notice?

**Mr Murphy**—Yes. The Consumer Credit Code is being picked up from the states. Gradually, we are working our way through to try to improve consumer credit regulation and the second tranche, the second phase, is addressing that.

**Senator PRATT**—Another issue that came up—and you are also welcome to take this notice—was the consideration that pre-existing contracts should perhaps also be subject to responsible lending provisions. How is it proposed that that will work? Has it come up in response to a perceived flaw in the original reform and, if so, is there any reason why old contracts should necessarily be any different to new contracts in respect of that?

**Mr Murphy**—I am not sure.

**Answer:**

**Loans for residential investment property – payment of interest in advance**

1. Credit provided to a natural person to purchase, renovate or improve a residential investment property (RIP loan) or to refinance a RIP loan will be regulated for the first time under the *National Consumer Credit Protection Act 2009* and the National Credit Code (Code), which commences on 1 July 2010. RIP loans are not regulated under the State and Territory Consumer Credit Codes (which apply to contracts made prior to 1 July 2010).
2. The Code largely prohibits lenders from requiring borrowers to make early interest payments (that is, before the end of the day to which an interest charge applies) but allows borrowers to make such payments voluntarily.
3. Currently, some lenders provide fixed rate RIP loans, which require borrowers to make early interest payments via a lump sum, usually 12 months in advance. This allows a borrower who pays a year's interest in advance to obtain a tax

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deduction on the lump sum. Some lenders and borrowers prefer this arrangement to arrangements for voluntary early payments of interest.

4. It was considered appropriate to allow existing practices to continue, in order not to impede the loan repayment opportunities for RIP loan borrowers. Treasury consulted on this issue with RIP loan providers, including the four major banks, industry bodies, other financial institutions and credit service providers. Following those targeted consultations draft Regulations were released for public comment in November 2009.
5. Consequently, a regulation was included to modify the effect of the Code to allow interest payments in advance for RIP loans and the refinancing of such loans (only where the refinancing is predominantly for an investment purpose). Industry has welcomed these changes.

#### **Pre-existing contracts and responsible lending obligations**

1. As a matter of equity and good policy, it is desirable for the application of consistent regulatory oversight to all contracts. However, there are constitutional limitations to the extent that this could be achieved for pre-existing contracts. It was always intended that the new responsible lending conduct obligations would apply to pre-existing contracts where the conduct triggering the obligations occurred after commencement of the new credit regime and these obligations would be implemented through regulations.
2. The type of conduct that could trigger the application of responsible lending conduct obligations to pre-existing contracts depends on the type of licensee, whether it is an intermediary or a lender. For an intermediary (such as a finance or mortgage broker) the conduct triggering the obligations includes when they suggest that the consumer stay in the existing credit contract or suggest that the existing contract credit limit be increased. For lenders and lessors, the obligations would be triggered when they provide a credit limit increase.
3. Once the responsible lending conduct obligations have been triggered the licensee would be required to make reasonable inquiries about the consumer's objectives and to verify their capacity to repay.
4. A draft of the *National Consumer Credit Protection (Transitional and Consequential Provisions) Regulations 2010* was released for public consultation in November 2009. The regulations proposed to extend the responsible lending conduct obligations to both intermediaries and lenders, where relevant, in relation to conduct that affected pre-existing contracts.
5. Regulations supporting the credit legislation were made by Executive Council on 10 March 2010. However, regulations relating to the application of the regime to pre-existing contracts were not included to allow the benefit of further consultation on the issue of the application of licensing requirements in relation to pre-existing contracts. To ensure consistency, it was decided that all regulations affecting pre-existing contracts should be made together. It is anticipated these regulations will be taken to the Executive Council shortly.