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FinCoNet report on responsible lending

Review of supervisory tools for suitable consumer lending practices

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Executive summary

FinCoNet

The International Financial Consumer Protection Organisation (FinCoNet) was established in 2003 as a network of financial consumer protection regulators and supervisors to discuss consumer protection issues of common interest. It is recognised by the Financial Stability Board (FSB) and Group of 20 (G20).

In November 2013, FinCoNet was formalised as a new international organisation of financial consumer protection supervisory authorities.

The goal of FinCoNet is to promote sound market conduct and enhance consumer protection through efficient and effective financial market conduct supervision, with a focus on retail banking and consumer credit.

Members see FinCoNet as a valuable forum for sharing information on supervisory tools and best practices for consumer protection regulators in financial services.

Responsible lending initiatives

As part of global discussions held in the context of the recent global financial crisis, particular attention is being paid to consumer protection and regulatory and supervisory deficiencies relating to consumer credit (i.e. credit provided for personal, household or domestic purposes). In particular, responsible lending – in terms of both business conduct and product suitability – has been identified as a response to these concerns.

FinCoNet set up Working Group 2, on supervisory tools for suitable consumer lending practices, to undertake work to help jurisdictions share information about current developments and enable jurisdictions to review the adequacy of their responsible lending arrangements. This work is intended to strengthen supervisory tools aimed at deterring unsuitable or irresponsible lending by helping jurisdictions identify current gaps and weaknesses in their regulatory regimes, including their supervisory and enforcement capabilities.

FinCoNet is uniquely positioned to canvas the issue of responsible lending across a full range of consumer credit products provided by a range of credit providers and credit intermediaries, from both a consumer protection and market conduct perspective.

Overview of the survey

In 2013, FinCoNet created the FinCoNet Survey on Responsible Lending (survey).

Survey features

The survey aimed to collect information from jurisdictions on their consumer credit and responsible lending frameworks and implementation arrangements. This applies to both secured and unsecured consumer credit.

The survey considered responsible lending in the context of tools and mechanisms that would specifically influence or affect a consumer's eligibility for or entry into a credit contract or agreement, and the decision making by both credit providers and consumers around the loan transaction. Thus, investigation of specific approaches to issues – such as the handling of arrears and debt collection, or the misaligned incentives ('conflicts of interest') of credit intermediaries and advisers – were out of scope.

The survey reviewed:

- the key benchmarks for defining unsuitable or irresponsible lending;
- the approaches used for identifying unsuitable or irresponsible lending in the marketplace; and
- the tools used for addressing unsuitable or irresponsible lending.

The types of responsible lending initiatives that were considered were:

- consumer engagement – measures to encourage consumers to identify and select a suitable product or credit limit (e.g. disclosure or truth-in-lending requirements);
- industry-based requirements (business conduct) – measures required of industry (the credit provider and any associated intermediary) to assess or determine whether a product or products is suitable or affordable for a consumer or class of consumer, or restrictions to prevent them from lending irresponsibly. The survey also considered whether the primary goal of the measure was prudential in nature or consumer protection; and
- regulatory controls (product intervention) – measures taken by a jurisdiction to restrict certain product designs to address systemic unsuitability (e.g. price controls such as interest rate caps, or the restriction or banning of certain products or product features).

The survey also focused on the tools and mechanisms available to supervisors, regulators and consumers to enforce or ensure compliance with responsible lending obligations, or to remedy unsuitable or irresponsible lending.

Survey responses

The survey went out to a large range of jurisdictions and representative bodies, including FinCoNet members.

A total of 20 responses were received from different jurisdictions, many of whom are considered to be leading developments in the area of responsible lending (see the appendix for a list of the jurisdictions and their primary regulators).

The graphs included in this report are based on the responses provided by all 20 jurisdictions unless otherwise specified.

In this report, ‘jurisdiction’ refers to one of the jurisdictions that responded to the survey.

These responses provide the basis from which trends and observations of good practice are drawn.

Purpose of the report

This report seeks to provide a holistic view of responsible lending obligations in relation to a full suite of consumer credit products, with a focus on consumer protection.

The report identifies practices and initiatives that promote responsible lending in the consumer credit market. In doing so, FinCoNet intends that the report will provide a platform for relevant authorities to exchange views regarding notable and effective approaches to address the issue of responsible lending. Consistent with FinCoNet’s mandate, this report also has a strong emphasis on supervisory and enforcement capabilities.

This report aims to be consistent with and build on the work already undertaken in this area. It is informed by and draws on a range of existing work on consumer credit and responsible lending, including the work of international standard-setting bodies, regulatory authorities in different jurisdictions, consumer bodies, scholarly literature and empirical research.

The report does not seek to provide an exhaustive policy framework for responsible lending. Rather, it seeks to draw attention to the range of current and emerging regulatory practices intended to promote responsible lending.

This work is important for the protection of consumers, and a component of safeguarding the stability of financial markets into the future.

Overview of the report

This report sets out the key results from the survey and, more broadly, reflects international developments and experience to date. It seeks to identify useful practices to promote responsible lending.

This is presented in five main sections:

- *Regulatory framework*, which sets out how a jurisdiction's financial regulatory framework regulates consumer credit;
- *Consumer engagement*, which identifies a range of regulatory tools and mechanisms to assist consumers in making a decision to obtain credit;
- *Industry obligations*, which identifies the suite of tools and mechanisms used to require industry to lend responsibly (business conduct requirements);
- *Regulatory controls*, which identifies controls or prohibitions on the provision of consumer credit and credit products or features; and
- *Supervisory and enforcement tools*, which identifies the suite of tools and mechanisms that enable jurisdictions to ensure compliance with responsible lending obligations, including supervisory and enforcement capabilities.

Each section sets out an overview of the survey and the main results. It also identifies trends, limitations and key approaches. Good practices among a variety of jurisdictions are identified in case studies and examples.

Observations from the report

The report identifies that responsible lending obligations and approaches have developed significantly over the past ten years.

The global financial crisis has drawn attention to the importance of consumer protection, particularly responsible lending, as a component of a stable financial system.

The report suggests that the policy and regulatory frameworks to support consumer credit and promote responsible lending in a jurisdiction are in a transition phase – moving towards a more robust and consumer-focused regulatory environment.

The current emerging practices, tools and mechanisms reflect a heightened concern about the impact of irresponsible lending on consumers and, as corollary, the economy as a whole.

In some part, these changes are a reflection of the development of international standards intended to respond to the financial crisis and promote financial stability. However, there are also a number of developments outside international standards that seek to advance the interests of consumers, due to policy concerns about irresponsible lending.

While this report and its observations reflect a current 'state of play', a majority of jurisdictions have identified that they are in the process of law reform to improve their responses to irresponsible lending and create a stronger consumer credit regulatory regime.

The evolution of responsible lending obligations

Promoting consumer interests

Obligations promoting transparency in the marketing and selling of consumer credit products are an established feature in most jurisdictions. However, the survey identified that among the jurisdictions that responded, these are no longer used as the primary tool for addressing concerns about irresponsible lending.

The report reveals that there is a growing focus on not only assisting consumers to make good decisions about their borrowing, but actively promoting consumer interests in the decision-making process.

At the forefront of these developments are responsible lending obligations that require the credit provider or credit intermediary to consider the interests of the consumer, particularly consumer affordability or suitability, before entering into a credit contract or agreement. Many of these obligations have been introduced since the financial crisis. These obligations are often principles based and apply across a full range of consumer credit products. This also reflects a growing recognition that, while prudential regulation may help prevent consumer over-indebtedness, it may not adequately address the suite of issues raised for consumers by irresponsible or unsuitable lending.

In some circumstances, where the detriment to consumers is considered particularly egregious, certain jurisdictions have considered it important to directly intervene in the provision of certain products or product features to consumers.

Scope of regulatory regimes

The report also highlights that a number of jurisdictions have or are in the process of expanding the scope of supervision and regulatory oversight to all relevant credit providers and credit intermediaries.

The report identifies that the scope of supervision and regulatory oversight of credit providers and credit intermediaries is not consistent across jurisdictions. The scope of responsible lending obligations and supervision has traditionally focused on prudentially regulated financial institutions, such as banks, or mortgage lending activity.

In some jurisdictions, key types of non-bank credit providers and credit intermediaries, including those that deal with the most vulnerable consumers, may operate outside the regulatory scope. This coverage gap may pose a number of policy complexities for countries and jurisdictions, including the risk of ‘bad apples’ operating in the unregulated part of the market (and consequent consumer detriment) and unfair competition due to regulatory arbitrage. However, a growing number of jurisdictions have, or are in the process of, addressing this gap. This shift, in part, reflects concerns about irresponsible or unsuitable lending across a suite of consumer credit products.

Promoting effective supervision and enforcement

The report also identifies a stronger emphasis being placed on effective supervision and enforcement to prevent or mitigate irresponsible lending.

While most jurisdictions enable consumers to seek redress, there is a growing recognition of the importance of a sound supervisory framework, including market entry requirements, to encourage compliance, enforce obligations and facilitate consumer outcomes to promote responsible lending.

Some jurisdictions also highlighted the benefits of adequate supervisory powers, including appropriate sanctions, clear regulatory obligations, and sufficient resourcing to ensure compliance and enforcement action against irresponsible or unsuitable lending.

Good practice observations

Throughout this report we have made a number of general observations of good practice, based on the initiatives of the jurisdictions that responded to the survey.

These are collected in Table 1.

The good practice observations highlight useful or common practices among jurisdictions that are consistent with international developments and standards, or reflect regulatory and policy insight into and experience of established or emerging good practice.

The good practice observations identified in this report may not fully reflect the range of experiences or tools and mechanisms available in countries or jurisdictions that were not able to participate in the survey. As a result, they are only an indication of current practices on responsible lending.

Nevertheless, they provide a useful benchmark for countries and jurisdictions to identify practices that may be useful to promote responsible lending in their jurisdiction.

Table 1: Good practice observations

1	Focus on consumer credit protection	Jurisdictions make consumer protection in relation to consumer credit products an integral part of the legal, regulatory and supervisory framework for financial services.
2	Appropriate oversight	Jurisdictions have oversight bodies (dedicated or not) that are explicitly responsible for consumer protection in relation to consumer credit (the 'primary regulator').
3	Comprehensive regulatory scope	The primary regulator has oversight over all credit providers and credit intermediaries who provide consumer credit products and related services. A more comprehensive scope benefits the application of responsible lending and consumer protection obligations across the full range of consumer credit products and services.
4	Appropriate supervisory and enforcement powers	Jurisdictions ensure that the primary regulator has a range of appropriate supervisory and enforcement powers, including information-gathering, administrative and enforcement powers, and the resources to administer the arrangements in practice.
5	Fair and clear promotion	Credit providers and credit intermediaries are required to provide advertising, marketing and promotional material that is fair, clear, and not misleading or deceptive. The requirements may be prescriptive or principles based.
6	Costs promoted clearly	Credit providers and credit intermediaries are required to clearly present costs, including interest rates, in their marketing, advertising and promotional material. In particular, they are required to present a separate standardised interest rate or annual percentage rate that takes into account the headline interest rate and any other upfront fees and costs.
7	Disclose key terms and conditions	Credit providers and credit intermediaries are required to provide consumers with the key terms and conditions of the credit product, including their legal rights, and any other information that is material to the consumer's decision to enter into a credit contract. This may be in a standardised format to facilitate comparison.
8	Appropriate disclosure	Credit providers and credit intermediaries are required to provide clear and relevant information to the consumer at key points before and during the consumer's decision to enter into a credit contract.
9	Specific disclosures	Additional disclosure obligations are required for specific credit products where there is increased risk to a consumer or class of consumer due to, among other things, the complexity or high value of a credit product or if the product raises particular consumer protection concerns.
10	Financial literacy education websites	Jurisdictions promote financial literacy through self-guided educational websites. The websites include information on consumer credit, specifically information and interactive tools to assist a consumer to understand the nature of a consumer credit product and the risks and benefits of entering into a credit contract.
11	Community outreach programs	Jurisdictions encourage or promote community outreach programs to raise awareness about consumer finance and improve financial literacy.
12	Reasonable inquiries to obtain information	Credit providers and credit intermediaries are prohibited from providing or facilitating the provision of credit to a consumer unless they have made reasonable inquiries to obtain information about the consumer's: • overall financial circumstances, taking into account a range of factors, including their income, assets, existing debt, current and future expenses, living requirements, and relevant personal circumstances (such as dependents); and • needs, requirements and objectives.

13	**Verifying financial information**	Credit providers and credit intermediaries are required to make reasonable efforts to verify the financial information obtained about a consumer, particularly income history and pre-existing debts. This can be through obtaining relevant data – such as recent payroll receipts or strips, financial statements, and tax account statements – and checking credit reports or registers.
14	**Reasonable assessment of the interests of a consumer**	Credit providers and credit intermediaries are prohibited from providing or facilitating the provision of credit to a consumer unless they have made a reasonable assessment that it meets the interests of the consumer, including affordability, or an analogous benchmark or principle. The credit will not be in the interests of a consumer if it is likely to or will: • put a consumer in a position where they could not repay the loan, or could only repay the loan with substantial hardship; or • not meet their needs, requirements or objectives.
15	**Targeted prevention of consumer over-indebtedness**	Credit providers and credit intermediaries have targeted obligations to prevent consumer over-indebtedness or to address concerning lending practices in particular products in the market. Factors that are taken into account include the type and vulnerability of the consumer or class of consumer, adverse financial effects on consumers, the type and complexity of the product, the nature of the credit provider or credit intermediary, and any other relevant risks.
16	**Direct regulatory interventions**	Jurisdictions prohibit certain products or product features to: • target particular risks to a consumer, class of consumer or the economy; • prevent over-indebtedness of a consumer or class of consumer; or • address potentially detrimental or irresponsible lending practices in particular products in the market. Factors that are taken into account include: the type and level of vulnerability of a consumer or class of consumer; adverse financial effects on consumers; the type, complexity and risk of the product; distribution channels; and the nature of the credit provider or credit intermediary.
17	**Market entry requirements**	Credit providers and credit intermediaries are subject to a strong licensing or authorisation regime with a range of investigative and administrative powers that can assist supervisors to monitor and supervise the compliance of their regulated population.
18	**Application criteria**	Credit providers and credit intermediaries are not licensed or authorised unless they meet the application criteria, including whether they are 'fit and proper' or trustworthy, and have adequate training.
19	**Mechanism to exclude 'bad apples'**	Jurisdictions have a mechanism to exclude certain persons or entities from operating in the consumer credit market, due to their inability to meet relevant conduct requirements. This mechanism is generally administered by the primary regulator.
20	**Exclusion from market due to irresponsible lending**	Irresponsible lending or the failure to meet responsible lending obligations is a basis on which a licence or other authorisation could be removed, or a person or entity excluded from providing credit products or services.
21	**Monitoring compliance**	The primary regulator is permitted to use a range of tools and mechanisms to monitor compliance with responsible lending obligations, focused on consumer affordability.
22	**Addressing individual complaints**	The primary regulator is able to obtain a complaint or breach report about a specific instance or allegation of irresponsible lending, including from a consumer. Where such a complaint or breach report is made, the primary regulator has the capacity to investigate and seek administrative or enforcement action in relation to the specific complaint or breach, and facilitate consumer redress where appropriate.

23	**Consumer access to internal dispute resolution mechanism**	Consumers are able to complain directly to the credit provider or credit intermediary if they consider that there has been a breach of a responsible lending obligation. Credit providers are required to have in place suitable processes to handle and mediate complaints, including the capacity to modify or amend a consumer credit contract or agreement as necessary.
24	**Consumer access to independent dispute resolution**	Consumers are able to access an independent complaints body or ombudsman that can make binding decisions on a credit provider or credit intermediary in relation to a breach of a responsible lending obligation. However, this decision does not preclude the consumer from seeking legal action if they do not agree to the terms of the decision.
25	**Complaints mechanism for primary regulator**	Consumers are able to complain directly to the primary regulator about a breach or allegation of a breach of the responsible lending obligations. The primary regulator has the capacity to consider specific breaches or allegations, seek suitable administrative or enforcement actions, and facilitate consumer redress where appropriate.
26	**Consumer access to legal redress**	Consumers are able to take legal action against a credit provider or credit intermediary for a breach of the responsible lending obligations. Courts and tribunals are able to undertake a variety of actions to provide consumer redress where a breach is found – including setting aside all or part of the consumer's obligations under the credit contract or agreement, providing compensation, or imposing other conditions on the credit provider or credit intermediary.

Contextual matters

Not all of the tools and mechanisms that supervisors, regulators and relevant policy makers may use to promote responsible lending will be useful or relevant to a particular country or jurisdiction.

Contextual matters that will influence whether a measure or approach is useful or relevant to a particular country or jurisdiction depend on a number of policy factors, including:

- the shape and sophistication of the market – for example, if short-term lending is a growing market;
- the legal framework of a jurisdiction;
- economic conditions, such as the availability of credit, interest rate conditions, productivity and growth agendas, and financial stability concerns;
- the general literacy, numeracy and financial literacy of the population – for example, disclosure may be less useful in a country where the general literacy of the population is limited; and
- the desire to promote financial inclusion overall, or among certain groups of consumers.

This report does not seek to analyse the policy settings or effectiveness of a particular measure or proposal, but may identify the contextual background in which certain mechanisms were introduced or may be considered useful.

Background

Key points

Consumer credit affects and plays a central role in most economies.

There are three broad grounds to justify regulatory involvement to encourage responsible lending that significantly interact, overlap and complement each other:

- promoting economic efficiency – to address market failures such as 'information asymmetry' between credit providers and consumers;
- consumer protection – taking into account principles of equity and fairness, particularly to overcome any imbalance of power between a credit provider and a consumer that results in abusive or predatory practices; and
- financial stability (prudential) concerns – to prevent systemic risk in the market.

International responsible lending initiatives have developed in the context of specific concerns, such as the mortgage market or financial stability, or in the context of consumer protection issues more broadly.

Responsible lending: An overview

Consumer credit is an integral part of the global economy.

In 2013, global household debt represented approximately US$40 trillion (this represents US$8 900 per adult person).[1] Household debt has grown at a particularly fast rate for transitioning or developing countries, and is growing significantly in emerging economies.[2]

The international focus on responsible lending for consumer credit is a relatively new phenomenon. The financial crisis in 2008 brought to attention significant failures in consumer protection relating to consumer credit, particularly irresponsible lending.

What is consumer credit?

Consumer credit is credit primarily provided to individuals for personal, domestic or household purposes.

For the purposes of this report, this generally does not include business purposes. However, in practice, distinctions between personal and business use of consumer credit can be blurred – for example, in micro-enterprises.

Consumer credit includes both secured credit (such as mortgage loans and personal loans) and unsecured credit (such as lines of credit, credit cards, overdraft facilities, payday lending and micro-finance).

[1] Credit Suisse Research Institute, *Global Wealth Databook 2013*, October 2013, p. 89. Household debt can be viewed as a proxy for outstanding consumer credit, although it may include other debt accrued by households, such as unpaid bills.
[2] Credit Suisse Research Institute, *Global Wealth Report 2013*, October 2013, p. 15.

Consumer credit is distinct from other financial products as it relates to the ability of a consumer to repay money to a credit provider, rather than the use of the consumer's existing funds to invest into or purchase a financial product. This unique characteristic can have a significant bearing on the dynamics of the contractual relationship and, consequently, how consumer credit is regulated.

Why responsible lending?

The decision-making process for how and when a consumer can, or should, enter into a credit contract can be very complex. A range of factors can influence the decision and it can have extensive ramifications for the consumer, the credit provider and, indirectly, the economy as a whole.

Consumers, credit providers and credit intermediaries all have a central role in ensuring that the decision to lend or enter into a credit contract or agreement is made responsibly. However, there is also an important role for regulatory involvement to promote and enforce responsible lending.

Insights from international developments, scholarly literature, empirical research, and recent events in the financial crisis suggest that there are three broad grounds to justify regulatory involvement to encourage responsible lending:

- promoting economic efficiency – to address market failures such as 'information asymmetry' between credit providers and consumers;
- consumer protection – taking into account principles of equity and fairness, particularly to overcome any imbalance of power between a credit provider and a consumer that results in abusive or predatory practices; and
- financial stability (prudential) concerns – to prevent systemic risk in the market.

These broad grounds significantly interact, overlap and complement each other.

Promoting economic efficiency

Traditionally, the efficient market hypothesis[3] and associated rational choice theory[4] placed an emphasis on consumer choice in entering into a credit contract – focusing on the ability of consumers to make rational choices to determine the type and amount of credit most suited to them.

This approach placed the onus of decision making on consumers to determine whether or not they should enter into a credit contract, on the basis that they are best placed to know their personal circumstances and needs.

[3] EF Fama, 'Efficient capital markets: A review of theory and empirical work', *Journal of Finance*, vol 25, 1970, pp. 383–417.
[4] RA Posner, 'Rational choice, behavioral economics, and the law', *Stanford Law Review*, vol 50, 1997, pp. 1551–1575.

As a corollary, it was also an accepted view that the prudential self-interest of credit providers would be sufficient to ensure that consumers would be provided with loans that were sustainable and affordable,[5] as the credit provider's profitability is dependent on consumers being able to repay their loan.

Any regulatory involvement focused on consumers obtaining accurate and relevant information about the credit product to make an informed choice – for example, through disclosure or truth-in-lending obligations. This type of regulatory intervention is intended to promote economic efficiency by addressing a type of market failure, 'information asymmetry', where one party to a transaction has more or better information than the other.[6]

Facilitating transparency – that is, enabling informed consumers and allowing suppliers to operate on a level playing field through standardised and comparable information – can also promote competitive markets.[7]

Limitations to consumer choice

However, developments in behavioural economics have shown that consumer choice is complex and may be flawed – consumers may not always make 'rational' decisions about borrowing due to behavioural biases in their decision making, regardless of the information available to them.[8] Further, a credit provider or credit intermediary may seek to exploit or take advantage of a consumer's decision-making biases, such as 'over-confidence' or excessive focus on short-term benefits over longer-term costs and risks, in order to maximise profitability at the expense of consumer welfare.[9]

In some circumstances, behavioural economics suggests that more targeted regulatory prompts may be required to 'nudge' or assist consumers to make more appropriate decisions relating to their choice of credit product and their ability to repay a loan.[10]

Further, credit providers may be in a better position to assess what an appropriate level of borrowing is, as they are more experienced and less likely to suffer from 'over-confidence' or other biased risk assessment.[11] This is because, as regular repeat players in the market, they have a clearer appreciation of the norms of consumers, including experience of what consumers can actually afford to repay.

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[5] European Banking Authority, *Opinion of the European Banking Authority on good practices for responsible mortgage lending* (EBA-Op-2013-02), 13 June 2013, p. 3.
[6] JE Stiglitz, 'Information and the change in the paradigm in economics', *The American Economic Review*, vol 92, 2002, pp. 460–501.
[7] R Grady, 'Consumer protection in the financial sector: Recent regulatory developments', *JASSA: The Finsia Journal of Applied Finance*, issue 2, 2012, p. 36–40.
[8] See, for example: RA Thaler, 'Toward a positive theory of consumer choice', *Journal of Economic Behavior and Organization*, vol 1, 1980, 39–60; G Elliehausen, *Implications of behavioral research for the use and regulation of consumer credit products*, discussion paper, Federal Reserve Board and George Washington University, 31 March 2010.
[9] RH Thaler and CR Sunstein, *Nudge: Improving decisions about health, wealth, and happiness,* Yale University Press, 2008.
[10] RH Thaler and CR Sunstein, *Nudge: Improving decisions about health, wealth, and happiness*, Yale University Press, 2008.
[11] R Tooth, *Behavioural economics and the regulation of consumer credit*, The Law Foundation of New Zealand, August 2012, p. 19.

Protecting consumers

An added concern is that certain classes of consumer may – due to their socio-economic or personal circumstances or credit history – have their choice and bargaining power impaired or severely limited. For example, they may be unable to access more mainstream credit due to their impaired credit history or insufficient income levels, or have limited financial or literacy skills. A consumer's lack of understanding can exacerbate information asymmetry.

As a result, consumers may have their financial vulnerability[12] or behavioural biases exploited. This could include encouraging them to enter into loans that they cannot afford[13] or imposing 'unfair' contract terms and conditions, such as exorbitantly high interest rates or unnecessary fees and charges – particularly in the sub-prime market (where the risk of default is higher than the mainstream credit market)[14] or the short-term lending, payday lending or micro-lending markets.[15]

A report by Consumers International, *Responsible lending: An international landscape* (November 2013), found that consumers often face 'aggressive, predatory selling practices pushing expensive, complex products that consumers can ill afford and do not understand'.[16] The report identified a range of practices across a number of jurisdictions that are considered harmful to consumers, or against their interests. These include:

- opaque marketing practices, including a lack of disclosure of key terms and features (such as annual effective interest rates), making it difficult for consumers to comparison shop;
- complex products and features that are difficult for consumers to understand, including:
    - features or terms and conditions that may be detrimental to consumer affordability – for example, 'honeymoon' or introductory rates that revert to a higher interest rate than a consumer can afford to pay; and
    - a lack of transparency in the terms and conditions of continuous credit contracts (i.e. credit cards), which enable some credit providers to impose retroactive interest rate hikes, arbitrary or unfair fees and change the due date of a bill, thus forcing a consumer to incur late payment fees;

[12] 'Vulnerability' is a broad term that relates to the susceptibility of consumers to detriment, and ability to bear it if it occurs, or their reduced ability to seek redress based on their personal characteristics and/or the circumstances that they find themselves in. Vulnerability may take into account systemic disadvantage – for example, poverty, lack of literacy and disability – or may be temporary in nature.
[13] Y Demyanyk and O Van Hemert, *Understanding the subprime mortgage crisis*, working paper, Federal Reserve Bank of Cleveland and New York University Stern School of Business, 5 December 2008, pp. 5–6.
[14] See, for example, O Bar-Gill, 'The law, economics and psychology of subprime mortgage contracts', *Cornell Law Review*, vol 94, 2009, pp. 1073–1151.
[15] See, for example, RP Christen, K Lauer, T Lyman, R Rosenberg, *A guide to regulation and supervision of microfinance: Consensus guidelines*, Consultative Group to Assist the Poor, October 2012.
[16] Consumers International, *Responsible lending: An international landscape*, report, November 2013, p. 4.

- a number of practices related to the rise in payday lenders and credit providers who offer short-term loans at very high interest rates to consumers who are shut out of mainstream credit due to insufficient income or bad credit history (i.e. due to the general economic conditions of a country, or personal circumstances);[17]
- offering inappropriate credit limit increases (including making claims to consumers that they are 'pre-approved') without considering whether this is affordable to the consumer;
- 'equity stripping', where consumers are intentionally or negligently entered into loans that they are unlikely to repay, where the credit provider is able to take advantage of the security or collateral secured against the loan on default; and
- bundled services with the provision of credit that do not offer any other benefits to the consumer or are not relevant to the consumer's needs or circumstances.

While it is recognised that consumers have responsibilities in the decision-making process when obtaining credit,[18] regulatory intervention may be necessary to address the imbalance of power between a consumer and a credit provider. In some instances, it may be appropriate to ban or restrict certain products or product features that may adversely affect a consumer's interests. For example, some jurisdictions have had longstanding or historic usury laws (laws to prevent or limit interest rates or other charges) to address concerns about the intentional exploitation by a credit provider of vulnerable consumers or certain situations to make excessive profits.[19]

Such regulatory intervention may also improve confidence in the market.

Limitations to prudential self-interest

The global financial crisis revealed that not all credit providers and credit intermediaries were incentivised to consider the prudential risks of entering a consumer into a mortgage that they could not repay (credit risk).

The growth of the securitisation market through new and complex financial products that bundled subprime mortgages, and the use of credit intermediaries prior to the financial crisis, allowed credit providers to divest themselves from the credit risk of their lending portfolios by passing it on to

[17] Examples of these practices are: applying excessive late-payment penalties to consumers; unfairly exploiting consumer behaviour and optimism about their ability to repay; or getting consumers caught in a 'debt spiral' – that is, enabling them to obtain more credit than they can afford to pay off existing credit debt, or 'rolling-over' existing debt as interest continues to accrue.
[18] FSB, *Consumer finance protection with particular focus on credit*, report, 26 October 2011, p. 13.
[19] See, for example, article 138(2) of the Bürgerliches Gesetzbuch (German Civil Code), which voids transactions (including credit agreements) where there is excessive 'pecuniary advantages' on those grounds.
Historically, usury laws forbade the lending of money on interest for moral and ethical reasons. In England the *An Act Against Usurie* (37 H.viii 9) of King Henry VIII, established in 1545, permitted lending at up to 10% interest, of which any greater amount was considered to be usury. In more modern times, interest rate ceilings and other restrictions on costs have been used to address concerns about excessive profits.

investors.[20] This hampered the incentives of credit providers or loan arrangers to adopt prudent lending standards, as it enabled them to obtain a profit without appropriately considering a consumer's ability to repay the loan.

Financial stability

The financial crisis also made clear that there is a link between irresponsible lending to consumers and financial instability. The G20 found that weak underwriting standards and a failure to exercise appropriate due diligence in lending (i.e. failure to appropriately obtain or verify information from consumers or credit intermediaries regarding the consumer's capacity to repay the loan and the value of the underlying security) caused excess leverage in the housing market (i.e. a 'housing bubble').[21] This built up risks in the financial system causing systemic vulnerability through common exposures to subprime mortgages when the housing bubble burst. This led to failures across a number of financial institutions, creating financial instability.

International responses to the financial crisis – including by the G20, the FSB and the European Union – identified that stricter underwriting practices should be put in place to limit the risks that mortgage markets pose to financial stability, and to better safeguard consumers and investors. Specifically, the European Union identified that irresponsible lending and borrowing should be addressed to avoid a repeat of the conditions that led to the global financial crisis, particularly the behaviour of certain market participants that contributed to the housing bubble and over-indebtedness.

Regulatory responses

Responsible lending can be encouraged by a range of regulatory tools and mechanisms that specifically influence or affect a consumer's eligibility for or entry into a credit contract and the decision making by both credit providers and consumers around the loan transaction.

Some regulatory tools or mechanisms can have a mixture of objectives or take into account many different policy considerations. Objectives such as consumer protection and financial stability are generally complementary to each other.[22] For example, the G20 leaders at the G20 Cannes Summit in November 2011 considered that the integration of financial consumer protection policies into regulatory and supervisory frameworks contributes to strengthening financial stability and can improve confidence in the market.[23]

However, not all objectives may achieve the same outcome. For example, taking a macro-economic and prudential approach to encourage financial stability may generally assist in preventing consumer over-indebtedness,

[20] Explanatory Memorandum to Proposal for a Directive of the European Parliament and of the Council on Credit Agreements Relating to Residential Property (2011/0062 (COD)), 31 March 2011; G20, *Declaration of the summit on financial markets and the world economy*, 15 November 2008.
[21] G20, *Declaration of the summit on financial markets and the world economy*, 15 November 2008.
[22] FSB, *Consumer finance protection with particular focus on credit*, report, 26 October 2011, p. 10.
[23] G20, *G20 high-level principles on financial consumer protection* (G20 Consumer Protection Principles), October 2011, p. 4.

but may not address the suite of individual consumer protection concerns that arise in relation to responsible lending.[24] Where objectives conflict, few jurisdictions have mechanisms in place to resolve such conflicts.[25]

International developments

There has been a substantial amount of work developed by other international bodies including the G20, the European Banking Authority (EBA), the FSB, the European Union, the Organisation for Economic Cooperation and Development (OECD) and the World Bank that relate to responsible lending and consumer protection more generally. The survey and this report draw on the work developed by these international bodies.

However, there are limitations on how these developments can be used and relied on. Some of this work has a narrower focus (e.g. on residential mortgages) or has a prudential or systemic stability perspective, whereas FinCoNet's ambit is one of consumer protection across a wide range of consumer credit products – including both secured and unsecured credit. Other work may have a broader consumer protection ambit but may not address the specific concerns and issues relating to consumer credit. Further, most international work has not had the same emphasis on supervisory and enforcement capabilities.

Nevertheless, the existing international work provides a strong base from which many jurisdictions may derive or assess their regulatory measures.

Consumer protection

The G20 recognised that consumer confidence and trust in a well-functioning market for financial services promotes financial stability, growth, efficiency and innovation over the long term.[26]

In October 2011 the G20 set out the framework for the regulation of financial consumer protection, the *G20 high-level principles on financial consumer protection* (G20 Consumer Protection Principles). This was a response to the request by G20 Finance Ministers and Central Bank Governors in February 2011 for the OECD, the FSB and other international organisations to develop common principles on consumer protection in the field of financial services. The principles are intended to complement sectoral work being done by other standard setting bodies, such as the International Organization of Securities Commissions (IOSCO).

The G20 Consumer Protection Principles call for, among other things, legal recognition of financial consumer protection, oversight bodies with the necessary authority and resources to carry out their mission, fair treatment,

[24] Consumers International, *Responsible lending: An international landscape*, report, November 2013, p. 5.
[25] FSB, *Consumer finance protection with particular focus on credit*, report, 26 October 2011, p. 1.
[26] G20 Consumer Protection Principles.

proper disclosure, responsible business conduct, and objective and adequate advice, as well as adequate complaints handling and redress mechanisms and policies.

Of particular interest are the principles promoting proper disclosure and responsible business conduct.

To support the G20 Consumer Protection Principles, the OECD released its *Update report on the work to support the implementation of the G20 high-level principles on financial consumer protection* in September 2013. This report recommends more detailed 'effective approaches' to deal with the G20 Consumer Protection Principles on disclosure and transparency, responsible business conduct of financial services providers and their authorised agents, and complaints handling and redress.

The World Bank released its *Good practices for financial consumer protection* in June 2012, based on in-depth country reviews of consumer protection and financial literacy arrangements. In conjunction with FinCoNet, this work has been followed up by a World Bank global survey on consumer protection and financial literacy. This survey is intended to update and expand on their earlier work, and help provide FinCoNet with baseline information to support their ongoing research on financial consumer protection issues. The World Bank's consequent results brief considers issues of disclosure, financial literacy, responsible lending and dispute resolution mechanisms for consumers.[27]

Financial stability

At the request of the G20, the FSB, in cooperation with the OECD, undertook work in late 2011 on financial consumer protection, with particular concentration on issues related to consumer credit.

The FSB's resultant report, *Consumer finance protection with particular focus on credit* (2011), considered the financial stability benefits of consumer finance protection. The FSB recommended that more work could be done to ensure consumer protection authorities are equipped with the necessary supervisory tools to address responsible lending, while at the same time ensuring that sufficient information is being provided to consumers. It observed that strengthening supervisory tools could be achieved by initially identifying gaps and weaknesses in the broad range of regulatory and supervisory tools used by consumer protection authorities worldwide, and also by establishing indicators of unsuitable product features.

Following a peer review of national approaches to mortgage underwriting, the FSB established the *Principles for sound residential mortgage underwriting practices* in April 2012 (FSB Residential Mortgage Principles). This set out key principles that the FSB expects member jurisdictions to

[27] World Bank, *Global survey on consumer protection and financial literacy: Results brief – Regulatory practices in 114 economies*, results brief, 2013.

implement to ensure sound residential mortgages. This work is prudential in focus and intended to address deficiencies in financial system regulation that resulted from the financial crisis.

Prudential standards

Other work that influences responsible lending obligations includes the Basel III reforms developed by the Basel Committee on Banking Supervision, which establish prudential standards to strengthen the regulation, supervision and risk management of the banking sector. Basel III is part of the Committee's continuous efforts to enhance the banking regulatory framework. It builds on the *International convergence of capital measurement and capital standards* document (Basel II). Among other things, these measures aim to improve the banking sector's ability to absorb shocks arising from financial and economic stress. In particular, the measures require the banking sector to address prudential concerns such as bank capital adequacy, market liquidity risk and credit risk.

Harmonisation efforts (European Union)

The European Union has also undertaken extensive efforts to harmonise its responsible lending obligations across its members.

The Consumer Credit Directive 2008/48/EC (CC Directive), established in 2008, requires EU member states to impose obligations on credit providers to provide standardised information and disclosures on a loan to consumers at advertisement, pre-contractual and contractual stage. It also requires creditworthiness assessments to be carried out by credit providers. It applies to consumer credit excluding mortgage loans, among other things. All EU member states are expected to comply with this obligation. The CC Directive was introduced to facilitate harmonised consumer protection laws and promote well-functioning markets in the European Union.

The Mortgage Credit Directive 2014/17/EU (MC Directive) entered into force on 20 March 2014. This Directive introduces an obligation to assess the consumer's creditworthiness before granting mortgage credit. The MC Directive also lays down standards for advisory services and competence levels for staff. In addition, the credit provider or, where applicable, the credit intermediary is required to inform the consumer at pre-contractual stage about the characteristics of the proposed loan and its inherent potential risks (e.g. variable rate loan). EU member states are expected to implement the MC Directive into national law within two years (i.e. by March 2016).

Supervision of compliance with the CC Directive and MC Directive is generally left to national supervisors, with the European Commission intervening where it considers that the legislation has not been correctly transposed or has been infringed on.

The EBA, in its *Opinion of the European Banking Authority on good practices for responsible mortgage lending*, released in June 2013, also sets out its expectations for mortgage lending by the banking sector. It is specifically concerned with responsible lending and the treatment of consumers in payment difficulties, including good practices in relation to the verification of information, reasonable debt service coverage and appropriate loan-to-value (LTV) ratios.

As a result, it is expected that many jurisdictions that are EU member states have, or will have, similar obligations over time.

Regulatory framework

Key points

The financial regulatory framework in which consumer credit regulation is situated is likely to influence how consumer credit and responsible lending obligations are viewed, administered and enforced. The framework is intended to complement objectives of market innovation and growth.

In most jurisdictions there are one or two regulators or supervisors that regulate consumer credit and administer responsible lending obligations (the primary regulator).

The primary regulator may have a range of powers to undertake their function. These include:

- information-gathering powers;
- administrative powers, such as licensing requirements and standard-setting powers; and
- enforcement powers, such as issuing fines and penalties.

In many jurisdictions, the scope of oversight and regulation for consumer credit may be limited to banks or other prudentially regulated credit providers. However, there is an emerging trend to extend consumer credit and responsible lending oversight to non-bank credit providers and credit intermediaries.

Overview

Financial consumer protection is an integral part of the legal, regulatory and supervisory framework for financial services.

The G20 Consumer Protection Principles recognise that the financial regulatory framework of a jurisdiction often reflects the diversity of national circumstances and global, market and regulatory developments within the financial sector. However, the structure and operation of a jurisdiction's financial regulatory framework provides insight into how consumer credit regulation can address irresponsible lending.[28]

The G20 also acknowledges that the financial regulatory framework is intended to complement and not unnecessarily restrict market innovation and growth; particularly that 'regulation should reflect and be proportionate to the characteristics, type and variety of the financial products and consumers, their rights and responsibilities and be responsive to new products, designs, technologies and delivery mechanisms'.[29]

The survey considered the regulatory framework in which consumer credit regulation is situated, including identifying the primary regulator in each jurisdiction. It also considered the general supervisory and enforcement powers the primary regulator is able to exercise.

[28] G20 Consumer Protection Principles, Principle 1.
[29] G20 Consumer Protection Principles, Principle 1.

Regulatory frameworks

The survey highlighted three key types of regulatory frameworks used for financial regulation in relation to consumer credit:

- a *unified approach*, which generally regulates all financial services providers and intermediaries, including credit providers and credit intermediaries, under one regulatory or supervisory authority. The regulator or supervisor generally combines monetary policy, prudential and conduct regulation;
- a *sectoral approach*, which is more likely to regulate a financial service provider according to the provider's activities (i.e. banking or insurance) or provision of certain financial products, such as consumer credit; and
- a *functional approach*, which regulates the financial industry based on the function or role of the regulator – for example, a dedicated conduct regulator and a dedicated prudential regulator, or a dedicated consumer protection authority.

However, there may be various iterations and combinations of each of these approaches, and the scope of regulatory coverage and supervision may vary significantly as a result. These approaches are explored more fully below.

These approaches are also consistent with the findings of the World Bank and FinCoNet's work, which highlighted five key institutional arrangements for financial consumer protection regulation: see Table 2.[30] However, this has different implications in the consumer credit context. In certain jurisdictions the focus of consumer credit regulation, particularly responsible lending obligations, can have a more prudential than consumer protection focus, or there may be shared responsibilities between prudential and consumer protection agencies. As a result, each jurisdiction's institutional arrangements may have a different emphasis.

Table 2: Types of institutional arrangements for financial consumer protection

Institutional arrangement	Description	Consumer credit context
Unified approach		
Integrated single agency model	Financial consumer protection supervision responsibilities fall under a single agency that is responsible for all aspects of supervision, including prudential, market conduct, and financial consumer protection of all supervised financial service providers.	The types of credit providers and credit intermediaries supervised may be more limited due to a greater focus on financial stability and prudential regulation. This approach may be focused on banks and large financial institutions that are also prudentially regulated.

[30] World Bank, *Global survey on consumer protection and financial literacy: Results brief – Regulatory practices in 114 economies*, results brief, 2013, p. 7.

Institutional arrangement	Description	Consumer credit context
Sectoral approach		
Integrated multiple agency model	Financial consumer protection supervision responsibilities fall under multiple agencies, most often separating regulatory authorities based on the industry sector.	A sectoral approach is more likely to regulate a financial service provider according to the financial service provider's activities (i.e. banking or insurance) or provision of certain financial products, such as consumer credit.
Functional approach		
Dedicated market conduct agency model	Financial consumer protection supervision responsibilities fall under a single regulatory agency dedicated to broad financial market conduct supervision, separated from prudential regulation ('twin peaks').	A twin peaks approach to financial regulation regulates the financial industry based on the function or role of the regulator. In this model, responsible lending oversight may be split between the two regulators: with the prudential regulator supervising certain credit providers such as banks (including prudential obligations relating to responsible lending) and the conduct regulator with oversight of the credit industry more broadly (including related responsible lending provisions).
Specialised financial consumer protection agency model	Financial consumer protection supervision responsibilities fall under a single specialised financial consumer protection agency that does not have broader financial sector market conduct supervisory responsibilities.	Even where there is a specialised financial consumer protection agency, in the consumer credit context, some responsible lending supervision may primarily rest with another regulator with a greater prudential focus, including as part of a twin peaks approach.
General consumer protection agency model	Financial consumer protection responsibilities fall under an agency or agencies responsible for broader consumer protection supervision within the jurisdiction, including non-financial activities.	In the consumer credit context, some supervision may primarily rest with another regulator with a greater prudential focus.

These regulatory frameworks are used in different ways to facilitate consumer credit regulation, particularly responsible lending. This is likely to affect the nature of the regulator or supervisor's powers and their regulatory focus, including whether consumer protection matters are a primary component of consumer credit regulation.

A jurisdiction's regulatory framework may also be affected by the legal systems and jurisdictional boundaries of each individual country. For example, there may be sub-national boundaries that result in different regulatory frameworks applying where the credit provider or credit intermediary only operates within a particular state or province, or if they operate on a national level. This may result in a range of administrative and regulatory arrangements applying in one jurisdiction.

Unified approach

An example of a unified approach is the Saudi Arabian Monetary Agency (SAMA), which is the regulatory and supervisory authority licensing and supervising banks, insurance companies and finance companies (including leasing companies and money changers). SAMA regulates both the conduct and prudential aspects of financial institutions that provide consumer credit. This can be described as a unified approach.

Similarly, in Singapore, the Monetary Authority of Singapore (MAS) is the financial supervisor, supervising regulated financial institutions from a prudential perspective, including the setting of prudential controls on certain deposit-taking institutions that also provide consumer credit. Some of the rules imposed by MAS relating to consumer credit deal not just with limiting the micro- and macroprudential risks, but also aim to encourage financial prudence among consumers and enhance consumer protection in general (e.g. caps on the credit limit for credit card and unsecured credit and the total debt servicing ratio for housing loans).[31]

In Japan, the Financial Services Agency is the integrated financial regulator, undertaking prudential supervision and inspection of financial institutions. The agency monitors banks, securities, insurers and consumer finance providers. In relation to consumer credit, it regulates the conduct of both consumer finance (non-bank lenders) and retail banking (bank lenders).

In Uganda, the Bank of Uganda is responsible for the prudential regulation of a three-tiered licensing regime for financial institutions and supervises consumer credit under this function. The main focus of regulation is to ensure that supervised financial institutions apply good risk management practises and maintain the quality of the loan book. However, the Bank of Uganda examiners also review compliance with the *Bank of Uganda Financial Consumer Protection Guidelines 2011* and the Financial Institutions (Credit Reference Bureaus) Regulations 2005 – which include significant consumer protection considerations, including responsible lending requirements.

[31] MAS also works closely with other relevant bodies dealing directly or indirectly with consumer protection in Singapore, including:

- The Association of Banks in Singapore, which represents the interests of the commercial and investment banking community. The ABS sets out industry guidelines/code for consumer banking;
- Financial Industry Disputes Resolution Centre Ltd, an independent, 'one-stop' dispute resolution centre to facilitate the resolution of disputes between financial institutions and consumers;
- MoneySENSE, a national financial education programme that brings together industry and public sector initiatives to enhance the basic financial literacy of consumers;
- Credit Counselling Singapore, which promotes the responsible use of credit and money management through education. Credit Counselling Singapore assists consumers in recovering from serious debt problems by providing general credit management information, credit counselling and where applicable, putting up a debt repayment plan for suitable consumers; and
- Consumers Association of Singapore, which protects consumer interest through information and education and help promote an environment of fair and ethical trade practices.

Sectoral approach

The South African National Credit Regulator (NCR) is dedicated to the supervision of consumer credit providers, reflecting a sectoral approach.

The NCR is mandated to enforce the provisions of the *National Credit Act 2005* (South Africa). This Act promotes a fair and non-discriminatory marketplace for access to consumer credit; it provides general regulation of consumer credit and improved standards of consumer credit information to:

- promote responsible credit granting and credit use;
- prohibit 'reckless lending'; and
- provide for debt re-organisation in cases of over-indebtedness.

It also provides for the registration of credit bureaus, credit providers and debt counsellors.

The NCR has a range of enforcement functions dedicated to ensuring compliance with the regulatory obligations, including promoting informal resolution between consumers and credit providers and monitoring the credit market and industry to ensure that prohibited conduct is prevented or detected and prosecuted.

In China, approved by the central government, the People's Bank of China, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission have set up four financial consumer protection bureaus to protect financial consumers and enhance the stability of the financial system.

The main responsibilities of Financial Consumer Protection Bureau of the People's Bank of China are to:

- conduct research on the main issues of the whole financial industry;
- collaborate with related authorities to make policies, regulations and laws for the whole financial industry;
- work with other departments to set cross-sector rules for financial consumer protection; and
- carry out financial consumer protection within the People's Bank of China's mandate by law.

The Banking Consumers Protection Bureau of the China Banking Regulatory Commission, the Investors Protection Bureau of the China Securities Regulatory Commission and the Insurance Consumers Protection Bureau of the China Insurance Regulatory Commission are respectively responsible for the banking, securities and insurance fields of consumer protection.

Further, the self-regulatory organisations such as the China Banking Association, the Securities Association of China and the Insurance Association of China also show growing influence on financial consumer protection work.

Functional approach

In the United Kingdom, recent changes have been made to the financial regulatory framework to establish a ‘twin peaks’ regulatory model – separating conduct supervision and prudential responsibilities into two market supervisors. These reforms are intended to protect and enhance the integrity of the financial system. The two key regulators are:

- the Financial Conduct Authority (FCA), which supervises consumer protection and markets regulation. This focus enables the FCA to better review the full financial product lifecycle (including consumer credit products) from design to distribution, with the power to ban products where necessary; and
- the Prudential Regulation Authority, which supervises significant financial institutions from a prudential perspective, including regulating in relation to the credit risk faced by those institutions.

The United Kingdom is currently in the process of integrating its existing regulation of consumer credit within the ‘twin peaks’ framework. The FCA regulates mortgages and other loans that are secured by the first charge on the consumer’s home under the *Financial Services and Markets Act 2000* (UK) and the FCA’s Mortgage Conduct of Business sourcebook. The Office of Fair Trading regulated unsecured consumer credit and second-charge secured loans, under the *Consumer Credit Act 1974* (UK), but its regulatory responsibilities transferred to the FCA from 1 April 2014 to create a single conduct regulator for consumer credit.

Canada has a specialised financial consumer protection agency, although the prudential regulator plays a significant role in the regulation of consumer credit. The Government of Canada places a strong emphasis on the safety and soundness of its financial system, while also ensuring that Canadians are well served and protected in their dealings with a financial institution. In order to achieve balance between these two objectives, Canada has two agencies that regulate the financial services sector: The Office of the Superintendent of Financial Institutions (OSFI) is charged with the prudential regulation of financial institutions, and the Financial Consumer Agency of Canada is responsible for financial consumer protection

The Department of Finance is the Canadian government department responsible for developing consumer protection policy and legislation for federally regulated financial institutions. Canada also has a number of financial institutions that operate and are incorporated at the provincial level. These provincial institutions are supervised by designated provincial authorities, either within designated provincial government departments or separate agencies with market conduct supervisory authority.

Good practice observation 1: Focus on consumer credit protection

Jurisdictions make consumer protection in relation to consumer credit products an integral part of the legal, regulatory and supervisory framework for financial services.

Consumer credit oversight

Regulatory oversight for consumer protection plays an integral role in effective supervision and enforcement of consumer credit obligations.

The G20 Consumer Protection Principles expect jurisdictions to have oversight bodies (dedicated or not) explicitly responsible for financial consumer protection, with the necessary authority to fulfil their mandates. The oversight bodies should have:

- clear and objectively defined responsibilities;
- appropriate governance, independence, accountability for their activities;
- adequate powers, resources and capabilities;
- a defined and transparent enforcement framework; and
- clear and consistent regulatory processes.[32]

The survey sought to identify the primary regulator or supervisor within a jurisdiction responsible for developing or administering benchmarks, standards and practices for responsible lending. It also considered how the primary regulator is situated in the broader financial services regulatory framework, including if they have other regulatory or supervisory roles.

The nature and operation of the primary regulator is significantly influenced by the financial system framework in which they function, and may have implications for the effective supervision and enforcement of responsible lending obligations.

For ease of reference, the term ‘primary regulator’ refers to the primary regulator(s) or supervisor(s) in a particular jurisdiction, even where there is more than one ‘primary’ regulator or supervisor in a jurisdiction.

[32] G20 Consumer Protection Principles, Principle 2.

Good practice observation 2: Appropriate oversight

Jurisdictions have oversight bodies (dedicated or not) that are explicitly responsible for consumer protection in relation to consumer credit (the 'primary regulator').

Primary regulator

The survey identified that a jurisdiction's regulatory framework typically includes a primary regulator (or in a number of instances, two primary regulators), supported by a range of other regulatory or supervisory bodies in administering responsible lending obligations. They include tribunals, ombudsmen, consumer advisory councils, inspectorates, and ministries.

For example, in France the primary regulator is the Autorité de Contrôle Prudentiel et de Résolution (ACPR), which is responsible for the prudential supervision and control of business practices in the French banking sector. The ACPR controls all prescribed processes in relation to lending, from advertisement to pre-contractual provisions and contractual terms. The ACPR's role is to ensure regulated entities' compliance with the law in order to identify any avoidance techniques, problematic industry practices or enforcement problems.

The ACPR cooperates with the General Directorate for Competition Policy, Consumer Affairs and Fraud Control within the Ministry for the Economy and Finance, which has the authority under Le code de la consommation (the French Consumer Code) to sanction regulated institutions during on-site inspections and conduct mystery shopping exercises.

The ACPR also works with the Comité Consultatif du Secteur Financier (Financial Sector Advisory Council), a council where consumer associations and industry representatives meet and establish standards. The Comité Consultatif du Secteur Financier takes part in the elaboration of practices on responsible lending.

Where there is more than one primary regulator, the regulators are generally split based on prudential and non-prudential activities, such as conduct or consumer protection regulation.

The primary regulator may include a range of different regulatory types – with a variety of other functions. Table 3 sets out examples of different regulatory types.

Table 3: Different types of primary regulator identified by the survey

Regulatory type	Example regulator	Example function	Example scope (who and what they regulate)
Central bank	SAMA, Saudi Arabia	Monetary policy Financial system stability Prudential regulation Market conduct	Banks Insurers Finance companies Credit information companies
Prudential regulator	ACPR, France	Prudential regulation	Banks Insurers
Financial market conduct regulator	FCA, United Kingdom	Market conduct Consumer protection Prudential regulation for sectors not prudentially regulated by the Prudential Regulation Authority	Financial services, including consumer credit
Consumer credit authority	NCR, South Africa	Market conduct and consumer protection for consumer credit	All credit providers, debt counsellors and credit bureaus
Financial consumer protection authority	Financial Consumer Agency, Canada	Consumer protection	Financial services, including consumer credit

Scope

The scope or extent of the primary regulator's oversight of consumer credit also varied greatly between jurisdictions. Scope can be influenced by the regulatory framework or institutional arrangements in which the primary regulator operates. Scope can be defined in terms of product (e.g. mortgages or unsecured loans), entity (e.g. bank lender, non-bank lender or credit intermediary), the activities undertaken by the entity (e.g. deposit taking), consumer type (e.g. 'retail' consumer), the conduct of the regulator, or a range of the above features.

Where the primary regulator's scope is limited to certain types of credit providers or credit intermediaries, this may result in some credit providers and credit intermediaries being outside regulatory oversight and enforcement – for example, short-term or payday lenders. This gap in oversight may result in these types of lender not being subject to certain types of consumer credit obligations, including responsible lending obligations.

Where the primary regulator has a prudential focus, the scope of their supervisory and regulatory regime is more likely to be limited and only apply to banks and bank-like entities.

Where the primary regulator has a consumer protection function or conduct mandate, their regulatory scope is more likely to apply to a broader suite of consumer credit products, or related entities.

Good practice observation 3: Comprehensive regulatory scope

The primary regulator has oversight over all credit providers and credit intermediaries who provide consumer credit products and related services. A more comprehensive scope benefits the application of responsible lending obligations and consumer protection across the full range of consumer credit products and services.

General supervisory and enforcement powers

It is important that the primary regulator has appropriate supervisory and enforcement powers to undertake its activities.

The survey sought to identify the general types of powers the primary regulator or supervisor could exercise, including in relation to any responsible lending obligations it administered. The responses varied widely.

Table 4 sets out a range of supervisory powers that are more commonly available to a primary regulator.

Table 4: Supervisory powers commonly available to a primary regulatory

Supervisory powers	Description	Example
Information-gathering powers		
Provision of information	Powers that require an entity to provide documents or information, or provide a statement.	In Singapore, MAS is empowered to inspect the books of any bank from time to time, which must be presented to MAS at a reasonable time and place. MAS may also appoint an external auditor to exercise these powers.[33]
Inspections	Powers that allow the regulator to inspect the premises of an entity, including any documents or materials found there. The regulator may also be empowered to seize documents or materials they find.	In South Africa, an inspector of the NCR may be awarded the right to enter and search. Under this warrant they are entitled to: enter, search, inspect any article or document that has bearing on the investigation, request information from the owner or person in control, take extracts from and make copies of any documents or book, use any computer system on the premises, seize any output from that computer, and attach and, if necessary, remove from the premises for examination and safekeeping anything that has a bearing on the investigation.[34]

[33] *Banking Act* (Singapore), s43–44A, Ch 19.
[34] *National Credit Act 2005* (South Africa), s153.

Supervisory powers	Description	Example
Administrative powers		
Licensing requirements	A regime that requires entities to be licensed or authorised to participate in the market.	In Germany, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) authorises market participants and, where appropriate, removes authorisation. This may occur in instances where entities fail to adhere to relevant legislation.[35]
Supervisory Conditions	Ability to revoke, suspend or vary conditions on authorised entities.	In Australia, the Australian Securities and Investments Commission (ASIC) is able to impose additional conditions or vary the existing conditions of a licence. These powers may be exercised to address systemic compliance issues.[36]
Standard setting	Ability to set out principles or rules for how authorised entities are to conduct their operations.	In Canada, OSFI is able to make guidelines, which are essentially best or prudent practices that it expects financial institutions to follow. Guidelines are used to set standards to govern industry activities and behaviour. For example, the Superintendent may make guidelines for the maintenance by banks of adequate capital and adequate and appropriate forms of liquidity.[37]
Enforcement powers		
Negotiated outcome	Powers that allow the regulator to enter into a legally binding agreement with an entity that imposes certain conditions on the entity. This is usually done to resolve matters in a timely fashion, without having to engage in extended legal proceedings.	Ireland enables the Central Bank to enter into an agreement with the regulated entity to resolve a matter (Settlement Agreement) if it suspects on reasonable grounds that a regulated entity is committing or has committed a prescribed contravention. The Settlement Agreement must be in writing and is binding on the Central Bank and the regulated entity. The terms of the Settlement Agreement may contain sanctions and will stipulate that a public statement containing details of the Settlement Agreement will be published.[38]
Directives	Issuing directives or compelling entities to enact certain procedures, or engage in or cease certain practices.	Norway's Finanstilsynet can compel institutions to arrange their internal controls in accordance with provisions laid down by Finanstilsynet, and can direct an institution to restrict overall credit to a customer to a lower amount than the statutory maximum.[39]

[35] *Banking Act* (Germany), s32.
[36] *National Consumer Credit Protection Act 2009* (Australia) (National Credit Act), s45.
[37] *Bank Act* (Canada), s485(2).
[38] *Central Bank Act 1942* (Ireland), s33AV(1).
[39] *Financial Supervision Act* (Norway), s4. Note: The authorisation to restrict overall credit is according to the capital requirement regulation and not an assessment of the customer's debt servicing capacity or capital.

Supervisory powers	Description	Example
Punitive	Most commonly, seeking fines and civil penalties, but may in certain cases involve seeking criminal convictions, including imprisonment for individuals.	In Australia, ASIC can issue infringement notices (fines) for breaches of some provisions of the credit law, and seek civil or criminal penalties from the courts. ASIC has issued a number of entities with infringement notices for transgressions, and commenced legal proceedings to achieve civil penalties and obtain criminal convictions for egregious conduct.[40]
Compensatory	Seeking an annulment or modification of a credit contract, or compensation on behalf of a consumer or class of consumers where it has been determined that the credit provider or credit intermediary has not adhered to the relevant provision.	In South Africa, the NCR may seek an order through the National Consumer Tribunal for, among other things, consumer remedies in relation to a relevant breach of the law by a regulated entity.[41]

Jurisdictions generally permit their primary regulator to exercise some or all of the identified supervisory and enforcement powers. However, more developed supervisory regimes are likely to have a full suite of supervisory and enforcement powers. These general powers can be applied to the regulation of other financial product and service providers, in addition to credit providers or credit intermediaries.

Good practice observation 4: Appropriate supervisory and enforcement powers

Jurisdictions ensure that the primary regulator has a range of appropriate supervisory and enforcement powers, including information-gathering, administrative and enforcement powers, and the resources to administer the arrangements in practice.

Temporary and permanent product intervention

Other more unique powers that may be relevant to a primary regulator include temporary and permanent product intervention powers.

In the United Kingdom, the FCA's regulatory toolkit includes emergency consumer protection powers in relation to the financial products it regulates.

The FCA is able to make temporary product intervention rules before public consultation if the FCA identifies a significant risk to consumers that requires prompt action.[42] This permits the FCA to take action, such as restricting the use of certain product features, requiring that a product not be promoted to some or all types of customers or, where the circumstances are most

[40] National Credit Act (Australia), s331, 274 and 275.
[41] *National Credit Act 2005* (South Africa), s143.
[42] *Financial Services Act 2012* (UK), s138M.

egregious, requiring that a product not be sold altogether. These may include rules:[43]

- requiring providers to issue consumer or industry warnings;
- requiring that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- requiring providers to amend promotional materials;
- requiring providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.

Some of the instances in which the FCA might consider making temporary rules include when:

- a product is in serious danger of being sold to the wrong customers – for example, where complex or niche products are sold to the mass market;
- a non-essential feature of a product seems to be causing serious problems for consumers; and
- a product is inherently flawed.

The rules are temporary, as they are not permitted to remain in existence beyond 12 months from the date on which they come into force. During that time, the FCA can decide after further consultation whether or not to implement permanent product intervention rules.

Market innovation

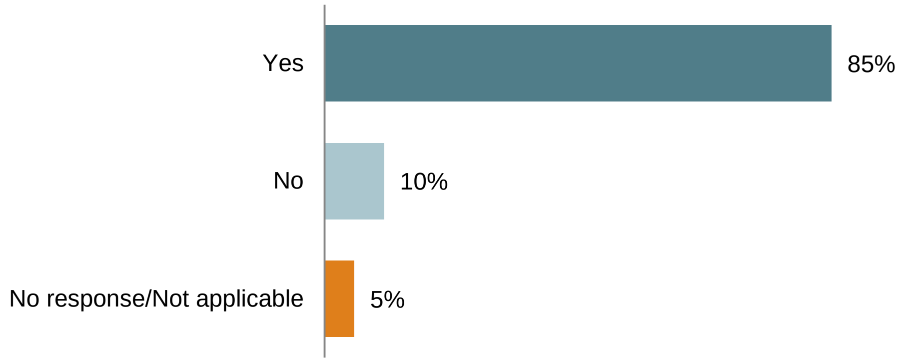
The G20 Consumer Protection Principles expect that a regulatory framework for consumer credit will promote and complement efficiency and innovation in a well-functioning market for financial services.[44]

The survey also considered the extent to which a jurisdiction permits flexibility to allow for market innovation, new credit products and distribution channels to be developed. The degree of market innovation and flexibility in relation to consumer credit products is closely linked to the nature of the economy, the nature and extent of credit access in the formal financial market, the regulatory framework, and the powers of the primary regulator.

[43] FCA, Policy Statement 13/3 *The FCA's use of temporary product intervention rules* (PS13/3), March 2013.
[44] G20 Consumer Protection Principles, Principle 1.

The overwhelming majority of respondents to the survey (85%) noted that their regulatory frameworks permitted some degree of flexibility to allow for market innovation and new credit products and distribution channels to be developed.

Figure 1: Percentage of jurisdictions that facilitate flexibility to allow market innovation in their regulatory framework



For example, Belgium permits a certain amount of flexibility for market innovation. A credit provider can offer any type of credit that meets the requirements of the definition of a credit agreement, set out in the *Consumer Credit Act 1991* (Belgium). There are, however, certain important legal restrictions, like the recently updated legislation restricting ‘payday loans’ and instituting maximum repayment periods and interest rate caps. Distribution channels are also limited, so that only a credit provider who meets the legal requirements to obtain authorisation by the primary regulator may operate in the market.

Similarly, Australia also permits a certain amount of flexibility for market innovation. In Australia, the regulatory framework set out in the *National Consumer Credit Protection Act 2009* (National Credit Act) does not include or require a list of approved credit products or require their primary conduct regulator, ASIC, to approve credit products. However, the National Credit Act does prohibit some products and product features to address particular concerns in the market (e.g. interest rates and fees in excess of legislated caps, early termination fees for residential loans). Some products cannot comply with responsible lending requirements (no document lending) and there are specific presumptions of unsuitability in relation to certain products (e.g. small amount loans, reverse mortgages).

All credit providers and credit assistance providers are required to hold an Australian credit licence issued by ASIC (or be an authorised representative of a licensee). Market participants are able to choose their business structure and distribution model. There are restrictions on unsolicited selling of credit or debit cards and canvassing of credit at a person’s home.

In contrast, Saudi Arabia and Singapore take a slightly different approach. In Saudi Arabia, the primary regulator, SAMA, allows banks and finance companies the flexibility to introduce new products and services but requires that these be reviewed and approved by SAMA prior to their market introduction. The requirement for pre-approval is to ensure that banks and finance companies are introducing appropriate and suitable products and services that conform to the level of market sophistication.

In a similar fashion, Singapore also closely monitors the release of new products. Where necessary, financial institutions must notify the primary regulator, MAS, and/or seek MAS's approval before they release new products.

Consumer engagement

Key points

Transparency in consumer decision making is a key feature in almost all jurisdictions, to ensure that consumers have a base level of knowledge to make an informed decision.

A significant majority of jurisdictions identified they had the following requirements to promote transparency:

- truth-in-lending requirements – intended to protect consumers from misleading or deceptive marketing, promotion or advertising; and
- disclosure requirements – to ensure that consumers have access to key information in relation to the credit product, credit provider or credit intermediary to make an informed decision about entering into a credit contract or agreement.

The promotion of financial literacy is also a significant overarching trend towards facilitating informed consumers.

Developments in disclosure requirements suggest that they are becoming more targeted, drawing on insights from behavioural and consumer research.

Overview

An informed and confident consumer is an important component of responsible lending.

The survey considered mechanisms governing consumer engagement – that is, measures to encourage consumers to identify and select a suitable product or amount of credit.

The survey identified that ensuring transparency is a key feature in almost all jurisdictions, to ensure that consumers have a base level of knowledge to make an informed decision about the credit contract they are proposing to enter into. This is consistent with international standards in this area.

This is generally achieved by obligations and actions relating to:

- how consumer credit is marketed, promoted and advertised;
- mandating what and how key terms, conditions and other relevant information is disclosed to a consumer prior to them entering into a credit contract; and
- promoting financial literacy.

Some jurisdictions also require greater disclosure for larger credit contracts such as mortgages.

The survey also identified that almost all jurisdictions have in place a range of measures to promote financial literacy to facilitate informed consumers – particularly self-guided educational websites and community outreach programmes.

Current international standards

A number of international standards exist in relation to disclosure and transparency in financial services, including as part of broader consumer protection guidelines. In particular, the G20 Consumer Protection Principles require that:

- financial services providers and authorised agents provide consumers with key information that informs the consumer of the fundamental benefits, risks and terms of the product. In particular, information should be provided on material aspects of the financial product. All financial promotional material should be accurate, honest, understandable and not misleading;[45] and
- financial education and awareness be promoted by all relevant stakeholders and clear information on consumer protection, rights and responsibilities should be easily accessible by consumers. Appropriate mechanisms should be developed to assist existing and future consumers to develop the knowledge, skills and confidence to appropriately understand risks (including financial risks and opportunities), make informed choices, know where to go for assistance, and take effective action to improve their own financial wellbeing. The provision of broad-based financial education and information to deepen consumer financial knowledge and capability should be promoted, especially for vulnerable groups.[46]

These principles are generally reflected in the OECD's *Recommendation of the council on good practices on financial education and awareness relating to credit* (May 2009), which echoes the themes of disclosure and promoting awareness. The OECD also makes recommendations to encourage the use of specific tools, such as a standardised effective interest rate in advertising and standardised information boxes on credit agreements to summarise key terms and conditions.

Advertising and marketing

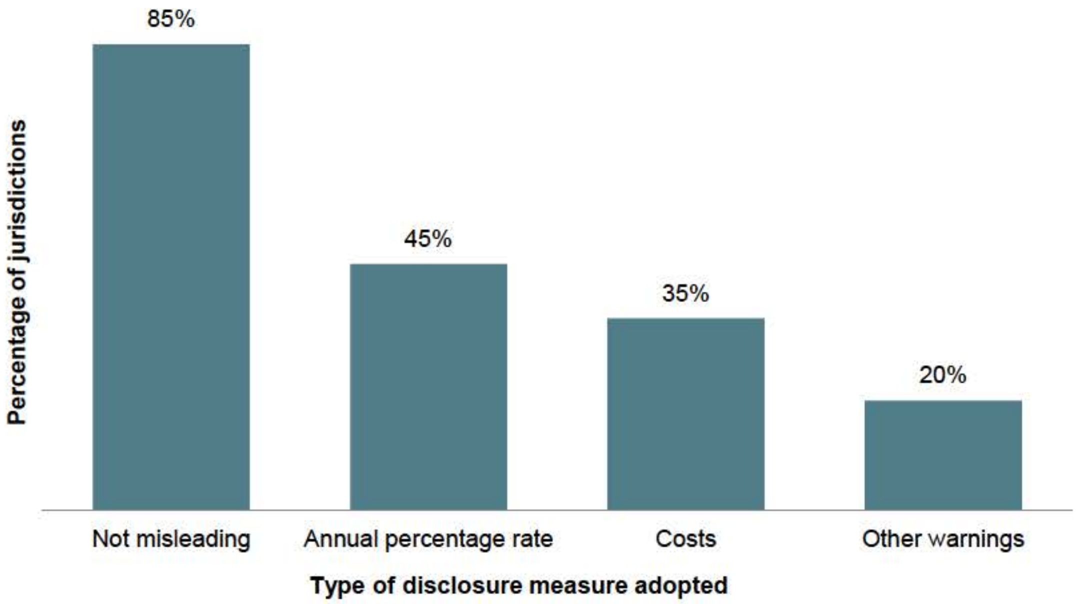
The survey identified that a significant majority of jurisdictions had specific obligations or prohibitions on the promotion, advertising or marketing of consumer credit products.

[45] G20 Consumer Protection Principles, Principle 4.
[46] G20 Consumer Protection Principles, Principle 5.

Figure 2: Percentage of jurisdictions with specific obligations for the promotion, advertising and marketing of consumer credit products

Key components include an overarching obligation that marketing and advertising should be not be misleading or deceptive, requirements to set out information on costs, and a requirement that information on the effective annual percentage rate, annual percentage rate, or comparison rate must be adequately disclosed in any marketing or advertising.

Figure 3: Percentage of jurisdictions with specific advertising requirements



Truth-in-lending requirements

A significant majority (85%) of jurisdictions have a requirement for information in advertising to be presented in a clear fashion, so as not to mislead or deceive consumers. In some jurisdictions, this is enforced as part of requiring specific information to be disclosed. However, generally truth-in-lending requirements were broad principles established in legislation or regulation. For example, the *Bank of Uganda Financial Consumer Protection Guidelines 2011* require that financial institutions ensure all advertising and promotional materials are fair, clear and not misleading.

This is consistent with the World Bank's *Good practices for financial consumer protection*, which expect that banks and non-bank credit institutions will ensure that their advertising and sales materials and procedures do not mislead customers and that they will be legally responsible for all false and misleading statements (i.e. subject to penalties).[47]

Good practice observation 5: Fair and clear promotion

Credit providers and credit intermediaries are required to provide advertising, marketing and promotional material that is fair, clear, and not misleading or deceptive. The requirements may be prescriptive or principles based.

Annual percentage rates

Just under half (45%) of the jurisdictions surveyed had a requirement for a standardised interest rate, such as a comparison rate or effective annual percentage rate, to be disclosed in credit advertising. The comparison rate or effective annual percentage rate aims to standardise information by adding the effect of fees and charges to the headline interest rate. This allows consumers to compare consumer credit products with different interest rates and fee structures with one another.[48] This is intended to both inform consumers and promote competition in the market by ensuring fair comparisons can be made. For example, in France, all advertising for consumer credit must state the annual percentage rate, which includes any costs, commissions or repayments, whether direct or indirect.[49]

Costs

Approximately a third (35%) of jurisdictions responded that they had some requirement for advertising to disclose the costs of credit. In general, the jurisdictions that had this requirement presented this information in a prescriptive way. For example, Saudi Arabia's Banking Consumer Protection Principles require that any advertising for a product indicate the amount of all fees and commissions relating to the use of the service or product, as well as the expiry date of any promotional offers such as low fees. Moreover, this information is required to be clear and understandable, in a legible font and size, including footnotes.[50]

[47] World Bank, *Good practices for financial consumer protection*, June 2012, Common Good Practice 10, pp. 8, 17, and 60.
[48] OECD, *Financial literacy and consumer protection: Overlooked aspects of the crisis: OECD recommendation on good practices on financial education and awareness relating to credit*, June 2009.
[49] Le code de la consummation (French Consumer Code), articles L311-4 and L313-1.
[50] Banking Consumer Protection Principles (Saudi Arabia), s10.

Good practice observation 6: Costs promoted clearly

Credit providers and credit intermediaries are required to clearly present costs, including interest rates, in their marketing, advertising and promotional material. In particular, they are required to present a separate standardised interest rate or annual percentage rate that takes into account the headline interest rate and any other upfront fees and costs.

Warnings

In addition, some jurisdictions go further by mandating warnings in consumer credit advertisements. The warnings are designed to alert consumers to the potential risks involved in borrowing money. For example, the Netherlands requires all credit advertising to include the warning 'Watch out! Borrowing money costs money'.[51] Similarly, Ireland requires advertisements for mortgage credit to include the following: 'Warning: If you do not keep up your repayments you may lose your home.' [52] There are also risk warnings set out in provisions 9.22–9.23 and 9.25–9.29 of the Central Bank of Ireland Consumer Protection Code 2012 (Consumer Protection Code). In the *Consumer Credit Act 1995* (Ireland) there are provisions on the advertising of credit under hire-purchase agreements (s21) and other credit (s22); advertising of credit is covered by reg 7 (Standard information to be included in advertising of credit) of the European Communities (Consumer Credit Agreements) Regulations 2010 (Consumer Credit Agreements Regulations).

Case study: Advertising requirements (Belgium)

In Belgium, the *Consumer Credit Act 1991* lays down various requirements concerning the advertising of credit products. Article 5 provides a general overarching obligation for information to be clear and not misleading. In particular, it provides that any advertisement for a credit agreement that mentions an interest rate or any figures relating to the cost of credit to the consumer must include certain standard information in a clear, concise and prominent way by means of a representative example. The standard information required includes the borrowing rate, the total cost, the total amount of credit, and the annual percentage rate. These provisions in particular are designed to reflect broader practices throughout the European Union.

There are also a range of prescriptive requirements; the standard information must be presented in a minimum font size or minimum level of clarity and audibility (where appropriate). Similarly, if another service must be purchased in order to access the credit (i.e. insurance), then this obligation must also be disclosed to the consumer. All other advertisements for consumer credit products must include the following mention (in French or Dutch): 'Watch out: borrowing money costs money'.

[51] *Financial Supervision Act* (Netherlands).
[52] Consumer Protection Code 2012 (Ireland) (Consumer Protection Code), provision 9.19.

In addition, article 6 sets out a range of specific prohibitions designed to eliminate practices seen as particularly harmful or likely to sway vulnerable consumers. These include prohibitions on advertising that focus on the ease of obtaining credit, encourage debt consolidation, or encourage consumers already unable to meet their debts to take out further credit.

Prohibitions also exist on displaying promotional rates without clearly stating the conditions attached to these rates, suggesting that the credit can be offered in cash, as well as offering free credit without referencing the annual percentage rate.

Disclosure

The survey revealed a vast majority of jurisdictions have a requirement for some form of pre-contractual disclosure. This usually entails specifying key aspects of the credit contract in a simple or standardised format – for example, interest rates, fees and charges, repayment amounts and the term of the contract.

The key driver for these protections is to ensure that consumers are sufficiently informed about the nature of the contract or agreement they are seeking to enter into, and to assist consumers in choosing the most suitable product for their needs.

Figure 4: Percentage of jurisdictions with obligations that address how credit providers disclose information to consumers

Disclosure information

Pre-contractual information that is required to be disclosed includes some or all of the information set out in Table 5.

Table 5: Information that jurisdictions require credit providers to disclose at the pre-contractual stage

Disclosure	Description	Example
Basic details	The amount of credit, the term of the contract, the type of credit, the features of the loan and any fees or charges.	MAS (Singapore) requires consumers to be provided with a fact sheet when a bank initiates discussions about a residential property loan, or a consumer shows an interest in obtaining a mortgage. The fact sheet must set out the information in a standardised format, to allow for comparisons across credit providers and products.[53]
Interest rate	The headline annual rate or rates that apply.	In Canada, all mortgages and personal loans must disclose both the headline annual interest rate(s), as well as the annual percentage rate. There is further, additional information that must accompany the interest rate information, as detailed in regulations.[54]
Annual percentage rate, effective annual percentage rate, comparison rate	A figure that represents the total or 'true' cost of borrowing by incorporating the effect of fees and charges.	As part of the Standard European Consumer Credit Information (SECCI) form, credit provides in the European Union must disclose the borrowing rate(s) as well as the annual percentage rate.
Schedule of repayments	An explanation of the size, number and date of the repayments.	In Saudi Arabia, a contract must specify the amount, number and frequency of payments.[55]
Simulations of different interest rates – repayments	A simulation of the repayments that would be due if the interest rate were to increase by a given amount.	In Portugal, pre-contractual disclosure must include both a simulation of repayments, as well as simulations for increases of the nominal interest rate by one and two percentage points.[56]
Amount of remuneration for credit intermediaries	Where a credit intermediary is involved, the intermediary is required to disclose any remuneration they receive as part of the contract.	In France, credit intermediaries are required to disclose their remuneration, and are prohibited from receiving it until after the consumer receives the credit.[57]
Warnings	Warnings about the effects of missing scheduled repayments must be given to the consumer, prior to credit being provided.	Ireland requires the following to appear in credit documentation: 'Warning: If you do not meet the repayments on your credit agreement, your account will go into arrears. This may affect your credit rating, which may limit your ability to access credit in the future'.[58] This requirement does not apply to credit agreements entered into under the Consumer Credit Agreements Regulations.

[53] MAS, Notice 632A, *Residential property loans – Fact sheet*, 30 November 2011, pursuant to s55 of the *Banking Act* (Singapore).
[54] *Bank Act* (Canada), s450, and Cost of Borrowing (Banks) Regulations (Canada).
[55] Regulations for Consumer Credit (Saudi Arabia), article 2.2.2.
[56] Banco de Portugal, Notice No 2/2010 and Instruction No 45/2012.
[57] Monetary and Financial Code (France), articles L519-6 and R519-30.
[58] Consumer Protection Code (Ireland) provision 4.23.

Disclosure	Description	Example
Information about the credit provider	Name and contact details of the credit provider and, where applicable, the credit intermediary.	Norway requires that, prior to the contract being entered into, the consumer must be given all relevant information concerning the product and the offer, including the name and details of the credit provider and, where applicable, the credit intermediary.[59]
Consumer rights	An explanation of legal rights that the consumer has, including recourse mechanisms, regardless of the terms of the contract.	In Germany, as part of the SECCI form, the credit provider must inform the consumer that they have a right to withdraw from the agreement within 14 days, and that they have a right to repay the loan early (though they may be required to pay compensation).[60]
Other terms and Conditions	Key features or aspects of the credit product, and any penalties that may apply.	In Saudi Arabia, a contract must include the terms and conditions and describe key features, such as the mechanism for either party to end the banking relationship, as well as details of fees, pricing and any potential penalties that the consumer may incur.[61]

Standardised disclosure

The World Bank's *Good practices for financial consumer protection* supports standardised disclosure and considers it good practice for a bank or other credit provider to provide consumers with a summary statement such as a 'key facts statement' – which summarises in a page or two the key terms and conditions of the specific product or service. The World Bank's *Good practices* expect that the statement be presented in a legible font, be written in plain language, and describe the key terms and conditions, including recourse mechanisms, applicable to the financial product or service.[62]

The European Union's CC Directive and MC Directive establish broad principles of disclosure and transparency, and aim to create a standardised approach to the presentation of advertising and the disclosure of information across the European Union, notably borrowing rate(s) as well as the annual percentage rate. As part of this, the European Union has developed the SECCI form, designed to summarise key information about consumer credit at pre-contractual stage. This key information includes costs, loan term and amount, details about the credit provider, and information on the consumer's rights. This form can then be used by consumers to compare different products in a structured fashion.

In addition, the MC Directive will introduce a specific standardised information sheet for mortgage credits and home loans, the European Standardised Information Sheet (ESIS). The ESIS will contain key information about the main features of the loan on offer and includes risk

[59] *Financial Contracts Act* (Norway), s46b.
[60] Bürgerliches Gesetzbuch (Germany), s355, 491 and 495; also see Einführungsgesetz zum Bundesgesetzbuch (Introductory Act to the German Civil Code), s247.
[61] Banking Consumer Protection Principles (Saudi Arabia), Principle 2.
[62] World Bank, *Good practices for financial consumer protection*, June 2012, Common Good Practice 8, pp. 7–8.

warnings, such as 'Your income may change. Please consider whether you will still be able to afford your [frequency] repayment instalments if your income falls.' [63]

Good practice observation 7: Disclose key terms and conditions

Credit providers and credit intermediaries are required to provide consumers with the key terms and conditions of the credit product, including their legal rights, and any other information that is material to the consumer's decision to enter into a credit contract. This may be in a standardised format to facilitate comparison.

Codes of conduct

While most disclosure obligations are directly mandated by the jurisdiction through legislation or regulations, there are also some voluntary codes of conduct that recommend additional disclosure.

For example, in the European Union, the European associations of consumers and the European Credit Sector Associations have negotiated a voluntary code of conduct that specifies additional information that must be given to consumers when providing a home loan.[64] This includes information on valuations and sureties required, as well as information on tax concessions or public subsidies available to the consumer, or where they can this information. The code also lays out a standard information sheet, which provides greater detail than the legally required SECCI form, as it includes information such as a description of the product, an illustrative amortisation schedule and information on internal complaint schemes. The ESIS (MC Directive) builds on the code of conduct while improving its content and layout.[65]

Similarly, Canada has a voluntary code of conduct for institutions that provide mortgage credit, which requires credit providers to provide additional information to consumers about prepayment (paying off a mortgage or other loan before its maturity date). The information includes an annual statement informing on the ways the consumer can prepay their mortgage without incurring extra costs, as well as information about how the charges are calculated in making prepayments.[66]

[63] MC Directive, Annexure 2.
[64] European associations of consumers and the European Credit Sector Associations, *European agreement on a voluntary code of conduct on pre-contractual information for home loans*, 2001.
[65] Commission of the European Communities, *Commission recommendation of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans* (2001/192/EC), March 2001.
[66] Code of Conduct for Federally Regulated Financial Institutions (Canada).

Types of disclosure documentation

The requirements and mechanisms used to disclose information typically includes some or all of the steps set out in Table 6. While disclosure may be of limited value to consumers in some circumstances, and is not a substitute for other protective measures, many jurisdictions consider it useful to inform consumers of relevant information about the proposed credit contract and agreement at key points during their decision-making process.

Table 6: Information disclosure cycle

1	**Pre-contractual disclosure**	Some jurisdictions require credit providers to make certain basic information available to a consumer, such as the loan term, interest rate and common charges. This must generally be provided in an easily accessible form before consumers have made a formal application, but usually after they have indicated some interest in applying for credit. This disclosure does not necessarily have to be personalised to the consumer, but in some circumstances may be tailored based on some limited information provided by them. For example, in Singapore, MAS requires that when a bank initiates discussions about a residential property loan, or a consumer shows an interest in obtaining a mortgage, they must be provided with a fact sheet that covers information essential to the consumer's decision to take up a mortgage. This includes costs, loan term, interest rates and simulations of repayments under different interest rates. The notice includes a prescribed format for the fact sheet, which allows for comparisons across credit providers or residential property loans.[67]
2	**Initial quote**	Credit providers or credit intermediaries may be required to provide a consumer with basic information about the credit contract proposed to be entered into, that is personalised to their particular circumstances. In some jurisdictions, this is often coupled with, or presented as a fact sheet. The format of a quote or fact sheet is also often specified. For example, South Africa prevents a credit provider from entering into a small, intermediate or large credit agreement unless the credit provider has given the consumer a pre-agreement statement and a quotation in the prescribed form. A quotation for an intermediate or large agreement must include the credit amount, the deposit, and the total of additional changes, instalments in respect of the total amount deferred, the total cost, and the interest rate. Subject to certain conditions, the quotation is binding on the credit provider for five business days.[68]
3	**Assessment document**	Jurisdictions may require credit providers and/or credit intermediaries to conduct an assessment of affordability prior to entering into the contract or agreement. Credit providers and credit intermediaries may be required to provide this document to the consumer prior to entering into a credit contract or agreement. For example, Ireland requires regulated entities to provide a statement to a consumer setting out why a financial product, including consumer credit products, is considered the most suitable for the particular consumer, taking into account their needs, objectives, personal circumstances and financial situation. This must be provided to the consumer prior to providing or arranging a credit service or product.[69]

[67] MAS, Notice 632A, *Residential property loans – Fact sheet*, 30 November 2011), pursuant to s55 of the *Banking Act* (Singapore).
[68] *National Credit Act 2005* (South Africa), s92.
[69] Consumer Protection Code (Ireland), provision 5.19. This provision doesn't apply to credit agreements entered into under the Consumer Credit Agreement Regulations.

4	**Credit intermediary's disclosure documents**	Some jurisdictions also require credit intermediaries to disclose information, such as any remuneration or commission they are receiving, before they recommend or suggest a credit product to a consumer. For example, Australia requires that consumers receive a range of disclosure documents from credit intermediaries that are 'credit assistance providers', such as brokers, in relation to their services. A credit assistance provider must give: • a credit guide prior to providing credit assistance, which includes details about the commissions being received by the credit intermediary, as well as details of their dispute resolution procedures;[70] • a quote that set out the estimated cost to a consumer of their services, if the consumer may be charged a fee;[71] and • a proposal document that sets out the actual costs to the consumer of using their services, including any commissions received at the same time credit assistance is provided.[72]
5	**Credit contract**	Many jurisdictions mandate that key information about the provision of credit, including costs, loan term and amount, and details about the credit provider and information on the consumer's rights. The credit contract itself will include many of the details covered by a quote, as well as relevant information and warnings. Saudi Arabia specifies the format of loan agreements and has minimum requirements for disclosure, including, among other matters, the amount of credit, description of repayments, annual percentage rate, and fees and charges.[73]
6	**Post-contractual disclosure**	Some jurisdictions also have in place protocols for post-contract disclosure or ongoing disclosure. For example, Canada requires that amendments to credit agreements be disclosed to consumers no later than 30 days prior to the amendment, and that consumers are given an ongoing disclosure statement at least once a month.[74]

Good practice observation 8: Appropriate disclosure

Credit providers and credit intermediaries are required to provide clear and relevant information to the consumer at key points before and during the consumer's decision to enter into a credit contract.

Product-specific requirements

Some jurisdictions have targeted disclosure or additional information requirements for specific products due to their complexity or concerns about their risks to consumers.

Mortgage loan disclosure

Certain jurisdictions have recognised that the purchase of a home is, for most consumers, the most substantial debt that they enter into, and the consequences for defaulting on a mortgage (including broader economic consequences) can be greater than that of defaulting on any other type of

[70] National Credit Act (Australia), s113 and 126.
[71] National Credit Act (Australia), s114 and 137.
[72] National Credit Act (Australia), s121 and 141.
[73] Regulations for Consumer Credit (Saudi Arabia), article 2.2.2.
[74] Cost of Borrowing (Banks) Regulations (Canada).

credit contract.[75] As a result, these jurisdictions mandate that mortgage loans have greater disclosure requirements, in line with the FSB's mortgage underwriting standards[76] and the OECD's recommendation that extra consideration be given to the awareness and protection of consumers entering into mortgages.[77]

This typically requires providing more information and warnings in a more prescriptive format, such as a prescribed information sheet. This is designed to provide greater information to consumers and encourage greater consideration, given the size of the contract being undertaken.

For example, the Netherlands requires all credit contracts to include basic information about the credit being provided, including terms and conditions, size and number of repayments, type and amount of credit, and interest and other charges that may apply. A consumer must also be given a financial leaflet that provides the consumer with information on the risk, costs and performance of a complex credit product or an insurance product accompanying the mortgage.[78]

Portugal mandates a pre-agreement quotation for all credit, which must include the credit amount, the deposit payable, the total of all additional charges, and the instalment amount payable. The interest rate, deferred amount and total amount repayable also must be disclosed. However, mortgage credit requires additional disclosure – a standardised information sheet must be provided to consumers, and it must include descriptions of the characteristics of the loan as well as simulations of repayments, and simulations of increases in the nominal interest rate by one and two percentage points.[79]

The United Kingdom has adopted the European Union-wide regulations for consumer credit, which require the creditor to explain the following issues adequately to the consumer prior to entering into the contract:[80]

- the features of the agreement that may make the credit unsuitable for particular types of use;
- how much the consumer will have to pay periodically and, where appropriate, in total;
- the features of the agreement that may have an adverse effect on the consumer which the consumer is unlikely to foresee;
- the consequences for the consumer arising from a failure to make payments; and
- the effects of exercising any right to withdraw.

[75] OECD, *Financial literacy and consumer protection: Overlooked aspects of the crisis: Recommendation on good practices on financial education and awareness relating to credit*, June 2009.
[76] FSB Residential Mortgage Principles.
[77] OECD, *Financial literacy and consumer protection: Overlooked aspects of the crisis: Recommendation on good practices on financial education and awareness relating to credit*, June 2009, p 17.
[78] *Financial Supervision Act* (Netherlands).
[79] Banco de Portugal, Notice No 2/2010 and Instruction No 45/2012.
[80] FCA, *Mortgages and home finance: Conduct of business sourcebook*.

There is no prescribed format for how this information is explained, but there is a prescribed disclosure document.

However, for first-charge mortgages (as distinguished from subsequent mortgages), the United Kingdom requires credit providers to disclose the above information, as well as further information such as the cost of insurance that may apply, in a prescribed form. First-charge mortgages also have additional prescribed disclosure requirements at the formal offer stage and post-contract – these cover additional rights and responsibilities the consumer has, as well as prescribed disclosure in the event the consumer wishes to take out additional credit on the facility.

Reverse mortgage disclosure

In Australia, a reverse mortgage allows older Australians to borrow money using the equity in their home as security, with the credit amount and interest capitalised and repaid when a trigger event (i.e. death or sale of property) occurs.

As a reverse mortgage is considered a significant financial transaction and often targeted at more vulnerable consumers in the community (i.e. the elderly), additional disclosure obligations apply. Australia requires consumers to be provided with a projection of their equity over time, with an explanation of the assumptions used to calculate the projection. This is intended to assist consumers to better balance their short-term needs for credit with the impact on future choices (e.g. for aged care), and so make more appropriate decisions relating to their choice of credit product and their ability to repay a loan. The projection must come from a reverse mortgage calculator available on ASIC's 'MoneySmart' website, and must show the effect of movements in interest rates, changes in house prices, and different drawdown patterns. Further, consumers must be provided with a reverse mortgage information sheet, which explains what a reverse mortgage is, what the interest charges are and what issues to consider if the consumer wants to conduct their own equity projection.[81]

Good practice observation 9: Specific disclosures

Additional disclosure obligations are required for specific credit products where there is increased risk to a consumer or class of consumer due to, among other things, the complexity or high value of a credit product, or if the product raises particular consumer protection concerns.

[81] National Credit Act (Australia), s133DB–133DD.

Other mechanisms to assist consumer engagement

Certain jurisdictions have additional mechanisms beyond disclosure requirements that affect the consumer's ability to identify and obtain a suitable product.

Cooling-off periods

Some jurisdictions offer cooling-off periods after a consumer has entered into a credit contract or agreement. In France, when taking out consumer credit, the consumer has 14 days from accepting the offer to change their mind about entering into the agreement. For mortgage credit, a 10-day cooling-off period exists.[82] This may be useful for consumers to compensate for behavioural biases such as 'over-confidence' at the point of entering into the credit contract or agreement.

Consumer responsibility

In recognition of the contractual nature of the credit agreement, some jurisdictions also impose obligations on the consumer to ensure that they are not misleading or deceptive about the information they provide to a credit provider or credit intermediary on their financial circumstances, or require them to respond truthfully to any requests for information from a credit provider or credit intermediary. This is intended to assist a credit provider to rely on the accuracy of the information provided. For example, in South Africa, a consumer must answer fully and truthfully any requests for information made by the credit provider as part of a credit assessment designed to prevent reckless lending.[83] In Australia, there is a general obligation that a person must not make a false or misleading representation in relation to a matter material to entry into a credit contract or related transaction – which applies equally to a consumer, the credit provider or credit intermediary.[84]

Penalties and prohibitions

The most commonly cited penalties for a breach of advertising and disclosure requirements are fines, including civil and criminal penalties. A number of jurisdictions indicated that imprisonment was a potential sanction – for example, Norway, Belgium and Luxembourg.

Additionally, such conduct requirements may reflect on the fitness of a licensee or authorised person to maintain their authorisation. Jurisdictions

[82] Le code de la consommation (France), articles L311-12 and L312-10.
[83] *National Credit Act 2005* (South Africa), s81(1).
[84] Schedule 1 of the National Credit Act (Australia) (National Credit Code), s154.

such as the United Kingdom and Australia may consider such breaches when determining whether a licensee can or should hold a licence. Jurisdictions may also permit the forfeiture of the credit provider's right to interest. In France, article L311-48 of Le code de la consommation provides that a lender who does not provide an offer in the prescribed format forfeits the right to interest arising from the credit contract. Others may permit the nullification or modification of the credit contract, such as in Ireland and South Africa.

Certain jurisdictions prohibit, or allow their regulator to prohibit, certain types of advertising. For example, in Germany, s23 of the *Banking Act* enables BaFin to prohibit certain kinds of advertising. In case of a general ruling addressing not only an individual institution central industry associations and consumer protection associations will be consulted.

Financial literacy

A significant majority of jurisdictions have some form of further educational, financial literacy or outreach programs in place to facilitate consumer knowledge and awareness about consumer credit. The aim of these programs is to:

- promote consumers' understanding of financial terms, products and services;
- help consumers identify their own financial needs and choices; and
- ensure consumers are aware of the consequences of their financial decisions.

They are also offered to encourage responsible financial management and behaviour by consumers.

The World Bank considers it good practice for jurisdictions to have a broad-based program of financial education and information to increase the financial literacy of the population across all ages. These programs generally cover issues relating to consumer finance and consumer protection in financial services.[85]

[85] World Bank, *Good practices for financial consumer protection*, June 2012, Common Good Practices 32–34, p. 9.

Figure 5: Percentage of jurisdictions with financial education and literacy material, programs or services that relate to responsible borrowing

Two key approaches to promote financial literacy are:

- self-guided educational websites; and
- community outreach programmes.

These initiatives are generally situated within broader programs or material targeted at a consumer's general financial literacy. These programs focus on raising consumer awareness about finance and improving general financial literacy, including consumer understanding of consumer credit, as well as providing tools for educators and community groups.

This information is targeted at specific life events (e.g. starting out in the workforce or planning for retirement) or financial products (e.g. mortgages, personal loans, credit cards and financial counselling).

Self-guided websites

The self-guided educational websites generally cover a range of finance topics and often include information on specific credit products, such as credit cards, home and car loans that aim to assist consumers in their financial decisions.

Websites promoting financial literacy in particular jurisdictions include the Netherlands 'Wijzer in geldzaken' (Money Wise), France's 'La Finance Pour Tous' (Finance for Everyone), Australia's 'MoneySmart', Spain's 'Fianzas Para Todos' (Finance for all), Singapore's 'MoneySense', and Portugal's 'Portal do Cliente Bancário' (Bank Customer Website) and 'Portal Todos Contam' (Everybody Counts Website).

Predominantly, the information is presented in an easy to understand format and usually includes helpful explanations and comments on the benefits and risks of various products. Some websites also provide practical examples related to specific circumstances. The websites often contain targeted resources and information for teenagers and young adults, intended to help them develop financial awareness and an understanding of the implications and consequences of financial decisions, including obtaining credit.

The websites often include basic calculators to assist in developing a budget and ‘real life’ examples of what may happen when a credit card is used irresponsibly. Some of the websites also provide external links to financial counsellors who may be able to assist with preparing a budget or provide guidance with managing mounting debt. The websites aim to provide the foundation stones for financial literacy and associated wise financial decisions in the long term.

Good practice observation 10: Financial literacy education websites

Jurisdictions promote financial literacy through self-guided educational websites. The websites include information on consumer credit, specifically information and interactive tools to assist a consumer to understand the nature of a consumer credit product and the risks and benefits of entering into a credit contract.

Wijzer in geldzaken (Netherlands)

The ‘Wijzer in geldzaken’ website is divided into two main themes: finance information based on life stage, and information based on a specific activity or purchase.

The information contained in the ‘life stage’ section of the website includes guidance on preparing your finances for children, study, moving house, changes in employment, marriage and divorce, retirement, and death.

Each ‘life stage’ section includes specific information relating to the particular stage and may also include links to external sources for further information. The information pages provide tips and thinking points that may enable a consumer to reflect on their own financial circumstances and how a significant financial change may affect their personal circumstances.

Information contained in the ‘specific activity or purchase’ section of the website includes guidance and resources on pensions, debt, investment, responsible lending and mortgages.

The responsible lending page provides information regarding the benefits of borrowing versus saving. The page provides a list of questions a consumer should consider when contemplating entering into a loan (e.g. rather than enter a loan, can you save for the item? Do you have the financial capacity to repay the loan?). It also provides guidance on good borrowing practices (e.g. pay off all existing loans before entering into a new loan, ensure that you are informed about the loan terms and conditions, make sure that it is appropriate for you, and do not be influenced or pressured by the bank to enter a loan that is not suitable for you).

It provides a link to a savings page for related information about saving and planning regarding the consumer's financial future.

The mortgage page provides information regarding changes to mortgages and interest relief that came into effect in January 2013. The page comments on the changes to the mortgage rules and provides an explanation of the various types of available mortgages, with information often provided in graphs for ease of understanding and comparison.

La Finance Pour Tous (France)

La Finance Pour Tous website also provides practical tips spanning a consumer's lifetime: from establishing a budget, applying for a loan for a holiday, car or property, marriage and divorce, death of loved one, health, disability and dependency, and settling disputes.

The website contains a page dedicated to consumer credit. Consumer credit is specific to loans up to €75,000 that are not intended to be used for construction or real estate. The consumer credit page provides information on the following topics:

- rights and obligations of the consumer;
- personal loans;
- revolving credit;
- lease with option to buy; and
- free credit (akin to a consumer lease).

La Finance Pour Tous website also includes budgeting tools, particularly for youth.

Educators and community groups

The community outreach programs offered by the jurisdictions predominantly focus on raising awareness about consumer finance and improving financial literacy through increasing consumer understanding of credit products and services, as well as providing tools for educators and community groups.

The community outreach programs offered generally cover a range of topics and can be implemented by teachers, welfare and healthcare professionals who provide general financial literacy education.

Good practice observation 11: Community outreach programs

Jurisdictions encourage or promote community outreach programs to raise awareness about consumer finance and improve financial literacy.

In Australia, ASIC undertook a comprehensive credit outreach campaign to coincide with the introduction of Australia's new responsible lending obligations in 2010. ASIC continues to undertake targeted consumer credit outreach, particularly for vulnerable consumers such as newly arrived migrants, young people and the elderly. For example, ASIC's recent 'MoneySmart Rookie' campaign was aimed at educating and equipping young Australians with tools to better manage their finances. The campaign was approached in a light-hearted and non-judgemental tone and used non-traditional media channels, across university campuses' and in social and digital media.

Japan has a range of financial education and literacy initiatives that relate to responsible borrowing. For example, Japan has developed consumer education campaigns, such as the 'Are you OK' campaign to educate consumers about illegal credit lending based on the *Money Lending Business Act* revised in 2006.

The NCR in South Africa runs ongoing campaigns, as well as seasonally focused campaigns. Annually, between November and February, the NCR runs the targeted 'Spend Wisely' and 'Borrow Wisely' campaigns. The 'Spend Wisely' campaign is disseminated during the December festive season, to caution consumers about the perils of over-spending. The associated 'Borrow Wisely' campaign commences in January, and urges consumer to plan their yearly finances. The NCR uses the following media to disseminate its campaigns aimed at creating awareness and education about unnecessary consumer debt:

- print media, including consumer magazines;
- national and regional radio stations;
- consumer focused programs on television; and
- billboards.

The Financial Consumer Agency of Canada is responsible for general consumer financial literacy. It has a website to engage consumers to improve their understanding of financial products and services. The Financial Consumer Agency, supported by the private sector, champions Financial Literacy Month, which is held each November. The aim of Financial Literacy Month is to raise awareness and promote financial literacy in Canada across the generations, from schoolchildren to seniors. Various media are used to promote the month, including traditional print media (such as posters), and emerging media (such as Facebook and Twitter). Additionally, Canada has a designated Financial Literacy Leader. The Financial Literacy Leader exercises leadership at the national level to strengthen the financial literacy of Canadians. The Leader acts under the instructions of the Financial Consumer Agency Commissioner.

Industry obligations

Key points

The survey found that a majority of jurisdictions impose obligations on credit providers and credit intermediaries to obtain and verify information about a consumer's financial circumstances and/or needs, requirements or objectives of obtaining credit, for the purpose of identifying and preventing consumer over-indebtedness.

While the focus is often on obtaining and verifying information in relation to the debt and income levels of the consumer, there is an emerging trend to look more holistically at a consumer's financial circumstances, including taking into account expenditure, living expenses, and subjective factors such as their needs, requirements and objectives.

The survey identified that a majority of jurisdictions impose prudential requirements on credit providers obliging them to consider the 'credit risk' of a consumer's ability to repay a residential mortgage loan – to limit the risk to the credit provider from a default by the consumer.

However, there is an emerging trend in some jurisdictions – such as Ireland, South Africa and Australia – to apply additional obligations on credit providers, requiring them to consider consumer affordability for all consumer credit products. This is in addition to any prudential requirements.

This generally involves a requirement that credit providers assess and ensure that the credit contract or agreement meets the interests of the consumer, usually with the aim of preventing consumer over-indebtedness. While the nature of the test varied between jurisdictions, the focus was on the consumer's interests.

This type of obligation was more likely to apply consistently across a wide range of consumer credit products and credit providers. Jurisdictions with a prudential focus primarily have responsible lending obligations in relation to residential mortgages, but not other forms of consumer credit.

Another emerging trend is to impose obligations on credit intermediaries to consider the interests of a consumer, including affordability, before they are permitted to suggest or recommend a credit product.

Overview

Credit providers and credit intermediaries play an integral role in preventing consumer over-indebtedness.

The survey considered obligations or measures on industry that would specifically influence or affect a consumer's eligibility for or entry into a credit contract and the decision-making around that transaction. These obligations may include meeting particular thresholds or benchmarks – but also encompasses conceptual understandings and principles relating to defining and identifying unsuitable or irresponsible lending.

There are generally two main components to the decision-making process of a credit provider or credit intermediary that would influence or affect a consumer's eligibility for or entry into a credit contract or agreement:

- process requirements to obtain and verify relevant information to make a decision; and
- a substantive requirement to assess or determine whether a consumer or consumers should be eligible for, or should enter into, a credit contract or agreement.

The survey identified the ways in which different jurisdictions address these components, with a focus on promoting responsible lending.

Current international standards

There are a range of international standards that may influence a jurisdiction's approach to responsible lending obligations on industry.

The G20 Consumer Protection Principles and related OECD guidance[86] also include principles in relation to the equitable and fair treatment of consumers (requiring that all financial consumers should be treated equitably, honestly and fairly and that special attention should be dedicated to the needs of vulnerable groups)[87] and the responsible business conduct of financial services providers and authorised agents,[88] specifically that:

- financial services providers and authorised agents should have an objective to work in the best interest of their customers and be responsible for upholding financial consumer protection;
- depending on the nature of the transaction, and based on information primarily provided by consumers, financial services providers should assess the related financial capabilities, situation and needs of the customers before providing them with a product, advice or service;
- financial services providers should also be responsible and accountable for the actions of their authorised agents; and
- financial services providers should assess the related financial capabilities, situation and needs of their customers (including the attitude to risk and interests of different types of consumers, particularly vulnerable consumers) before agreeing to provide them with a product, advice or service.

The OECD further identified that, in relation to consumer credit, more targeted obligations should apply. According to the OECD, a financial services provider should not provide credit to a consumer unless the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely to be met in the manner required under that agreement.[89]

[86] G20/OECD Taskforce on Financial Consumer Protection, *Update report on the work to support the implementation of the G20 high-level principles on financial consumer protection – Principles 4, 6, and 9*, OECD, September 2013.
[87] Principle 3 of the G20 Consumer Protection Principles requires that all financial consumers should be treated equitably, honestly and fairly at all stages of their relationship with financial service providers. Treating consumers fairly should be an integral part of the good governance and corporate culture of all financial services providers and authorised agents. Special attention should be dedicated to the needs of vulnerable groups.
[88] G20 Consumer Protection Principles, Principle 6.
[89] G20 Consumer Protection Principles, Principle 6.

The OECD recognised that taking into account the consumer's financial situation, the purpose of the credit agreement and all other relevant circumstances, is important to protect consumers against repayment problems and resulting debt issues and assist the credit provider to avoid mis-selling.

The World Bank also identified that, before a financial institution makes a recommendation to a consumer regarding a specific financial product or service, it is good practice to gather sufficient information from the consumer to ensure that the product or service is likely to meet the needs and capacity of that consumer.[90]

The FSB and the EBA also endorse a number of targeted practices in relation to residential mortgages.

Obtaining and verifying information

In a majority of jurisdictions, credit providers and credit intermediaries are required to obtain relevant information about the consumer's financial circumstances and/or needs, requirements or objectives in obtaining credit, and verify the information received. This is an important component in showing a consumer's ability to repay a loan or consider their indebtedness, and mitigating the risk of lenders adopting poor lending practices where the risk of loss can be transferred to a third party.

Jurisdictions impose a variety of different obligations on credit providers and credit intermediaries to obtain and verify information. This is often principles based, placing the onus on industry to determine what information is appropriate to obtain and verify.

The general obligation to obtain and verify information is often tied to a requirement for credit providers and credit intermediaries to undertake a credit assessment regarding the consumer's ability to repay the loan. For example, the European Union's CC Directive requires a credit provider to make a creditworthiness assessment on the basis of *sufficient information* appropriately obtained from the consumer and, where necessary, consulting the relevant database (i.e. credit registry).[91] The MC Directive explicitly requires that the procedures and information on which the credit assessment is based are established, documented and maintained.[92]

In Uganda, a credit provider or credit intermediary is expected to undertake an assessment of a consumer's debt repayment history and their existing financial means and, based on a prevalence of information available to the credit provider, determine whether the information indicates that entering into the credit agreement would make the consumer over-indebted.[93]

[90] World Bank, *Good practices for financial consumer protection by financial services*, June 2012, Common Good Practice 7, p. 7.
[91] CC Directive, article 8.
[92] MC Directive, article 18.
[93] *Financial Institutions Act* (Uganda), s6(1)(c).

However, a jurisdiction may prescribe both the type and form of information that must be collected. For example, in France, credit providers are required to ask the consumer to fill in a prescribed information sheet describing their resources and expenditures and, if relevant, outstanding loans.[94]

Obtaining information

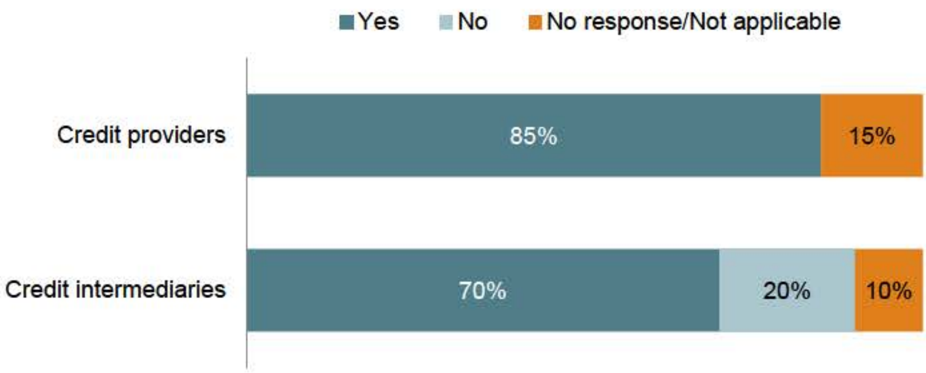
The survey identified that a majority of jurisdictions impose positive obligations on credit providers (85%) and credit intermediaries (70%) to obtain information about a consumer's financial circumstances and/or needs, requirements or objectives of obtaining credit, for the purpose of identifying unsuitable or irresponsible lending. However, there is a varying degree of information that may actually be obtained.

Generally, the type of information that may be obtained is not prescribed but collected based on a general or principles-based obligation to appropriately identify and verify information relevant to the consumer. In many instances, the information collected and verified is expected to be 'reasonable' or proportionate or scalable to the circumstances (i.e. the type of credit product and amount of credit being provided). This is to prevent undue regulatory burden on the credit provider or credit intermediary.

For example, in Japan, a money lender (credit provider) must investigate matters concerning the repayment capacity of the consumer, such as income, profit or other financial resources, credit, the status of borrowings and any other relevant matters.[95]

Article 20 of the MC Directive requires that a credit provider obtain information on a consumer's income and expenses and other financial and economic circumstances that is 'necessary, sufficient and proportionate'. The information must be obtained by the creditor from relevant internal or external sources, including the consumer and information provided to the credit intermediary or appointed representative during the credit application process.

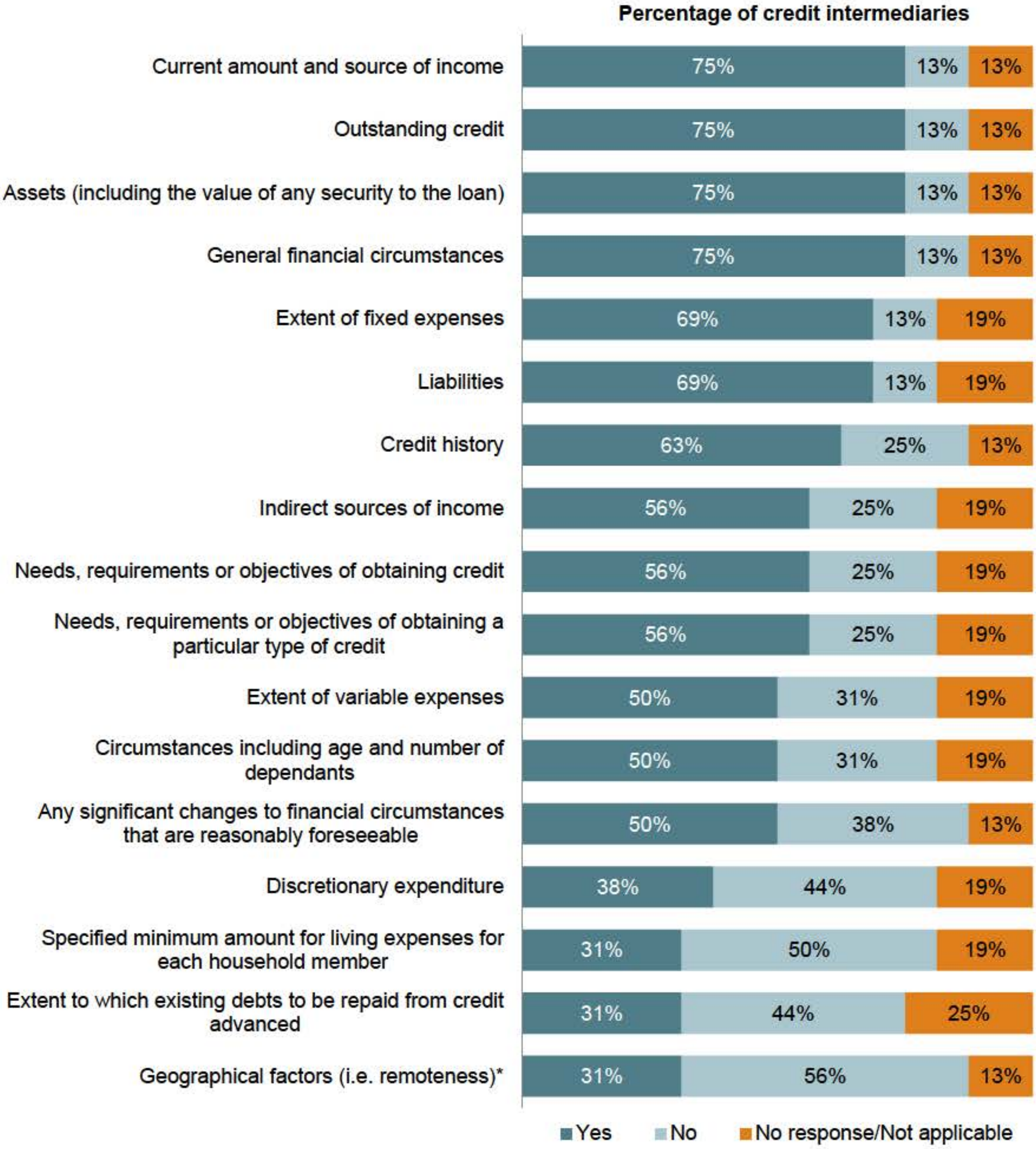
Figure 6: Percentage of jurisdictions that require credit providers and credit intermediaries to obtain information about a consumer



[94] Le code de la consommation (France), article L311-10.
[95] *Money Lending Business Act* (Japan), article 13(1).

Jurisdictions permit credit intermediaries and credit providers to obtain the information set out in Figure 7 and Figure 8.

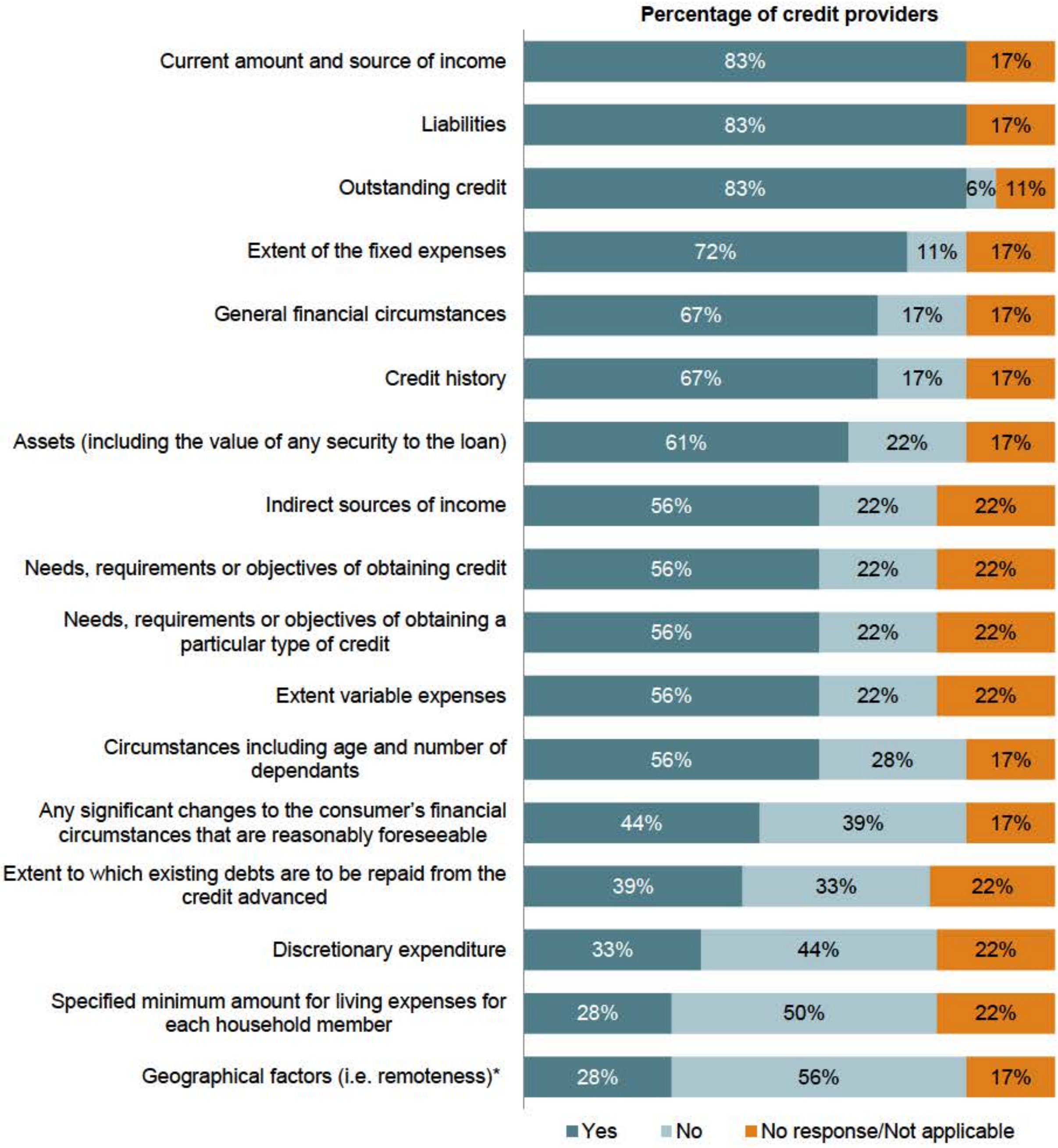
Figure 7: Information about a consumer that credit intermediaries may collect



* This may require consideration of specific issues, such as potentially higher living costs compared with urban areas.

Note: The percentages in this graph are based on responses from the 14 jurisdictions that require credit intermediaries to obtain information about consumers.

Figure 8: Information about a consumer that credit providers may collect



Note: The percentages in this graph are based on responses from the 17 jurisdictions that require credit providers to obtain information about consumers.

The most common information obtained is in relation to the consumer's current amount and source of income, outstanding credit, and the consumer's liabilities.

Other types of information obtained were the extent of the consumer's fixed expenses, the consumer's assets (including the value of any security to the loan), the consumer's general financial circumstances, and the consumer's credit history. This emphasis is on obtaining information relating strictly to the debt and income or revenue of the consumer. However, there is a growing trend to seek information from a consumer that presents a more holistic picture of their financial circumstances. This includes taking into account factors relating to their actual outgoings (such as their fixed and variable expenses), what would be reasonable expenditure, their personal circumstances (such as whether or not they have dependents) and minimum living standards.

Further, half of the jurisdictions, such as Australia and Ireland, require credit providers and credit intermediaries to identify subjective information about the consumer, such as their needs, objectives and/or requirements. This places a greater emphasis on the interests of the consumer in obtaining credit.

Good practice observation 12: Reasonable inquiries to obtain information

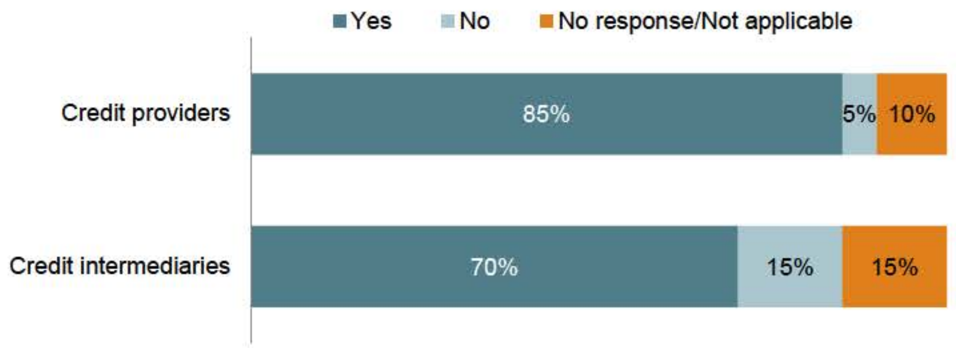
Credit providers and credit intermediaries are prohibited from providing or facilitating the provision of credit to a consumer unless they have made reasonable inquiries to obtain information about the consumer's:

- overall financial circumstances, taking into account a range of factors, including their income, assets, existing debt, current and future expenses, living requirements, and relevant personal circumstances (such as dependents); and
- needs, requirements and objectives.

Verifying information

A significant majority of jurisdictions also require credit providers (85%) and credit intermediaries (70%) to verify the information obtained.

Figure 9: Percentage of jurisdictions that require credit providers and credit intermediaries to verify the consumer's information



Among other things, a majority of jurisdictions require or permit the following to be obtained:

- recent payroll receipts or strips;
- financial statements; and
- tax account statements.

Credit providers may use information in credit registers. However, significantly fewer jurisdictions permit their credit intermediaries to access credit register information.

Figure 10: Sources credit providers may use to verify information

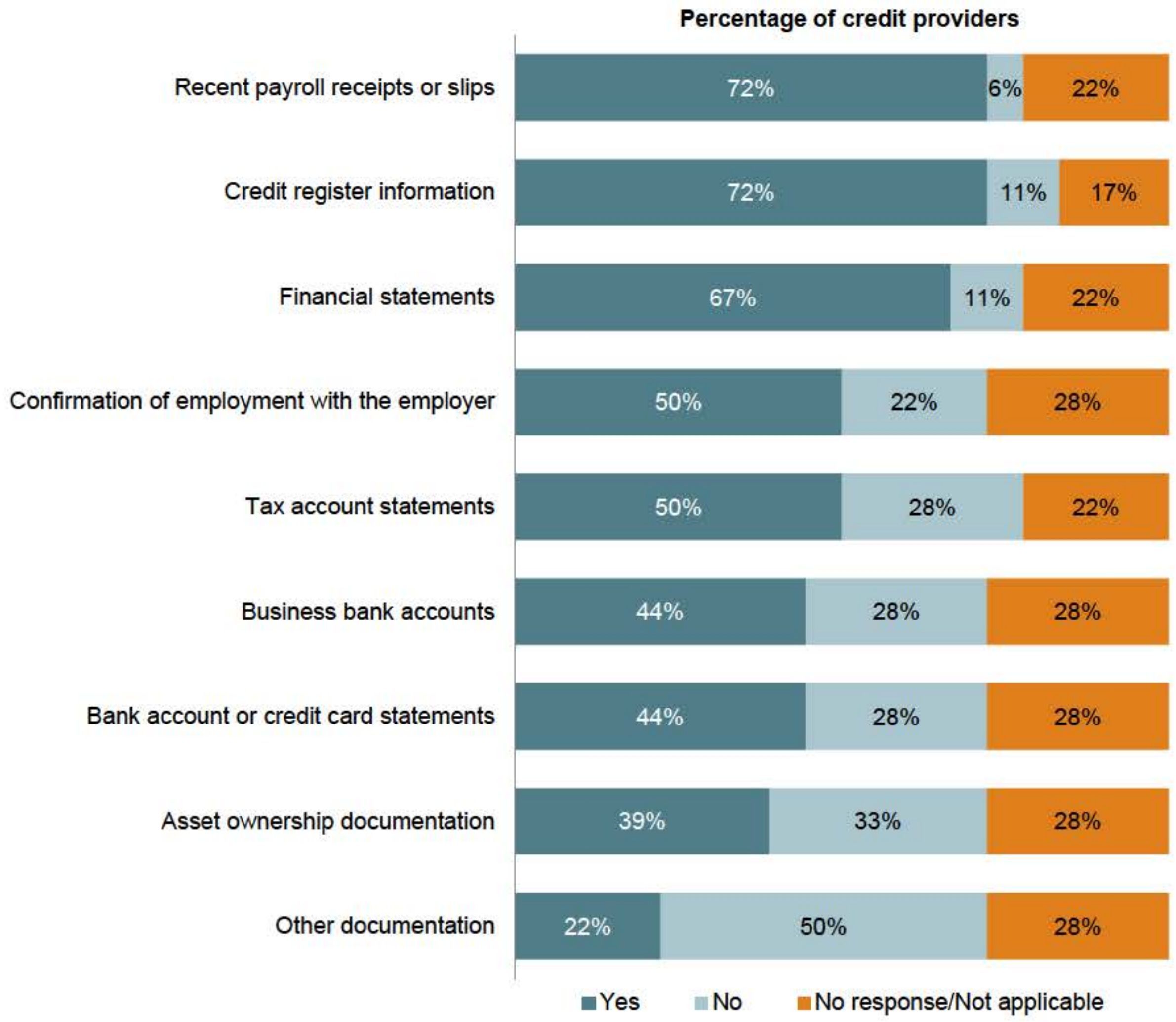
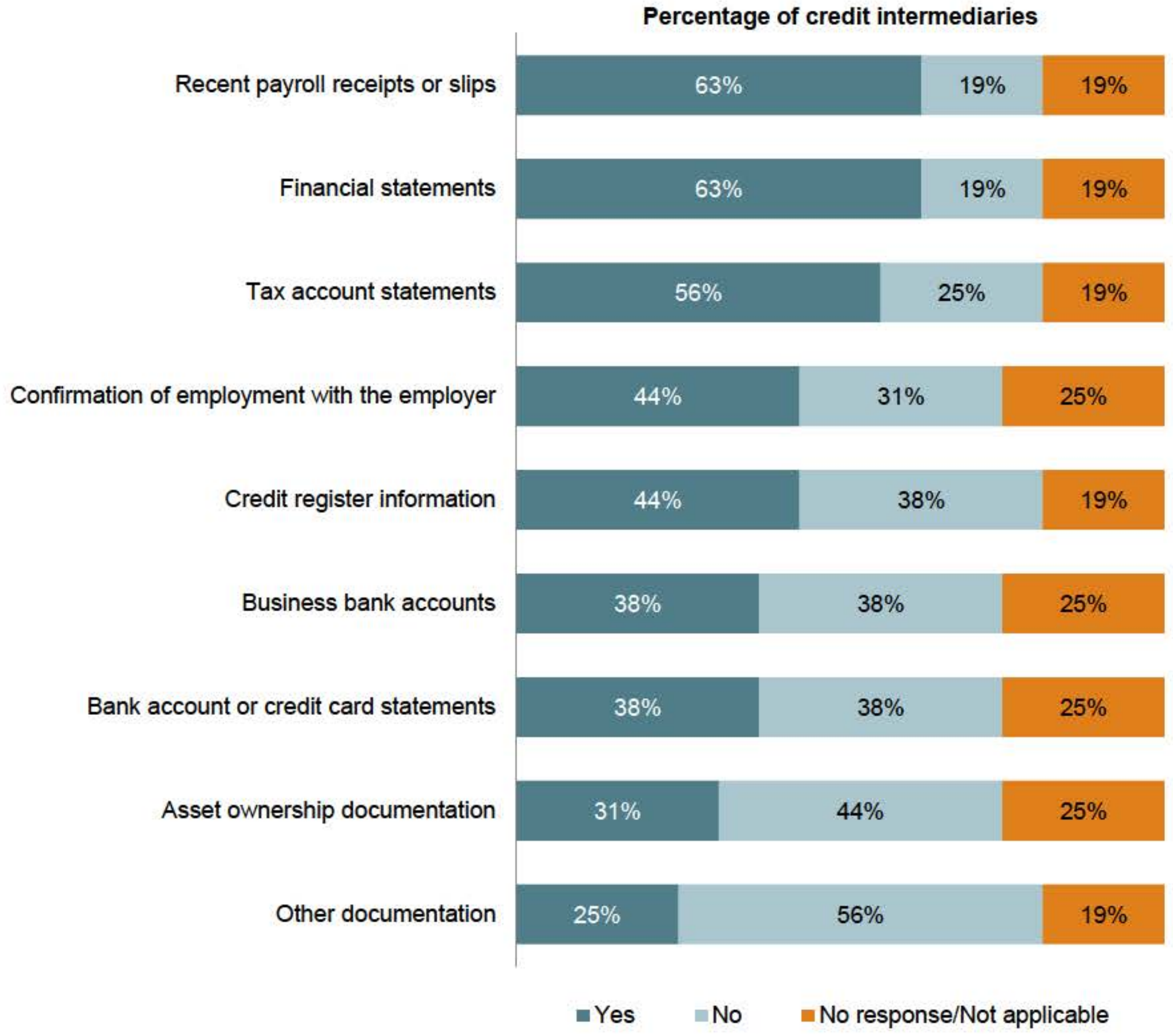


Figure 11: Sources credit intermediaries may to use to verify information



Generally, the type of information that should be verified is not prescribed, but linked to the information expected to be obtained by the credit provider. For example, article 20 of the MC Directive requires the information collected to be appropriately verified, including through reference to independently verifiable documentation where necessary.

Some jurisdictions have additional obligations on credit providers to either take responsibility for the information received by credit intermediaries, or to ensure that the information provided by credit intermediaries is accurate. For example, in the United Kingdom, it is the credit provider's responsibility to assess creditworthiness and affordability,[96] and they are expected to take appropriate responsibility for credit intermediaries acting on their behalf, including any information obtained by them.

[96] FCA, *Mortgages and home finance conduct of business sourcebook* and FCA, *Consumer credit sourcebook*.

Alternatively, in some jurisdictions, such as Uganda and Australia, obligations to obtain relevant information may be imposed directly on a credit intermediary.

Some of these obligations were introduced to respond to concerns about conduct that contributed to excessive mortgage lending in the lead up to the global financial crisis. Specifically, that credit intermediaries were falsifying or providing inaccurate information to credit providers, resulting in consumers being entered into credit contracts or agreements that they could not afford. The EBA has noted that the practice of not requiring consumers to provide information on their income ('low-doc' loans or self-certification of income) was a common practice prior to the global financial crisis.[97] As a result, the EBA also considers it important that consumers be able to demonstrate, and not merely claim, that they have resources to repay the loan, including income.

Case study: Obtaining and verifying information (Ireland)

In Ireland, the Consumer Protection Code requires regulated entities (credit providers and credit intermediaries) to comply with 'know the consumer' and suitability requirements. This is focused on the interests of the consumer.

As part of the 'know the consumer' requirements, the Consumer Protection Code requires regulated entities to assess affordability in order to ascertain a personal consumer's likely ability to repay the debt over the duration of the agreement, on the basis of information gathered on the consumer's needs and objectives, personal circumstances and financial situation.

Provision 5.1 of the Consumer Protection Code sets out that a regulated entity must gather and record sufficient information from the consumer prior to offering, recommending, arranging or providing a product or service appropriate to that consumer, including credit products and services.

The level of information gathered is scalable – that is, the information gathered should be appropriate to the nature and complexity of the product or service being sought by the consumer, but must be at a level that allows the regulated entity to provide a professional service. It must include the details of the consumer's:

- *needs and objectives* – including, where relevant, the length of time for which the consumer wishes to hold a product, the need for access to funds (including emergency funds), and the need for accumulation of funds;
- *personal circumstances* – including, where relevant, the consumer's age, health, knowledge and experience of financial products, dependents and employment status, and any known future changes to their circumstances; and

[97] EBA, *Opinion of the European Banking Authority on good practices for responsible mortgage lending* (EBA-Op-2013-02), 13 June 2013.

- *financial situation* – including, where relevant, the consumer's income, savings, financial products and other assets, debts and financial commitments, and attitude to risk (in particular, the importance of capital security to the consumer).

Provision 3.1 of the Consumer Protection Code states that, if a regulated entity has identified that a personal consumer is a vulnerable consumer, it must provide the vulnerable consumer with such reasonable arrangements and/or assistance that may be necessary to facilitate their dealings with them.

The identification of vulnerability is expected be an inherent part of the 'know the consumer' requirements. Regulated entities should consider whether there is any evidence of consumer vulnerability, such as consumers who:[98]

- are capable of making decisions, but their particular life stage or circumstances may make them unsuitable (e.g. if they are elderly or young, have a poor credit history, have a low income level, are suffering an illness, or are bereaved);
- are capable of making decisions, but require reasonable accommodation in doing so (e.g. if they are hearing or vision impaired, do not speak English as their first language, or have poor literacy skills); and
- have a limited capacity, whether temporary or permanent, to make decisions (e.g. if they have a mental illness or an intellectual disability).

The Consumer Protection Code also sets out additional requirements where the loan is a mortgage to a personal consumer. Provisions 5.6–5.8 of the Code require a mortgage lender to have sighted all original supporting documentation showing the personal consumer's identity and ability to repay, or receive from a mortgage intermediary a signed declaration that they have sighted all the original supporting documentation.

A declaration signed by the personal consumer (or their representative) certifying income and/or ability to repay is not considered sufficient evidence for these purposes. The regulated entity must also:

- assess the reasonableness of the information contained in the documentation submitted by a personal consumer in support of a mortgage application and take all reasonable steps to ensure that the documentation submitted is legitimate and authentic; and
- ensure that it has sighted an original valuation report for the property that will act as security for the mortgage, prior to providing a mortgage.

These requirements do not apply where a regulated entity is providing credit under credit agreements that fall within the scope of the Consumer Credit Agreements Regulations. These credit agreements are subject to different obligations consistent with the European Union's CC Directive.

[98] Central Bank of Ireland, *Feedback to CP54 – Review of the Consumer Protection Code*, 2011.

Good practice observation 13: Verifying financial information

Credit providers and credit intermediaries are required to make reasonable efforts to verify the financial information obtained about a consumer, particularly income history and pre-existing debts. This can be through obtaining relevant data – such as recent payroll receipts or strips, financial statements, and tax account statements – and checking credit reports or registers.

Current international standards for residential mortgages

In some jurisdictions, the obligation to obtain and verify information only applies to residential mortgages. This is consistent with international standards on mortgage underwriting.

Following a peer review of national approaches to mortgage underwriting, the FSB Residential Mortgage Principles identified that a consumer's underlying income capacity is a key input into effective mortgage underwriting. Principle 1 requires that jurisdictions should ensure that credit providers make reasonable inquiries and take reasonable steps to verify a consumer's underlying income capacity. Specifically, it expects that a credit provider:

- will verify and document each applicant's current employment status, relevant income history, and other financial information (e.g. credit scores, credit registers) submitted for mortgage qualification;
- should obtain sufficient income history on the consumer and make appropriate efforts to capture any variability in the consumer's income by collecting and analysing sufficient income history, the income report should be based on authoritative sources; and
- may require even more extensive history or third-party verification to document income and profit capacity for consumers who are self-employed, entrepreneurs, or have seasonal or irregular sources of income.

In the *Opinion of the European Banking Authority on good practices for responsible mortgage lending*, the EBA also establishes that it is good practice for jurisdictions to:

- ensure that credit providers make reasonable inquiries and take steps to verify a consumer's underlying income capacity, including making appropriate efforts to obtain and review sufficient income history to capture any variability to the consumer's income; and
- specify, or require credit providers to specify, aspects of the income verification process, such as the information required, or the means of

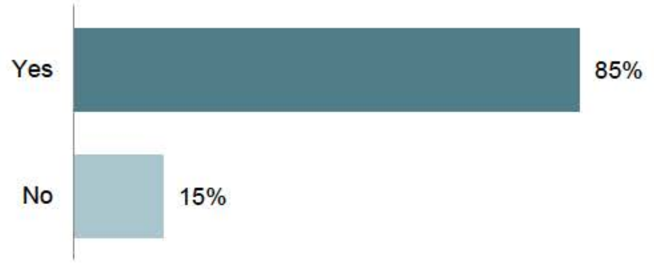
verifying income information, such as seeking documentary evidence of salary.[99]

Credit registers

Credit registers promote transparency and assist credit providers' to source independent information as an indication of a consumer's financial health and to verify their outstanding debts. They are a valuable source of information to a credit provider to overcome any 'information asymmetry' in assessing the risk involved in granting credit.

Credit registers (also called credit bureaus) are available in a significant majority of jurisdictions. They are able to provide credit reports (an extract of a consumer's credit history) or a credit score that indicates a consumer's ability to repay a loan, based on a range of factors.

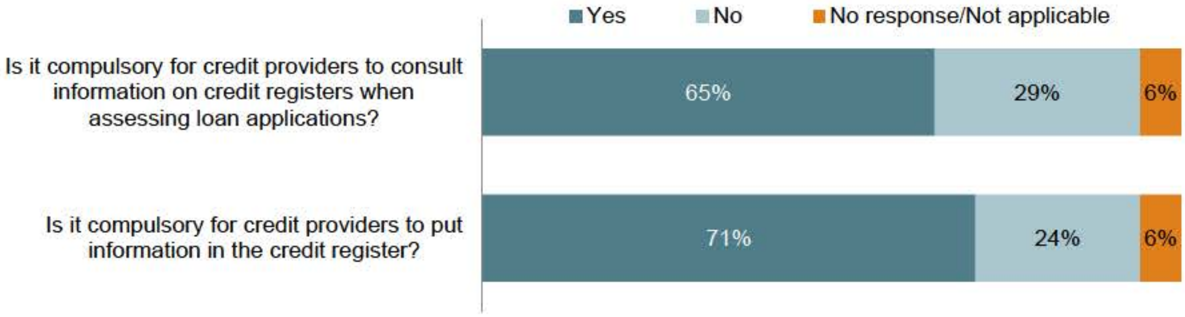
Figure 12: Percentage of jurisdictions that use credit registers



While a majority of jurisdictions permit the use of credit registers, the use of credit registers may not be compulsory or may only be compulsory for specific types of entities, such as banks or credit card issuers.

In a majority of jurisdictions (71%) credit providers are required to put information on a credit register. Similarly, a majority of jurisdictions (65%) also make it compulsory for credit providers to directly consult information on credit registers when assessing loan applications.

Figure 13: If jurisdictions require credit providers to inform and consult a credit register



Note: The percentages in this graph are based on responses from the 17 jurisdictions that use credit registers.

[99] EBA, *Opinion of the European Banking Authority on good practices for responsible mortgage lending* (EBA-Op-2013-02), 13 June 2013.

In Singapore, retail banks, finance companies and credit card companies put consumers' credit information on a credit register. Every month, payment performance data is uploaded by the banking and finance industry to the Credit Bureau (Singapore). Data relating to loan payment performance is collated and may be used by banks, finance companies and card companies as part of the assessment process for any new loans an individual applies for, or for a review of their existing loans. It is also compulsory to conduct credit bureau checks when assessing loan applications.

In Japan, a credit provider must consult information on credit registers when investigating the repayment capacity of the customer.[100]

The relevant EU directives expect that credit registers will be consulted where appropriate. In Belgium, a credit provider is required to consult the registry information on a consumer from the Central Office for Credits to Private Individuals, a mandatory central credit registry maintained by the National Bank of Belgium. However, the onus is on the credit provider to interpret the results from their consultation of the register. The register captures information on all credit agreements contracted by natural persons for private purposes, including any possible overdue debts arising from these credit agreements.

Alternatively, it can be common practice or encouraged, but not compulsory, for credit providers to take into account information in credit registers. In the United Kingdom, credit providers can consult a credit register or database to facilitate their responsible lending decisions, or develop a scorecard or analysis based on this information. However, there is no requirement to do so. The United Kingdom has a number of credit bureau or credit reporting agencies that collect a range of information about a consumer's credit history – including positive information about a consumer's payment history, and negative information about a consumer's defaults.

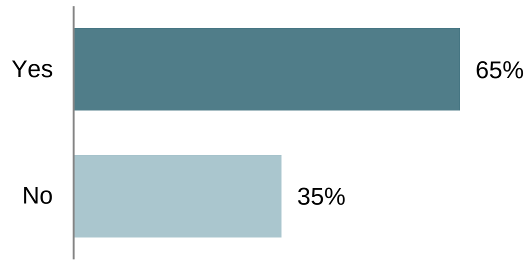
In Canada, OSFI requires that federally regulated financial institutions ensure that they make a reasonable inquiry into the background, credit history, and borrowing behaviour of a prospective residential mortgage loan consumer, as a means to establish an assessment of the consumer's ability to repay a mortgage loan.[101] Looking at a credit bureau score (credit report), offered by the major credit bureaus, is an indicator often used to support the provision of credit. However, OSFI expects that a credit score will not be relied on solely to assess consumer qualification; as such, an indicator measures past behaviour, and does not immediately incorporate changes in a consumer's financial condition or demonstrated willingness to service their debt obligations in a timely manner. Federally regulated financial institutions must also ensure that they obtain appropriate consumer consent for this assessment and comply with relevant provincial and federal legislation governing the use and privacy of personal information.

[100] *Money Lending Business Act* (Japan), article 13-2.
[101] OSFI, *Residential mortgage underwriting practices and procedures* (B-20), guideline, June 2012.

Key benchmarks and principles

A majority of jurisdictions surveyed (63%) have key principles, benchmarks, standards or practices to define and identify unsuitable or irresponsible lending for credit providers (including where different obligations apply according to the type of entity such as bank and non-bank lenders).

Figure 14: Percentage of jurisdictions that define unsuitable or irresponsible lending for credit providers



The survey identified that the obligations on industry reflect a range of approaches, from prescriptive requirements to principles based, or a combination of both. This generally occurs through regulations although some regulatory requirements are supported by industry standards and initiatives (i.e. codes of conduct).

Two key approaches identified in defining and identifying responsible lending include considerations of:

- credit risk – often from a prudential perspective and concerned with the risk to the credit provider of entering into a 'bad loan' (i.e. the likelihood of a consumer defaulting or being unable to repay their loan obligation). This approach is more likely to include prescriptive requirements such as LTV ratios; and
- consumer affordability – from a consumer protection perspective, to ensure that the credit contract or agreement meets the interests of the consumer, particularly affordability.

The survey also identified that many responsible lending obligations are targeted at residential mortgages. This is more likely to be the case if a jurisdiction's responsible lending obligations are primarily prudential in nature.

The FSB's international standards on residential mortgage underwriting practices expects that its member jurisdictions will ensure that credit providers of residential mortgages have reasonable debt service coverage,[102] specifically:

[102] FSB Residential Mortgage Principles, Principle 2.

- appropriately assessing a consumer's ability to service and fully repay their loans without causing the consumer undue hardship and over-indebtedness (while taking into account data protection rules in their jurisdiction). This includes taking into account all relevant factors that could influence the prospect for the loan to be repaid according to its terms and conditions over its lifetime. This should include an appropriate consideration of other servicing obligations, such as the level of other debt (secured and unsecured), the interest rate and outstanding principal on such debt, and evidence of delinquency;

- making reasonable allowances for committed and other non-discretionary expenditures in the assessment of repayment capacity. This could include establishing the consumer's actual obligations, including appropriate substantiation and consideration of normal living expenses. Credit providers should also include risk limits in their internal loan policies, such as specifying minimum levels of residual net income after meeting obligations or fixed ratios of repayment to some measure of gross or net income; and

- making prudent allowances for future negative outcomes – that is, an increase in benchmark interest rates in the case of variable rate mortgages or an unfavourable change (for a consumer) in the exchange rate in the case of mortgages granted in foreign currencies.

The FSB principles are reflected in a number of jurisdiction's approach to responsible lending.

Credit risk

A key approach to defining and identifying responsible lending is considerations of 'credit risk'. These obligations are applied to residential mortgages as part of prudential underwriting standards. It may take into account the indebtedness of a consumer and their ability to repay a loan. These obligations are administered by a regulator or supervisor who is responsible for prudential regulation. In some instances, the obligations may only apply to banks or bank-like institutions, and not to other non-prudentially regulated credit providers such as finance companies or short-term lenders.

The survey identified a number of principles and benchmarks used to manage credit risk. These approaches are set out in Table 7.

Table 7: Principles and benchmarks to manage credit risk

Principle or benchmark	Description
Adequate servicing capacity – Loan-to-income (LTI) ratios	An LTI ratio is the annual or monthly mortgage loan servicing requirements as a percentage of annual or monthly income that is available to repay the loan. This benchmark considers the credit risk of the consumer based on a set maximum debt-servicing ratio calculated by the debt repayment obligations set against assessable income. It is generally applied to residential mortgages. Some jurisdictions apply more complex calculations for determining assessable income, including taking into account a consumer's fixed and variable expenses and tax obligations. In June 2013, MAS (Singapore) introduced a total debt-servicing ratio of 60% for a loan for the purchase of or secured against property granted by a financial institution to an individual. The ratio must be calculated taking into account the percentage of total monthly debt obligations (including other outstanding debt) to gross monthly income. Property loans in excess of the threshold of 60% can only be granted by on an exceptional basis.[103] This reform is intended to strengthen credit underwriting practices by credit providers and encourage financial prudence among consumers.
Adequate servicing capacity – Income assessments	This principle requires a credit provider to make an assessment of the adequacy of a consumer's income to repay a loan, taking into account a range of factors, including their own lending criteria such as maximum debt servicing ratios. For example, in Canada, OSFI requires a credit provider who is providing a residential mortgage to assess the adequacy of a consumer's income, taking into account relevant mortgage payments and all debt.[104] A credit provider is also expected to take into account a range of factors, including: • commonly used debt serviceability ratios; • where the mortgage is to be insured, the insurer's debt serviceability limits; • other factors that would not ordinarily be captured by debt serviceability metrics, such as the consumer's assets and savings, other living expenses and recurring payment obligations; • the stability of the consumer's income, including variability in the salary/wages of the consumer (e.g. overtime wages, irregular commissions and bonuses); and • the amortisation period, as it affects the required debt service for the consumer, the speed of repayment of the mortgage and the growth of consumer equity in the underlying property.
LTV ratios	An LTV ratio is the ratio of the amount of a mortgage loan outstanding to the appraised value of the residential property. This benchmark considers the credit risk of the consumer based on the value of assets against the outstanding loan. For example, in Saudi Arabia the maximum LTV ratio is 70%.[105] In the Netherlands, the maximum LTV ratio for residential mortgages is being gradually reduced from 105% in 2013 to 100% in 2018.[106] This tightening is intended to address both consumer protection and financial stability concerns regarding consumer over indebtedness. The FSB expects jurisdictions to ensure that their regulatory and supervisory frameworks appropriately incentivise prudent approaches to the collateralisation of mortgage loans, including considering LTV ratios. However, they expect a LTV ratio should not be relied on as an alternative to assessing repayment capacity.[107]

[103] MAS, *MAS introduces debt servicing framework for property loans*, press release, 30 June 2013.
[104] OSFI, *Residential mortgage underwriting practices and procedures* (B-20), guideline, June 2012.
[105] Implementing Regulations of The Real Estate Finance Law 2013 (Saudi Arabia), article 12.
[106] Cabinet of the Netherlands, *Banking vision paper: Towards a robust ethical and competitive banking sector*, paper, 23 August 2013.
[107] FSB Residential Mortgage Principles, Principle 3.

Principle or benchmark	Description
Capital adequacy requirements	Prudential controls on the amount of capital a credit provider must hold for credit exposures, which can affect the lending criteria of the financial institution and, indirectly, the eligibility of a consumer for a particular credit contract or agreement. For example, a prudential authority can specify a risk weighting based on risk factors such as the LTV ratio. This LTV ratio and associated risk weighting can have an indirect effect on the eligibility of a consumer for a particular credit contract or agreement, as credit providers are expected to calibrate their internal lending standards to meet these obligations. This is commonly applied by prudential regulators such as the Australian Prudential Regulatory Authority, MAS (Singapore), BaFin (Germany) and ACPR (France) in their respective jurisdictions.

Penalties and consumer rights

There is generally no direct or indirect consumer recourse for individual breaches of such 'credit risk' obligations. However, jurisdictions indicated that administrative actions or penalties for a breach of a 'credit risk' obligation may be available to the primary regulator or supervisor. For example, in Germany, BaFin is able to apply administrative penalties for a contravention of any requirements to mitigate credit exposures and risk.[108]

Consumer affordability

Another key approach focuses on consumer affordability. This approach applies over and above any existing prudential requirements in a jurisdiction, to specifically target consumer protection.

This approach typically takes into account ethical principles, such as fairness, and is more likely to be focused on the interests of the consumer or the implications to a consumer's welfare. Jurisdictions that use this approach generally apply it consistently across all types of consumer credit. This approach is also more likely to be principles based. These obligations may also apply to credit intermediaries who are facilitating or advising on the provision of credit to a consumer.

This approach is more likely to provide for direct or indirect consumer recourse for individual breaches of the relevant consumer affordability obligations.

Table 8 sets out principles and benchmarks used and provides examples of jurisdictions where these are applied.

[108] *Banking Act* (Germany), s13, 18 and 56.

Table 8: Principles and benchmarks used in the consumer affordability approach

Principle or benchmark	Description
Creditworthiness	Requiring a credit provider to undertake an assessment of the maximum borrowing capacity of the consumer: the European Union and, to a greater extent, the Netherlands.
Reckless lending	A prohibition on entering a consumer into a credit contract or agreement that is reckless, where a consumer is over-indebted, or could result in them being over-indebted: South Africa.
Principle of fairness	Looking at the equitable nature of the credit contract or agreement. Entering a consumer into a credit contract or agreement a consumer cannot repay will be considered a breach of the principle of fairness: Uganda.
Unsuitability	A requirement to assess and determine whether a credit contact (including an increase to a credit limit) is unsuitable for a consumer, with a prohibition on entering a consumer into a credit contract that is unsuitable to them: Australia.
Suitability	A positive test requiring a credit provider to assess and place a consumer into a credit product that is suitable to them: Ireland.

The key features of this approach include:

- a procedural requirement on credit providers or their agents to make an assessment to determine consumer affordability against the relevant principle or benchmark; and
- consideration of consumer indebtedness and the appropriateness of credit to a consumer, based on a holistic view of the consumer's finances and ability to repay debt, including factoring in the consumer's outgoings (i.e. fixed and variable expenses), and reasonable living standards. Some jurisdictions take a more expansive view of responsible lending and require credit providers to consider subjective factors, such as a consumer's needs, requirements and/or objectives.

The procedural requirement to make an assessment to determine consumer affordability against the relevant principle or benchmark may be linked to the requirement to identify and verify certain information regarding the consumer's financial circumstances. For example, in South Africa, a credit provider is required to make an assessment of the financial state of the consumer, to determine whether the consumer is over-indebted or the credit contract will make the consumer over-indebted, taking into account a range of factors.[109]

Some jurisdictions also have specific and additional benchmarks and principles for certain credit products that complement the general affordability obligations – for example, Australia has additional obligations in relation to small amount lending and reverse mortgages. These obligations can be distinguished from regulatory controls on products and features, as they generally permit a level of assessment or discretion from the credit provider or credit intermediary prior to entry into the credit contract or

[109] *National Credit Act 2005* (South Africa), s80.

agreement. They are often targeted at credit products or features that raise specific concerns to a particular jurisdiction.

Good practice observation 14: Reasonable assessment of the interests of a consumer

Credit providers and credit intermediaries are prohibited from providing or facilitating the provision of credit to a consumer unless they have made a reasonable assessment that it meets the interests of the consumer, including affordability, or an analogous benchmark or principle. The credit will not be in the interests of a consumer if it is likely to or will:

- put a consumer in a position where they could not repay the loan, or could only repay the loan with substantial hardship; or
- not meet their needs, requirements or objectives.

Creditworthiness (European Union)

As noted earlier, the European Union has obligations intended to harmonise and provide a minimum standard of responsible lending arrangements amongst its member states. Article 8 of the European Union's CC Directive requires that member states ensure that a credit provider assesses a consumer's creditworthiness based on sufficient information before entering into a credit agreement, or increasing the total credit amount. This is expected to be standard practice for EU member states. However, certain EU member states, such as Ireland[110] and the Netherlands, have additional requirements.

The strengthened obligations will apply for residential mortgage credits and home loans by March 2016, when EU member states are expected to have incorporated the MC Directive into their national laws.

Creditworthiness (Netherlands)

The Netherlands require credit providers to undertake a creditworthiness assessment to determine the maximum borrowing capacity of a consumer. This applies generally to secured and unsecured consumer credit, including mortgage loans, and is consistent with the European Union's CC Directive and MC Directive.

Under the Netherlands' *Consumer Credit Act*, a credit provider is required to carry out a creditworthiness assessment of the consumer before entering into, or substantially increasing the credit limit of, a consumer credit agreement. The assessment entails obtaining information about the consumer's financial position and considering whether it is a sound decision for the consumer to enter into the credit agreement, with a view to preventing consumer over-indebtedness. A credit provider is prevented from

[110] However, the Consumer Protection Code (Ireland) does not apply to credit agreements entered into under the Consumer Credit Agreements Regulations (Ireland).

entering into a credit contract or agreement that would exceed the maximum borrowing capacity of the consumer. This obligation applies to consumer credit generally, including residential mortgages.

The details of these responsible lending obligations are set out in voluntary industry codes by the De Nederlandse Vereniging van Banken (the Netherlands Banking Industry Association), the Vereniging van Financieringsondernemingen Nederland (the Netherlands Finance Companies Association), and the Nederlandse Thuiswinkel Organisatie (the Netherlands Home Shopping Organisation).

The Nederlandse Vereniging van Banken Gedragscode Hypothecaire Financieringen (Code of Conduct for Mortgage Lending) sets out the industry standard intended to limit the risks of consumer over-indebtedness for mortgage loans. Among other things, the Code requires that:

- the maximum borrowing capacity of a household is calculated by the percentage of the disposable household income that is spent on repayments and interest payments. This calculation must take into account a range of factors, similar to that of the Vereniging Financieringsondernemingen Nederland Code (see below); and

- the current principal amount of a mortgage loan must not exceed 105% of the market value of the mortgaged property. This is to be reduced to 100% by 2018. This is in line with legislative requirements introduced in 2011.

The Vereniging Financieringsondernemingen Nederland Code applies to other non-mortgage consumer credit. It includes the requirement to undertake a creditworthiness assessment of a consumer based on a formula of ‘norms’ to assess a consumer’s financial situation. These ‘norms’ have been defined for four different profiles: single, single with children, two adults, and two adults with children. It sets out a formula for the net amount the consumer, after deducted fixed charges (i.e. rent against relevant income), must have available for their daily expenses. The formula does not apply where the net income is greater than €3,000 a month.

The financing charges for existing and new financing is set to a maximum of 2% of the credit limit (for revolving credit) or credit amount (unsecured credit with monthly instalment), even if the real periodical payment by the consumer is smaller.

The Nederlandse Thuiswinkel Organisatie Code requires its members to apply an income and charges test for credit used to purchase goods over €205 and up to €5,000. Based on the information provided by the consumer, the set expenses of the consumer (i.e. monthly housing charges, and existing loan obligations) is deducted from the net monthly income. The ‘credit space’ – that is, the amount available to be used to make credit repayments – is determined by deducting a ‘standard amount’ of expenses from the remaining available income. The ‘standard amount’ of expenses is based on a calculation of a range of factors, including the fixed charges, administrative expenses and reserve expenses, and reduced by avoidable expenses. If there is no available 'credit space' once the calculation is made, it is expected that credit will not be offered.

In exceptional cases, it is possible to deviate from these code requirements, if appropriately explained.

While the codes are voluntary, compliance with these obligations, including the ability to enforce fines and non-compliance penalties, is administered by the Autoriteit Financiële Markten (the Netherlands Authority for the Financial Markets).

Reckless lending (South Africa)

South Africa uses the concept of 'reckless lending' to impose responsible lending obligations on credit providers. Section 80 of the *National Credit Act 2005* (South Africa) prohibits reckless lending. A credit provider will be lending recklessly if:

- they fail to conduct an affordability assessment on the consumer; or
- when an affordability assessment has been conducted, it can be shown that credit was extended to a consumer who was already over-indebted, or the extension of the credit resulted in the consumer becoming over-indebted.

Section 81(2) provides that a credit provider must not enter into a credit agreement without first taking reasonable steps to assess a consumer's general understating and appreciation of the risks and cost of credit and the consumer's rights and obligations under a credit agreement. The credit provider must also assess the consumer's debt re-payment history and their existing financial means, prospects and obligations.

The obligation was introduced in an attempt to hold credit providers accountable for over-extending credit to consumers who were not in a position to meet those debt obligations. The provisions are aimed at promoting overall credit health within the economy.

South Africa's NCR monitors compliance with the reckless lending obligations. A breach can result in enforcement action being taken by the NCR, including requests for fines and penalties by the National Consumer Tribunal, and seeking the credit agreement being declared void by the courts.

Principle of fairness (Uganda)

The *Bank of Uganda Financial Consumer Protection Guidelines 2011* require a financial services provider (which includes banks and credit institutions) to comply with three key principles – fairness, reliability and transparency.

Under the 'principle of fairness', a financial services provider must generally act fairly and reasonably in all its dealings with the consumer.[111] Among other things, a financial services provider must not take advantage of a consumer, whether or not they are able to fully understand the character or nature of a proposed transaction, or include an unconscionable term in an agreement. A financial services provider must also comply with the specific obligation of fairness that the financial services provider must not lend recklessly.

A financial services provider is deemed to have lent recklessly if:

- they did not undertake an assessment of:
    - the consumer's general understanding and appreciation of the risks and costs of the proposed credit agreement and their rights and obligations under the agreement;
    - their debt repayment history for credit;
    - their existing financial means, prospects and obligations; and
    - whether there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose in applying for the credit; or
- they entered into the credit agreement with the consumer where the prevalence of information available to the financial services provider indicated that:
    - the consumer did not generally understand or appreciate their risks, costs or obligations under the proposed credit agreement;
    - it would make a consumer over-indebted; or
    - that there is no reasonable basis for concluding that any commercial purpose for applying for the credit may prove to be successful.

A consumer is considered to be over-indebted if the consumer would not be able to meet their obligations under all the credit agreements the consumer is a party to, taking into account the consumer's financial means, prospects and obligations; and the probability of meeting all their obligations under all their credit agreements, as indicated by the consumer's history of debt repayment.

These obligations are enforced by the Bank of Uganda and can result in civil penalties prescribed under the *Financial Institutions Act 2004* (Uganda).

[111] Consumer Protection Guidelines 2011 (Uganda), s6.

Unsuitability test (Australia)

In Australia, Ch 3 of the National Credit Act sets out the responsible lending obligations that prohibit a licensed credit provider or credit intermediary from entering into, suggesting a consumer enter into or increasing the credit limit of an unsuitable credit contract or agreement.

A licensed credit provider or credit intermediary must make a formal assessment to determine whether a credit contract is 'unsuitable'. In making the assessment, the licensee must make reasonable inquiries about the intended consumer's credit needs and objectives and their financial circumstances, and take reasonable steps to verify a consumer's financial circumstances – for example, by checking documents like payslips, bank accounts and tax returns.

A credit contract will be considered unsuitable for the consumer if:

- it is likely that the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship; or
- the contract does not meet the consumer's requirements and objectives.

The 'unsuitability' test is supplemented by targeted responsible lending obligations, to address concerns about consumer over-indebtedness or concerning lending practices in particular areas or products in the market. It establishes a number of rebuttable presumptions that the credit contract will be unsuitable:

- if a consumer will only be able to repay the loan by selling their principal place of residence, to counteract the predatory practice of 'equity stripping';[112]
- in relation to a payday loan, if the consumer is already in default under another small amount contract (i.e. a payday loan) or if, in the preceding three-month period, the consumer has been a debtor under two or more small amount credit contracts. This is intended to target the problem of 'debt spiralling';[113]
- in relation to a reverse mortgage:
  - where the youngest consumer is 55 years or younger, if the LTV ratio exceeds 15%; or
  - where the consumer is over 55, if the LTV ratio exceeds 15%, plus an additional 1% for each year the consumer is over 55.

  This is intended to target concerns about eroding equity in consumers' homes.

[112] Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 (Australia).
[113] Explanatory Memorandum to the National Consumer Credit Protection Amendment (Enhancements) Bill 2011 (Australia).

Good practice observation 15: Targeted prevention of consumer over-indebtedness

Credit providers and credit intermediaries have targeted obligations to prevent consumer over-indebtedness or to address concerning lending practices in particular products in the market. Factors that are taken into account include the type and vulnerability of the consumer or class of consumer, adverse financial effects on consumers, the type and complexity of the product, the nature of the credit provider or credit intermediary, and any other relevant risks.

These obligations are supported by regulatory guidance on responsible lending set out by the national consumer credit regulator, ASIC.[114] Each credit provider or credit intermediary is expected to decide how they meet their responsible lending obligations – it is considered 'scalable' according to the nature and type of credit contract. The guidance sets out ASIC's expectations for compliance, including what reasonable inquiries would be appropriate and examples of what ASIC would consider to be an 'unsuitable' credit contract or agreement.

A breach of the responsible lending obligations by a licensee can trigger enforcement action by ASIC and may result in fines, significant criminal penalties (including jail terms of up to two years and financial penalties) and licensing action (including banning from the market). Consumers, or ASIC on their behalf, may also seek compensation for any loss as a result of irresponsible lending.

Suitability test (Ireland)

Chapter 5 of Ireland's Consumer Protection Code requires regulated entities, including credit providers and mortgage intermediaries, to assess the suitability of a credit product.

While the obligation of 'suitability' applies generally to other non-credit financial products and services, there are additional and more specific obligations in relation to credit products and services.

This obligation to positively identify when a product is suitable or 'most suitable' can be distinguished from an 'unsuitability' test in that it proactively requires affirmation that the product meets a consumer's requirements and objectives.

Assessment of suitability

Provision 5.16 of the Consumer Protection Code requires that, when assessing the suitability of a product or service for a consumer, the regulated entity (including credit providers and credit intermediaries) must,

[114] ASIC, Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209), September 2013.

at a minimum, consider and document whether, on the basis of the information gathered under the ‘know the consumer’ requirements:

- the product or service meets the consumer’s needs and objectives;
- the consumer is likely to be able to meet their financial commitment to the product on an ongoing basis;
- the consumer is financially able to bear any risks attached to the product or service;
- in the case of credit products, the consumer has the ability to repay the debt in the manner required under the credit agreement, on the basis of the outcome of the assessment of affordability; and
- the product or service is consistent with the consumer’s attitude to risk.

A regulated entity must ensure that any product or service offered to a consumer is suitable to that consumer, given the facts disclosed by the consumer and other relevant facts, of which the regulated entity is aware, about that consumer.[115]

The assessment of affordability requires the credit provider or credit intermediary to ascertain the consumer’s likely ability to repay the debt over the duration of the agreement, and assess the suitability of a product or service for a consumer, based on information gathered on the consumer’s needs and objectives, personal circumstances and financial situation.

In addition, there are targeted obligations that a mortgage lender must carry out on an assessment of affordability to ascertain the consumer’s likely ability to repay the debt over the duration of the agreement. The purpose of including the assessment of the effect of interest rate increases on the instalment amount is to ensure that credit providers take account of the effect rising interest rates could have on the consumer’s ability to repay the mortgage.[116]

An affordability assessment must include the results of a test on the consumer’s ability to repay the instalments over the duration of the agreement, based on a minimum 2% interest rate increase above the interest rate offered to the consumer. This test does not apply where the interest rate is fixed for a period of five years or more.

Where there is an introductory rate, the 2% increase must be applied to the variable interest rate after the introductory period has ended (or the current variable interest rate, if not yet known).

For interest-only mortgages, in addition to carrying out the assessment of the 2% interest rate increase, the mortgage lender must also assess the consumer’s likely ability to repay the principal at the end of the mortgage

[115] Consumer Protection Code (Ireland), provision 5.17.
[116] Consumer Protection Code (Ireland), provision 5.9.

term, or likely ability to repay the capital and interest instalment amount that will apply at the end of the interest-only period.[117]

Where a regulated entity offers a selection of product options to the consumer, the product options contained in the selection must represent the most suitable options from the range available from the regulated entity. In addition, where a product is recommended, the recommended product must be the most suitable product for that consumer.[118]

Written statement of suitability

Prior to providing or arranging a product or service, a regulated entity must prepare a written statement setting out the reasons why:

- a product or service offered to a consumer is considered to be suitable to that consumer;
- the product options contained in a selection of product options offered to a consumer are considered to be the most suitable to that consumer; or
- a recommended product is considered to be the most suitable product for that consumer.

The reasons set out in the statement must reflect the information gathered to assist the consumer to understand how the product(s) or service(s) offered or recommended meet, where relevant, the consumer's needs and objectives, personal circumstances and financial situation.

The written statement must also include, where relevant, an outline of how the risk profile of the product is aligned with the consumer's attitude to risk, and how the nature, extent and limitations of any guarantee attached to the product is aligned with the customer's attitude to risk.[119]

These obligations do not apply to consumer credit contracts subject to the Consumer Credit Agreements Regulations, which operate alongside the European Union's CC Directive.[120] Regulation 11 of the Consumer Credit Agreements Regulations requires that, before concluding a credit agreement with a consumer, a credit provider must assess the consumer's creditworthiness on the basis of sufficient information, where appropriately obtained from the consumer and, where necessary, on the basis of a consultation of the relevant database.

The Central Bank of Ireland has the power to administer sanctions for a contravention of the Consumer Protection Code, under Pt IIIC of the *Central Bank Act 1942* (Ireland).

[117] Consumer Protection Code (Ireland), provisions 5.11 and 5.12.
[118] Consumer Protection Code (Ireland), provision 5.17.
[119] Consumer Protection Code (Ireland), provision 5.19.
[120] The MC Directive will not take effect until it is transposed into national legislation – member states have until March 2016 to complete this.

Credit intermediaries

A minority of jurisdictions (28%) also impose key principles, benchmarks, standards or practices for responsible lending on credit intermediaries.

Certain jurisdictions may consider responsible lending obligations for credit intermediaries in the context of the provision of financial advice, which may be regulated or treated differently to considerations of affordability that apply to credit providers. For example, in France, financial intermediaries (including credit intermediaries) are required to act in their client's, or potential client's, best interest.[121] A few jurisdictions, such as Australia and Ireland, apply responsible lending principles and benchmarks to credit intermediaries, equivalent to those that apply to credit providers.

[121] Monetary and Financial Code (France), article R519-19.

Regulatory controls

Key points

To address more egregious conduct or complex products, a number of measures operate to restrict or control access to credit.

Price controls have been retained or re-introduced by half of the jurisdictions surveyed.

This is generally to prevent consumer over-indebtedness, particularly in relation to credit products and sectors where there have been systemic concerns about consumer detriment.

A common approach is the use of maximum 'adjustable' cap on costs (relative interest rate ceilings) intended to be responsive to market changes.

A minority of jurisdictions also prohibit, ban or limit unsuitable products or product features.

Overview

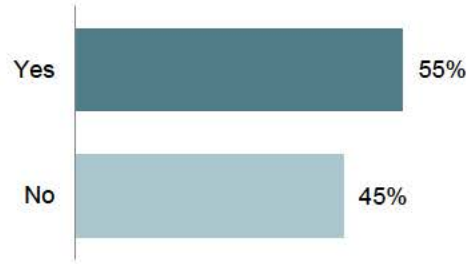
In addition to measures to regulate the decision-making process regarding entering into a credit contract, there are a number of measures that restrict certain credit products or features in the market due to concerns about their inherent unsuitability to persons or certain classes of persons in the market.

The survey indicated that some jurisdictions consider it appropriate to include extra protections for certain classes of consumer who obtain particular credit products, or to include specific limitations on certain product features – such as interest rate caps or a prohibition on certain products from being provided – to address systemic concerns in their market.

Price controls

Half of the jurisdictions surveyed had in place price controls for credit contracts or agreements. These price controls can be general in nature, but are often targeted to specific sectors or consumer credit products in the market.

Figure 15: Percentage of jurisdictions that have price controls on some consumer credit products



Interest rate ceilings

The most common way jurisdictions impose price controls is through interest rate ceilings.

Interest rate ceilings can be considered a modern manifestation of traditional usury laws, and are intended to prevent the exploitation of a consumer's inability to obtain mainstream credit by charging 'excessive' interest rates.

For example, in 2006 Japan revised the *Money Lending Business Act* and other relevant ordinances to strengthen consumer protection and ensure that there was consistency with the existing laws to prohibit illegally high interest rates on lending.

In Japan it is prohibited to provide a contract that exceeds the interest rate ceilings.[122] The maximum applicable interest rate is set as a percentage of the principal amount being borrowed; for example, it is 20% where the principal amount being borrowed is less than ¥100,000.[123] Where interest is deducted in advance, the amount of interest is calculated on the principal amount received by the consumer.[124] The maximum applicable interest rate is deemed to include any money other than the principal, regardless of its name (e.g. reward, discount charge or commission). However, the interest rate is not deemed to include administrative charges, such as expenses for concluding the contract or for the performance of obligations under the contract.[125] Consumers have rights to request a repayment of paid interest in excess of the legal amount.

In Portugal, it was considered that the interest rates that applied to credit contracts in their jurisdiction were high in comparison to other European countries. To address this, Portugal introduced a maximum interest rate for credit agreements not secured by a mortgage on 1 January 2010. The calculation for the maximum rate was further amended on 1 July 2013.

The maximum applicable rate is calculated on the average annual percentage rate of charges applied by credit institutions in the previous quarter based on different types of contracts, plus one quarter of the annual percentage rate (previously one third). The annual percentage rate is an annual measure of the total cost of credit (includes all fees, expenses, taxes and insurance charges required in addition to interest), expressed as a percentage of the respective amount. Further, the maximum interest rate for each segment of credit cannot exceed 50% of the average annual percentage rate of all consumer credit agreements concluded in the previous quarter.[126]

[122] *Money Lending Business Act* (Japan), article 12-8.
[123] *Interest Rate Restriction Act* (Japan), article 1.
[124] *Interest Rate Restriction Act* (Japan), article 2.
[125] *Interest Rate Restriction Act* (Japan), article 3.
[126] Decree-Law No 133/2009 (Portugal).

The Banco de Portugal (Portuguese Central Bank) is responsible for identifying the types of credit agreements relevant to the determination of the maximum rates of the respective contracts and its dissemination to the public on a quarterly basis. The types of credit agreements include: personal loans for the purpose of education, health and renewable energy; personal loans for other purposes, no particular purpose or the purpose of debt consolidation when not secured by a mortgage; car loans; and revolving credit such as credit cards, credit lines and overdraft facilities.[127]

Portugal's approach reflects a general trend to use an adjusted cap on costs (relative interest rate ceilings), intended to be responsive to market changes. The adjusted cap on costs can be calculated in different ways. For example, in France the maximum interest rate is calculated by reference to the annual percentage rate applied by credit institutions for credit contracts of the same type during the previous quarter, plus one third of the annual percentage rate.[128] This is similar to the model used in Portugal.

Alternatively, in South Africa the maximum interest rate ceiling is a relative interest rate calculated by the reference rate, which is the ruling South African Reserve Bank repurchase rate (RR) multiplied by 2.2% plus a set percentage depending on the type of credit contract:[129]

Mortgage agreements	(RR x 2.2%) + 5%
Credit facilities	(RR x 2.2%) + 10%
Unsecured credit facilities	(RR x 2.2%) + 20%
Developmental credit agreements (for small business)	(RR x 2.2%) + 20%
Other credit agreements	(RR x 2.2%) + 10%

Short term credit transactions have a different interest rate ceiling of 5% per month, and incidental credit agreements have a maximum rate of 2% per month.

Case study: Price controls in payday lending (Australia)

The payday lending market in Australia provides short-term small amount loans to consumers who usually cannot access further credit from mainstream credit providers.

Australia experienced a number of problems with their payday lending market. Concerns were raised that payday lenders were seen to be taking advantage of vulnerable and desperate consumers – who were on low incomes, unemployed or unable to access mainstream credit – through excessive fees and charges, and high interest rates.

[127] Banco de Portugal, Instruction No 12/2009.
[128] Le code de la consommation (France), article L313-3.
[129] National Credit Regulations 2006 (South Africa), reg 42.

Consumers using this market were more likely to end up in an ongoing debt cycle, increasing their reliance on credit for day-to-day living expenses and having repeated roll-overs of their loans ('debt spiralling'). This reduced their capacity to improve their situation, with consequent costs through adverse social and health impacts. Further, credit providers' compliance with existing responsible lending obligations was considered lacking.

As a result, from 1 July 2013, Australia introduced a national tiered maximum cap on costs (including interest and fees) that a credit provider can charge under their credit contract. The cap varies based on the term of the contract and the amount of credit.[130]

The cap on costs excludes more mainstream credit that is provided by prudentially regulated banks and credit unions. The cap involves a general 48% per annum interest rate cap, including all fees and charges, but with two specific caps for loans of a smaller amount:

- for loans between AU$2,000 and AU$5,000 (medium-sized loans) where the term of the loan is less than two years, the cap is 48% plus an additional fee of AU$400. The additional fee provides an allowance for the relatively high ratio between the set up costs for the credit provider and the loan size; and
- for loans less than AU$2,000 where the term is less than one year (small amount loans), the permitted charges are 20% upfront for establishment costs and then 4% of the original loan amount per month. These are generally payday loans of very short duration.

The caps are only expected to affect the pay day lending market as existing mainstream lending falls well below the amounts allowed under the caps for higher amount contracts.

The cap applies in addition to the general responsible lending obligations for consumer credit preventing consumers from being entered into a loan that is 'unsuitable' to them. Other prohibitions specifically aimed at the risks in the payday lending market include a ban on contracts for small amounts where the term of the contract is 15 days or less.

Fees and charges

Certain jurisdictions may limit or prohibit certain fees and charges relating to credit if there are concerns about their excessive nature. For example, in Portugal early repayment fees for variable interest loans are banned. Where there is a fixed interest rate component, a credit institution cannot charge a fee that is above:

- 0.5% of the amount of the principal that is repaid, if the remaining period between the date of the early repayment and the date stipulated for the end of the loan contract is greater than one year; or
- 0.25% of the amount of the principal that is repaid, if the remaining period between the date of the early repayment and the date stipulated for the end of the loan contract is less than or equal to one year.[131]

[130] See, generally, the National Credit Act (Australia), s133CA and National Credit Code, Divs 4 and 4A.
[131] Decree-Law No 133/2009 (Portugal).

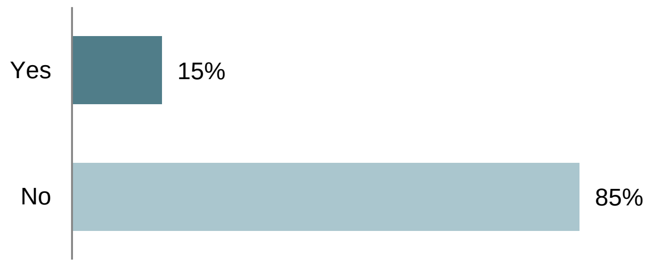
Some jurisdictions include fees and charges in their interest rate ceilings – so a credit provider is restricted as to the total amount of fees that may be charged.

A more principles-based approach is used in Germany, through a general prohibition against usury. Section 138 of the Bürgerliches Gesetzbuch (German Civil Code) prohibits oppressive contracts in general by voiding transactions (including credit agreements) where there is the intentional exploitation of a weak person or situation to make excessive 'pecuniary advantages'. This applies to both interest charges and fees.

Prohibitions on products or product features

A small minority of jurisdictions also impose prohibitions on products or product features. This is generally targeted at specific concerns in their jurisdiction.

Figure 16: Percentage of jurisdictions with prohibitions on products or product features



Reverse mortgages (Australia)

In Australia, a reverse mortgage allows older Australians to borrow money using the equity in their home as security, with the credit amount and interest capitalised and repaid when a trigger event (i.e. death or sale of property) occurs. As the amount owed in a reverse mortgage increases over time due to capitalisation, it was identified that there were difficulties in determining the value of the equity in the home over time. As a result, debtors were not fully apprised of the risks involved, including the risk of having to repay more than the value of the mortgaged property as a result of going into negative equity.[132]

To address this concern, Australia introduced a 'no negative equity' guarantee protection though a prohibition against credit providers requiring or accepting repayment of the loan for an amount that exceeds the market value of the mortgaged property.[133] The debtor may terminate the contract if the amount they repay is at least equal to the property's market value. Such

[132] Explanatory Memorandum to the National Consumer Credit Protection Amendment (Enhancements) Bill 2011 (Australia).
[133] National Credit Act (Australia), s86A–86E.

a termination would discharge all the debtor's liabilities and the mortgage over their property. This restriction works hand-in-hand with other obligations targeted at reverse mortgages, such as a presumption of unsuitability if certain LTV ratios are breached.

Unfair contract terms (European Union)

Another mechanism that may be used to prohibit or limit certain terms and conditions include a prohibition on 'unfair' consumer contract terms – including consumer credit contracts. The EU Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts requires that member states ensure that contracts concluded with consumers do not contain unfair terms.

This approach is adopted by the United Kingdom, where a consumer is not bound by a standard term in a contract (that is not individually negotiated) with a seller or supplier if that term is unfair.[134] A standard term is unfair if it creates a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer, contrary to the requirement of good faith. However, it does not apply to the 'core' terms of a product, provided that they are in plain and intelligible language – such as terms setting the price of a product or defining the product.

Credit cards and unsecured credit (Singapore)

In Singapore, MAS has enhanced credit card and unsecured credit rules aimed at improving lending practices by financial institutions and enabling individuals to make better borrowing decisions.[135] Specific restrictions include:

- restrictions on further credit – financial institutions will not be allowed to grant further unsecured credit to individuals whose unsecured debts with those financial institutions are more than 60 days past due, until all past due amounts are paid. Other financial institutions will also not be allowed to grant new cards and unsecured credit facilities or increase credit limits on existing facilities. This is intended to help individuals who already have difficulties repaying their existing debt avoid getting into further debt problems; and

- aggregate limits on credit – financial institutions will not be allowed to grant further or new unsecured credit to individuals whose aggregate interest-bearing outstanding unsecured borrowings across all financial institutions exceed their annual income for three months or more. This includes not being able to charge further amounts to all existing unsecured cards and unsecured credit facilities. This will help individuals who have already accumulated high levels of debt, through

[134] Unfair Terms in Consumer Contracts Regulations 1999 (UK), reg 5.
[135] MAS, *Credit card and unsecured credit rules strengthened to help individuals avoid getting into debt problems*, press release, 11 September 2013. Note: All obligations are expected to be in place by 1 June 2015.

credit cards and unsecured credit, avoid accumulating further unsecured debt. The aggregate limit on what an individual can borrow through all their credit cards and unsecured lines aims to address concerns regarding individuals accumulating significant credit and unsecured borrowing debt.

MAS expects financial institutions to work actively with affected consumers to facilitate debt refinancing and restructuring in order to reduce their debt burdens.

Good practice observation 16: Direct regulatory interventions

Jurisdictions can prohibit certain products or product features to:

- target particular risks to a consumer, class of consumer or the economy;
- prevent over-indebtedness of a consumer or class of consumer; or
- address potentially detrimental or irresponsible lending practices in relation to particular products in the market.

Factors that are taken into account include: the type and level of vulnerability of a consumer or class of consumer; adverse financial effects on consumers; the type, complexity and risk of the product; distribution channels; and the nature of the credit provider or credit intermediary.

Supervisory and enforcement tools

Key points

A majority of jurisdictions have market entry requirements in place.

Generally, a person or entity is not permitted to provide credit products or services if they do not meet key criteria such as being 'fit and proper' or sufficiently trustworthy to provide credit products or services.

In some jurisdictions, a licensing or other market entry requirement only applies to certain types of credit providers that are prudentially regulated, such as banks. However, market conduct requirements may apply to non-bank lenders.

A majority of jurisdictions also have the capacity to exclude a person or entity from the market through their licensing regime or through a banning process. This process may include exclusion for irresponsible lending.

While a majority of jurisdictions enabled their primary regulator to monitor compliance, obtain breach reports and enforce responsible lending obligations:

- most jurisdictions do not enable their primary regulator to directly assist consumers or take action in relation to a specific instance or allegation of irresponsible lending; and
- a number of jurisdictions identified problems in enforcing responsible lending obligations, including insufficient enforcement powers, inadequate sanctions, lack of resourcing and lack of clarity in the responsible lending obligations themselves.

A significant majority of jurisdictions indicated that their regulatory frameworks permit a consumer to take some form of action against regulated institutions if those credit providers participate in irresponsible lending. However, there is a clear impetus for regulators to take a more proactive role to ensure compliance, facilitate consumer redress and exert market discipline.

Overview

The ability to appropriately supervise and enforce responsible lending obligations is an essential component to protecting consumers from irresponsible lending, particularly predatory practices.

Regulatory enforcement can be complex and can dictate the effectiveness of, and compliance with, responsible lending obligations.

The survey considered what tools and mechanisms jurisdictions had in place to monitor compliance, identify specific allegations or instances of irresponsible lending and to enforce responsible lending obligations.

Market entry requirements, such as registration or licensing of credit providers and credit intermediaries, are key features in most regulatory frameworks for consumer credit and provide a way of supervising their conduct.

Some jurisdictions noted that while they considered they had adequate laws in place to address the concerns experienced in their jurisdiction, there was a lack of adequate enforcement capacity, whether it be through lack of resources, difficulties in interpreting the law, or lack of supervisory capacity.

In the absence of sufficient regulatory powers and resources for a primary regulator to adequately enforce regulation or act on behalf of consumers, many jurisdictions still rely on consumers to enforce their rights directly.

However, even where a consumer has many rights in relation to responsible lending, a consumer's circumstances – such as financial capacity to proceed with legal action and their ability to understand their rights – may prevent them from taking advantage of them.

As a result, a strong supervisory and enforcement framework can assist protect consumers and enhance their rights.

Market entry requirements

The survey considered whether a jurisdiction had market entry requirements.

Market entry requirements can be an important feature in enforcing responsible lending obligations. These requirements can play an important role in:

- influencing market behaviour, such as by standardising and improving conduct in the market;
- preventing dishonest or incompetent credit providers and credit intermediaries from continuing to operate; and
- deterring irresponsible lending.

The survey found that a vast majority of jurisdictions have a form of licensing or registration system or other market entry requirements for credit providers or credit intermediaries, although this may only cover a subset of formal lenders operating in the market.

Figure 17: Percentage of jurisdictions with licensing or registration requirements for credit providers and credit intermediaries

Generally, it was found that the primary regulator in that jurisdiction is also the gatekeeper that administers a licensing or registration system for credit providers and/or credit intermediaries.

However, in certain jurisdictions there may be a different body responsible for licensing or registering credit intermediaries. For example, in France the ACPR licenses and authorises credit providers, but credit intermediaries must be registered and authorised by the Organisme pour le registre unique des intermédiaires en assurance, a national register of banking, insurance or financial intermediaries.

Good practice observation 17: Market entry requirements

Credit providers and credit intermediaries are subject to a strong licensing or authorisation regime with a range of investigative and administrative powers that can assist supervisors to monitor and supervise the compliance of their regulated population.

Application requirements

Scope of market entry requirements

The scope of the primary regulator's jurisdiction will affect who is required to be licensed or registered.

The type of regulatory authority (including associated mandates and powers) that oversees the licensing or registration will also have an effect on the nature of their supervisory role, regulatory priorities and enforcement activities.

In certain jurisdictions only credit providers that are expected to be prudentially regulated, such as banks, are required to be licensed or registered. As a result, other types of credit providers may be permitted to operate without the same level of regulatory oversight. For example, in Luxembourg only 'credit institutions' that provide a suite of activities, including deposit taking (i.e. banks), are licensed by the primary regulator.

Alternatively, some jurisdictions – such as Australia, the Netherlands and Ireland – apply a licensing or registration regime to all persons and entities who engage in consumer credit related activities (e.g. credit providers, assignees and mortgagees, beneficiaries of guarantees, lessors and credit intermediaries), with some small exceptions.

In certain jurisdictions, whether or not an entity is licensed or registered, or required to be licensed or registered, will determine whether certain responsible lending obligations will apply. This can have significant ramifications for the scope and application of responsible lending obligations.

Application criteria

Licensing or registration may involve an application by an entity to the primary regulator. Jurisdictions often impose a number of criteria to assess whether a credit provider or credit intermediary should be allowed to operate in the market.

A range of factors may be considered when deciding whether an applicant should be allowed to operate in the market, including whether the applicant (or a relevant executive or director of a body corporate) is fit and proper or trustworthy, including training requirements. For example, in Germany a licence can be refused if facts are known that suggest the applicant is not trustworthy and does not satisfy the necessary professional qualifications.[136] Other factors that may be taken into account are set out in Table 9.

Table 9: Factors that inform market entry requirements

Factors	Example
Whether the applicant (or a relevant executive or director of a body corporate) has previously been banned from providing credit or financial services or disqualified from managing corporations.	In Australia, a person cannot be licensed if a banning or disqualification order is in force against them. A person or body corporate may not be granted a licence if they are not considered 'fit and proper', taking into account any previous banning or disqualifications.[137]
Whether the applicant (or relevant executive or director or a body corporate) has been convicted of certain criminal activity.	In South Africa, a person may not be registered if in the last 10 years they have been convicted of, among other things, theft, fraud or forgery, a crime involving violence against another natural person, or sentenced to imprisonment without the option of a fine, unless the person has received a grant of amnesty or free pardon for the offence.[138]
Whether the responsible or relevant staff have adequate expertise and training.	In the Netherlands, an applicant for a credit licence must have staff with relevant expertise to undertake the business operations of their financial enterprise.[139]
Whether adequate financial, technological and human resources are in place to provide the financial services covered by the licence.	In France, a credit institution may not be licensed if, for instance, they do not have a suitable program of operations and technical and financial resources to undertake their activities. Moreover, before licensing a credit institution, the ACPR checks the institution's ability to fulfil its development objectives in a way that is compatible with the smooth functioning of the banking system and ensures sufficient protection to the consumer.[140]

[136] *Banking Act* (Germany), s32.
[137] National Credit Act (Australia), s37 and 40.
[138] *National Credit Act 2005* (South Africa), s46.
[139] *Financial Supervision Act* (Netherlands), s2:12 and 3:8.
[140] Monetary and Financial Code (France), article L511-10.

In some jurisdictions, additional licensing requirements may be required for prudential purposes, including the ability to meet capital adequacy and other prudential standards and expectations.

Good practice observation 18: Application criteria

Credit providers and credit intermediaries are not licensed or authorised unless they meet the application criteria, including whether they are 'fit and proper' or trustworthy, and have adequate training.

Certain jurisdictions may also have additional or separate licensing or registration obligations for certain credit providers if they are required to be prudentially regulated.

For example, in Australia, a credit provider who also undertakes authorised deposit-taking activities (i.e. a bank) must be licensed as an authorised deposit-taking institution with the Australian Prudential Regulation Authority for prudential regulation, and as a credit provider for the provision of consumer credit with ASIC in relation to their market conduct.

Alternatively, credit providers that are not prudentially regulated may be required to comply with separate market entry and supervision requirements. For example, the MC Directive requires EU member states to have appropriate measures in place for the adequate admission and supervision of 'non-credit institutions' (credit institutions that are not prudentially regulated under Regulation (EU) No. 575/2013 of the European Parliament and the Council (26 June 2013)) that provide credit agreements relating to residential immovable property.[141] This was put in place in order to ensure a level playing field between creditors and to promote financial stability.

There may also be separate admission and supervision requirements for credit intermediaries. For example, the MC Directive also mandates that EU member states establish an admission and supervision regime for credit intermediaries who facilitate mortgage credit on residential immovable property.[142]

Excluding 'bad apples'

The survey identified that a significant majority (90%) of jurisdictions that have a licensing or registration system in place also have a process to exclude a credit provider or credit intermediary from operating in the consumer credit market based on specified criteria ('bad apples'). This can operate as a penalty for breaches of the law, assist the primary regulator in monitoring and maintaining compliance, and act as a deterrent for bad conduct.

[141] MC Directive, article 35.
[142] MC Directive, article 29.

In most instances, this is enabled as part of primary regulators' general licensing or registration system as a revocation of credit providers' or credit intermediaries' licensing or registration authorisation, which prevents them from undertaking the authorised activity. However, it may also include a separate 'banning' mechanism for individuals.

Good practice observation 19: Mechanism to exclude 'bad apples'

Jurisdictions have a mechanism to exclude certain persons or entities from operating in the consumer credit market, due to their inability to meet relevant conduct requirements. This mechanism is generally administered by the primary regulator.

In Australia, ASIC can suspend or cancel a licence without a hearing if, among other things, the licensee becomes insolvent, is convicted of a serious fraud, or is incapable of managing their affairs because of physical or mental incapacity.[143]

ASIC can cancel or suspend a licence after offering a hearing if:

- the licensee has contravened its general conduct obligations. This includes the requirement to comply with the credit legislation (such as responsible lending obligations), have adequate arrangements and systems to ensure compliance with its obligations, and do all things necessary to ensure that they are acting honestly, efficiently and fairly;
- ASIC has reason to believe that the licensee is not a fit and proper person to engage in credit activities; or
- the application for the licence was false in a material way or materially misleading.[144]

ASIC can also directly ban an individual person from engaging in credit activities permanently or for a specified period of time due to, among other things, contravention with the law, including responsible lending, or where they believe that person is not a fit and proper person to engage in credit activities.[145] This ban can occur regardless of whether they are currently licensed or a representative of a licensee.

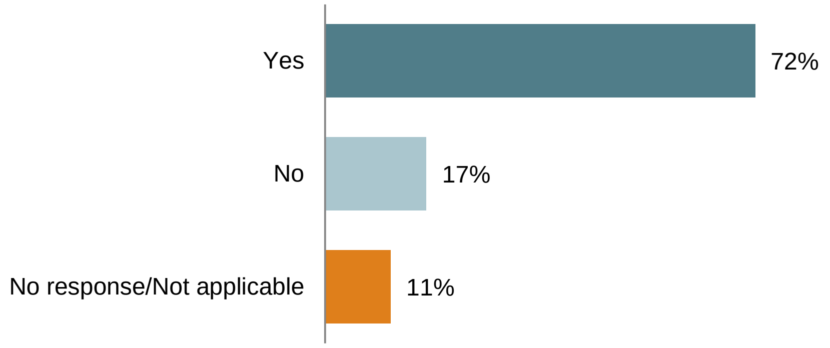
Reasons for exclusion

In some jurisdictions, failing to lend responsibly is a consideration on which a person or entity may be excluded from the market; this is often an indirect, rather than direct, grounds for exclusion. A credit provider or credit intermediary may be required to meet certain principles, standards or conduct requirements in order to maintain their licence or registration. This

[143] National Credit Act (Australia), s54.
[144] National Credit Act (Australia), s55.
[145] National Credit Act (Australia), s80.

may take into account any irresponsible lending. For example, it may be part of a general requirement to comply with the law, which would include any responsible lending obligations. A failure to meet these standards could result in a licence or registration being suspended or withdrawn.

Figure 18: Percentage of jurisdictions that can exclude a person or entity from the market because of irresponsible lending



Note: The percentages in this graph are based on responses from the 18 jurisdictions that have a licensing or registration system.

For example, the *Central Bank and Financial Services Authority of Ireland Act 2004* amended the *Central Bank Act 1942* and provides the Central Bank of Ireland with the power to administer sanctions to regulated financial service providers and persons concerned in the management of regulated financial service providers for prescribed contraventions, including breaches of the Consumer Protection Code. The sanctions include, among other things, the ability to issue a direction disqualifying a person from being concerned in the management of a regulated financial service provider.

In Japan, failing to lend responsibly may be a consideration on which a credit provider is excluded from the market. The Financial Services Agency has the power to rescind the registration of a credit provider, should the provider be judged no longer an appropriate person to continue acting as a credit provider.[146] A person or entity who continues to engage in money lending business (providing credit) in violation of an order – including an order of suspension of business – may be fined up to ¥10 million or imprisoned for up to five years.[147]

Good practice observation 20: Exclusion from market due to irresponsible lending

Irresponsible lending or the failure to meet responsible lending obligations is a basis on which a licence or other authorisation could be removed, or a person or entity excluded from providing credit products or services.

[146] *Money Lending Business Act* (Japan), article 24-6-5.
[147] *Money Lending Business Act* (Japan), article 47-2.

Process requirements

Responses to the survey highlighted that the process for excluding 'bad apples' from the marketplace is largely consistent across jurisdictions. This process is set out in Table 10.

Table 10: Process for excluding 'bad apples' from the marketplace

1 Investigation	Typically, the primary regulator or supervisor will obtain information and undertake an investigation into suspected contraventions of the regulatory framework. In Australia, ASIC is able to undertake an investigation into the conduct of a licensee and has broad ranging powers to obtain information from a licensee.[148]
2 Hearing	Once an examination has been undertaken, based on all evidence provided, and a view formed to withdraw the entity's licence to operate in the market, jurisdictions typically afford the entity under investigation a hearing or 'right of reply'. For example, in South Africa, if a credit provider is found to be extending credit recklessly, the NCR may approach the National Consumer Tribunal for the suspension or de-registration of the credit provider.[149]
3 Settlement	In some jurisdictions, the entity and primary regulator may reach a settlement agreement prior to the hearing or final decision, binding both the entity and regulator/supervisor to its terms concerning the management of the regulated financial service.
4 Decision	At the conclusion of the hearing or 'right of reply', a decision will be made as to whether the entity's licence to operate will be removed or whether they will be excluded from operating in the market. In some jurisdictions, there are different rules to govern the withdrawal of a licence where allegations of fraud are present.
5 Appeal	Often, jurisdictions who permit market exclusion allow a banned individual or excluded entity (regardless of the basis for banning) to appeal to a court or tribunal if they are unhappy with the decision made. In the Netherlands, a decision to ban or exclude an entity from operating in the market by the primary regulator (the Autoriteit Financiële Markten) may be appealed in the District Court of Rotterdam.[150]

Responding to irresponsible lending

The survey closely considered whether jurisdictions have the ability to respond to irresponsible lending and enforce responsible lending obligations.

A primary regulator that is able to monitor and enforce responsible lending obligations can facilitate a robust supervisory regime. A strong supervisory and enforcement capacity is not intended as an alternative to consumer redress, but rather to complement and promote consumer outcomes.

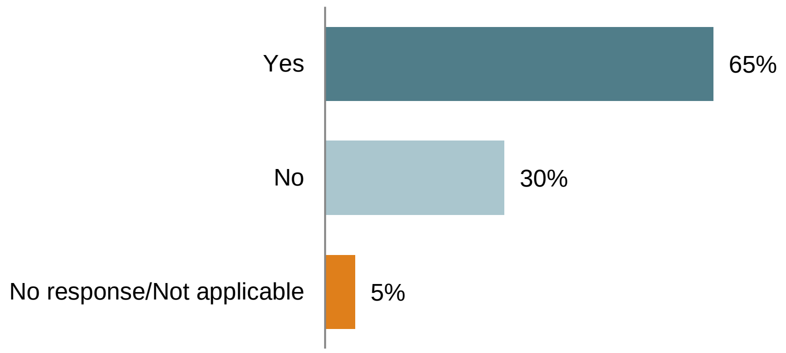
The primary regulator may be able to seek or facilitate outcomes for a consumer, or take administrative action and seek penalties for breaches of responsible lending obligations independently of consumer action. This is particularly important where consumer action may be difficult to undertake, due to the circumstances of the consumer or the legal environment.

[148] National Credit Act (Australia), s49, 50, 51.
[149] *National Credit Act 2005* (South Africa), s57.
[150] *Financial Supervision Act* (Netherlands), s1:110.

Further, a primary regulator is more likely to identify and address systemic issues that arise from a particular credit provider or credit intermediary, or are prevalent across the market. A regulatory framework that permits a primary regulator to monitor compliance and enforce obligations is also likely to exert market discipline.

A small majority of jurisdictions (65%) indicated that their regulatory frameworks have granted their primary regulators or supervisors the appropriate or required authority to respond to instances or allegations of irresponsible lending by the regulated population.

Figure 19: Percentage of regulators and supervisors who have powers to respond to irresponsible lending



In some jurisdictions, regulators may obtain compliance information and even take complaints from consumers, but cannot achieve outcomes for individual consumers in relation to specific instances or allegations of responsible lending.

However, compliance information and complaints will generally assist to inform broader supervisory activities, including compliance with licensing requirements.

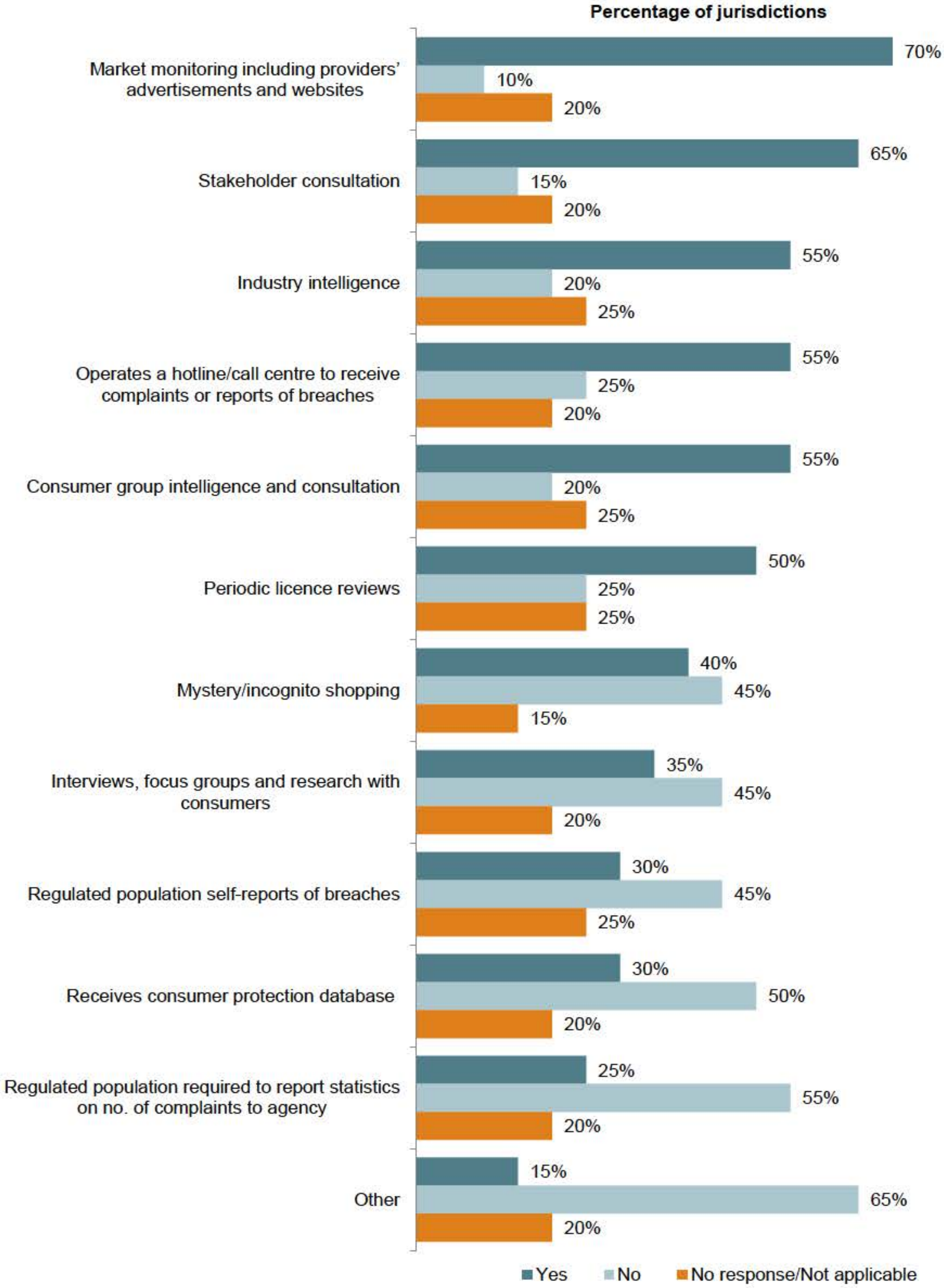
Where the primary regulator is singularly prudential in focus, there may be less capacity for the regulator or supervisor to achieve outcomes in relation to specific instances or allegations of irresponsible lending. However, they are generally able to use such information to undertake their supervisory activities.

Monitoring compliance

The survey investigated a number of ways a primary regulator could potentially monitor regulated entities' compliance with their responsible lending obligations or receive information about possible irresponsible lending.

Most jurisdictions indicated that the primary regulator has a number of mechanisms to assist with monitoring compliance with responsible lending obligations and/or receiving information about possible irresponsible lending as a part of their regulatory frameworks.

Figure 20: Mechanisms to assist regulators monitor compliance with responsible lending obligations



The primary regulators or supervisors in a significant majority of jurisdictions surveyed are able to:

- conduct market monitoring including providers' advertisements and websites (70%);
- collect and review industry intelligence (55%);
- collect and review consumer group intelligence (55%); and
- conduct stakeholder consultation (65%).

These approaches place a greater onus on the primary regulator to actively engage in the regulated population and the public. Other proactive approaches that primary regulators have adopted include:

- operating a hotline or call centre to receive complaints or reports of breaches (55%);
- conducting periodic licence reviews (50%); and
- conducting interviews, focus groups and research with consumers (35%).

Only some jurisdictions enable their primary regulators or supervisors to rely on tools and mechanisms that place a greater onus on the regulated population to monitor and report compliance. These reactive approaches include requiring the regulated population to report statistics on the number of complaints to the agency and require the regulated population to self-report breaches.

Some primary regulators may also receive consumer protection databases and conduct mystery or incognito shopping.

Good practice observation 21: Monitoring compliance

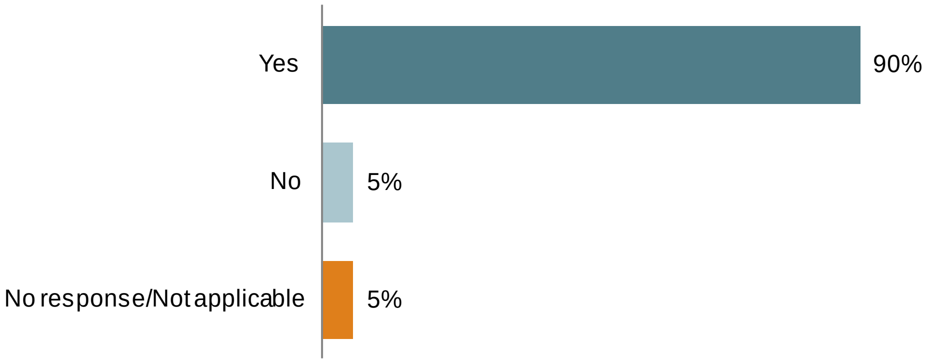
The primary regulator is permitted to use a range of tools and mechanisms to monitor compliance with responsible lending obligations, focused on consumer affordability.

In Ireland, the primary regulator, the Central Bank of Ireland, monitors compliance with consumer credit and responsible lending obligations. As part of its regulatory framework, the Central Bank of Ireland has an extensive suite of mechanisms to assist with monitoring compliance with responsible lending obligations or receiving information about specific instances of irresponsible lending. The Central Bank of Ireland may require the regulated population to report statistics on the number of complaints to the agency, require the regulated population to self-report breaches and conduct mystery or incognito shopping.

Complaints and breach reports

As distinct from powers to assist with and monitor compliance, the survey considered how the primary regulator or supervisor addressed individual complaints from consumers or breach reports from the regulated entity.

Figure 21: Jurisdictions that can receive complaints or breach reports



Most jurisdictions that permitted their primary regulator to obtain complaints or breach reports about irresponsible lending indicated that their primary regulator was able to take undertake a range of different responses to a complaint or breach report received.

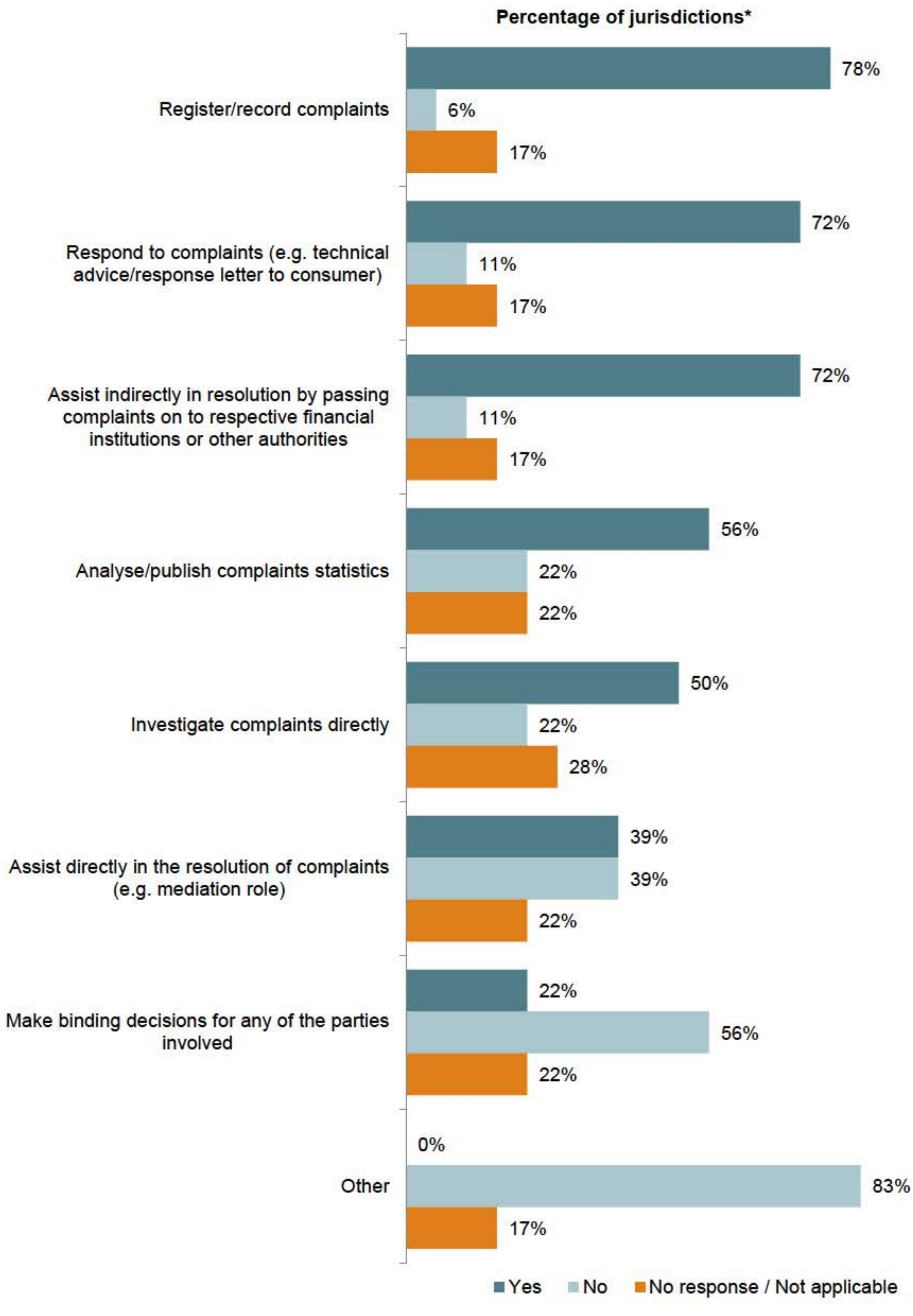
While the primary regulator was able to respond to a complaint in some form, not all could assist a consumer to resolve the complaint in relation to responsible lending, either directly or indirectly.

Certain jurisdictions also noted that even where their primary regulator was able to receive complaints, the complaint may only be used to meet supervisory objectives, such as identifying any breaches of their licensing requirements (such as ‘fit and proper’ requirements) or to assist with and monitor compliance, rather than address specific instances or allegations of irresponsible lending. It was less likely that a primary regulator could address an individual complaint of irresponsible lending directly if they had a prudential focus.

Of those who could obtain complaints or breach reports, a significant majority of jurisdictions enable their primary regulator or supervisor to respond to complaints and assist consumers in the following way:

- register or record complaints (78%);
- respond to complaints – for example, through the provision of technical advice and/or response letters to consumers advising them of their consumer rights (72%); and
- assist indirectly in the resolution of a complaint by passing complaints on to respective financial institutions or other authorities, such as an ombudsman (72%).

Figure 22: Actions primary regulators can take in response to complaints or breach reports



* These percentages are based on responses from the 18 jurisdictions that allow their primary regulator to collect complaints or breach reports.

Half were able to investigate a complaint by a consumer about a regulated entity directly (50%). A primary regulator was more likely to be able to investigate a complaint directly if their role was not singularly prudential in nature.

Some jurisdictions (39%) enabled their primary regulator to assist directly or indirectly in the resolution of a complaint between a regulated entity and a consumer, such as through adopting a mediation role. However, only a small minority of jurisdictions (22%) enabled the primary regulator to make binding decisions for the parties involved in the dispute.

Good practice observation 22: Addressing individual complaints

The primary regulator is able to obtain a complaint or breach report about a specific instance or allegation of irresponsible lending, including from a consumer. Where such a complaint or breach report is made, the primary regulator has the capacity to investigate and seek administrative or enforcement action in relation to the specific complaint or breach, and facilitate consumer redress where appropriate.

Enforcement of responsible lending obligations

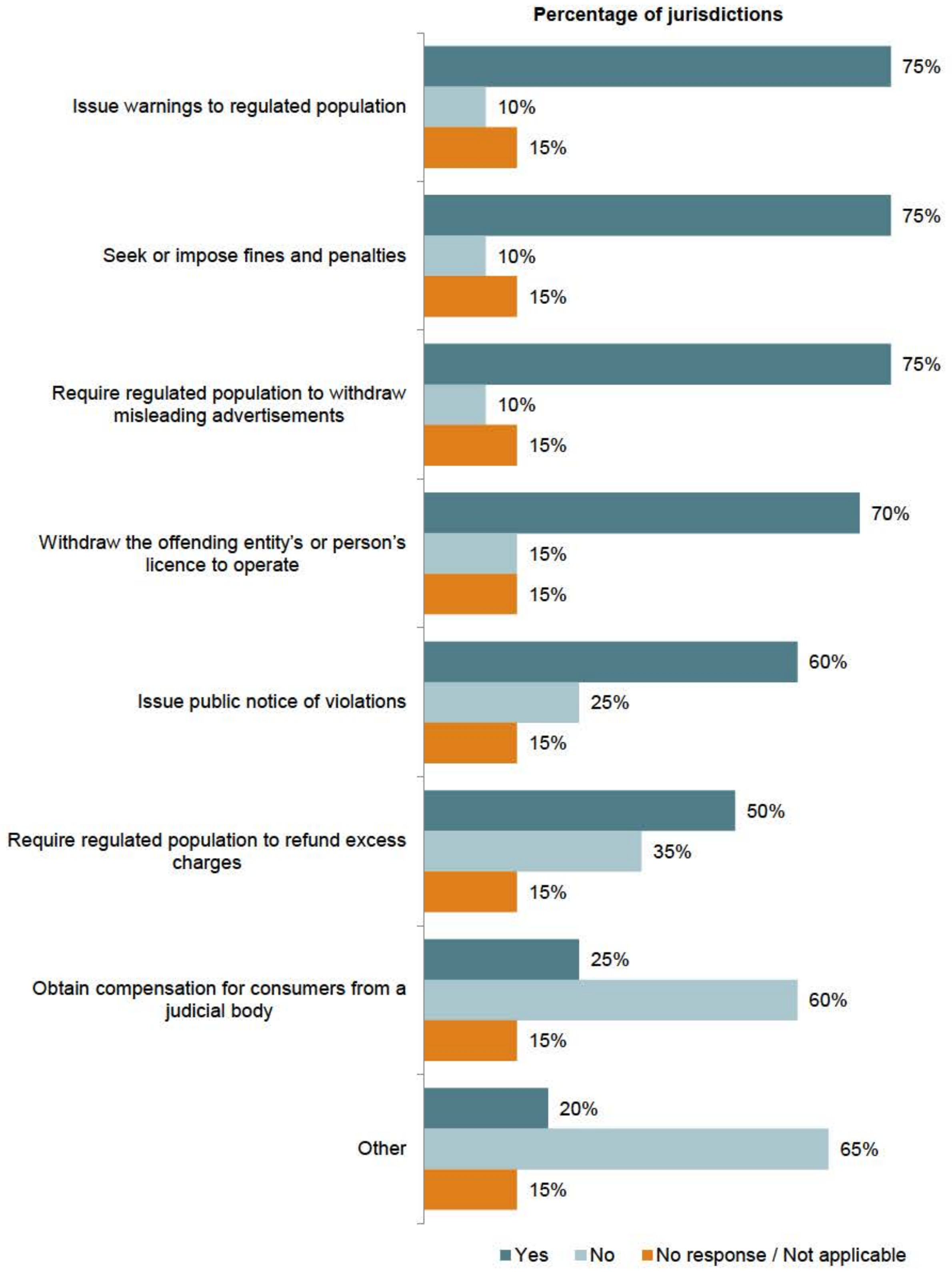
The ability of the primary regulator to appropriately enforce responsible lending obligations is essential to the maintenance of an effective regulatory framework for the provision of consumer credit, and the ability to protect consumers from irresponsible lending or predatory practices

As a result, the survey considered whether the primary regulator could take action, and what types of action they could take, to specifically enforce applicable responsible lending obligations within their jurisdiction.

The survey did not seek to measure the effectiveness of enforcement mechanisms due to difficulties in measuring and quantifying outcomes of enforcement action, such as reductions in consumer detriment or over-indebtedness flowing from regulatory action. Further, each jurisdiction will have different policy imperatives that may influence how enforcement action for responsible lending is undertaken.

Responses to the survey indicated that the primary regulator in most jurisdictions is able to undertake a range of actions in response to breaches of responsible lending obligations.

Figure 23: Actions regulators can take in response to breaches of responsible lending obligations



The primary regulator in a significant majority of jurisdictions is able to:

- issue warnings to the regulated population (75%);
- require regulated population to withdraw misleading advertisements (75%); and
- seek or impose fines and penalties (75%).

Further, the primary regulator in a small majority of jurisdictions is able to:

- require regulated population to refund excess charges (50%); and
- issue public notice of violations (60%).

As noted earlier, the primary regulator in a large majority of jurisdictions (70%) is able to withdraw the regulated entity or person's licence or authorisation to operate should a breach of responsible lending obligations occur.

Typically, others measures are considered to address irresponsible lending in first instances, such as a fine or penalty, before a banning is contemplated.

For example, the Central Bank of Ireland has broad powers to administer sanctions in response to prescribed contraventions (which would include breaches of the Consumer Protection Code or other relevant legislation) by regulated financial service providers and persons concerned in the management of regulated financial service providers.

The Central Bank of Ireland has a wide suite of regulatory sanctions which may be imposed,[151] including:

- cautions or reprimands;
- directions to refund or withhold all or part of money charged or paid, or to be charged or paid, for the provision of financial service by a financial service provider;
- direction to pay the Central Bank a monetary penalty – not exceeding the greater of €10 million or 10% of turnover when the financial service provider is a body corporate or an unincorporated body, and not exceeding €1 million when the financial service provider is a natural person or the person is concerned in the management of a financial service provider;
- disqualification of a person from being concerned in the management of a regulated financial service provider;
- revocation or suspension of an authorisation;

[151] See, generally, the *Central Bank (Supervision & Enforcement) Act 2013* (Ireland).

- direction to the regulated financial service provider to cease committing the contravention; and
- direction to pay the Central Bank all or part of its costs incurred in the investigation of the matter and the holding an inquiry.

Case study: Enforcement actions (South Africa)

The NCR has consistently taken a wide variety of formal actions in response to breaches of credit and responsible lending obligations by regulated entities. The NCR has extensive powers to conduct both on-site and off-site investigations of regulated entities, and can apply to the National Consumer Tribunal for the imposition of fines as well as the cancellation of licences.

For example, in October 2013 the NCR achieved a settlement agreement with African Bank settling two cases referred to the National Consumer Tribunal regarding reckless lending.

In terms of the settlement agreement, African Bank has agreed to pay an amount of R20 million into the National Revenue Fund, write off the loans, refund consumers, rescind judgements taken against consumers, remove judgement and adverse information listings from the credit records of consumers, and develop an active engagement process with the NCR.

In another enforcement outcome on 10 October 2013, the National Consumer Tribunal imposed a fine of R420,000 and cancelled the registration of Credit Care (Pty) Ltd operating in Orkney, Kanana and Klerksdorp in the North West province of South Africa. This followed an investigation conducted by the NCR into the business activities of Credit Care (Pty) Ltd.

The investigation of the NCR showed that Credit Care (Pty) Ltd granted credit to consumers who are under administration, induced consumers to sign the NuPay agreements and pay fees for the NuPay service, failed to provide consumers with pre-agreement statements and quotations before entering into credit agreements, improperly split loans in order to charge more interest and fees and required consumers to sign agreements which prohibit them from applying for debt counselling.

The National Consumer Tribunal ordered the cancellation of the credit provider with immediate effect and payment of an administrative fine of R420,000 within 30 days of receipt of the judgement by Credit Care (Pty) Ltd.[152]

Consumer rights

Consumer rights are an essential element to the enforcement of responsible lending requirements, as they enable consumers to take direct action against a credit provider or credit intermediary who breaches a relevant obligation. Further, they can enable consumers to obtain redress for irresponsible lending and the opportunity to receive just and equitable outcomes, particularly where they have experienced loss and damage from the unlawful conduct.

[152] *National Credit Regulator v Credit Care (Pty) Ltd* (NCT/7751/2013/57(1)) [2013] ZANCT 40 (10 October 2013).

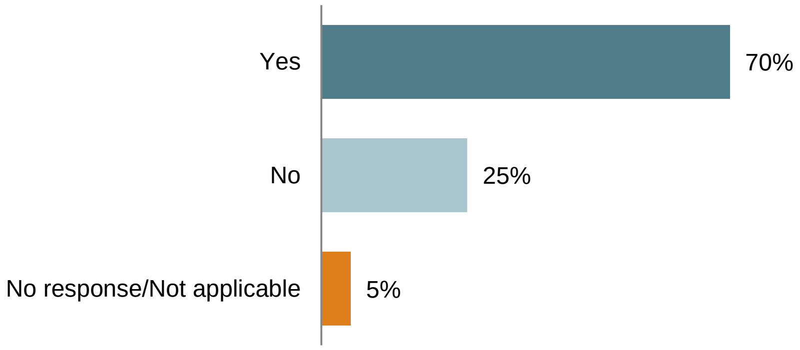
Private actions are also an important way of influencing and curbing market behaviour, as these actions can have a deterrence effect against breaches of the law.

The G20 Consumer Protection Principles expect that jurisdictions will ensure that consumers have access to adequate complaints handling and redress mechanisms that are affordable, independent, fair, accountable, timely and efficient.[153]

The survey considered whether a jurisdiction allows or enables a consumer to take action against regulated institutions if they are subject to irresponsible lending.

A significant majority of jurisdictions indicated that their regulatory frameworks permit a consumer to take some form of action against regulated institutions if they are subject to irresponsible lending.

Figure 24: Percentage of jurisdictions that allow a consumer to take action if they are subject to irresponsible lending



A jurisdiction's regulatory framework will influence how these rights and remedies are made available. A variety of avenues may be open to consumers to take action should they be subject to irresponsible lending by a regulated institution.

Key consumer rights include allowing a consumer to:

- complain directly to the credit provider or credit intermediary, taking advantage of their internal dispute resolution processes;
- seek redress through an external or alternative dispute resolution mechanism such as an ombudsman, mediation service or complaints handling body;
- complain directly to the primary regulator; and
- initiate court proceedings.

[153] G20 Consumer Protection Principles, Principle 9.

Some jurisdictions permit consumers to pursue a number of avenues of redress, although this may not be allowed simultaneously.

Internal dispute resolution

Credit providers and credit intermediaries may be required to have in place internal complaints or dispute resolution systems, and consumers are usually directed to raise the matter directly with the entity in the first instance.

Consumers may obtain a variety of outcomes through internal dispute resolution procedures. This may be broader than what is permissible than if they took court action, due to its informal nature. It may also result in an agreed variation to a credit contract or agreement.

For example, in the United Kingdom, the Financial Ombudsman Service directs consumers to complain to their financial institution before they will take an active role in a matter.

Some jurisdictions mandate that credit providers or credit intermediaries have in place suitable internal dispute resolution processes

In France, a credit provider or credit intermediary must advise the consumer in their credit contract about their complaints handling process. It must contain information about their redress procedures, complaint submission channels and complaint mediation.[154]

The World Bank considers it good practice for every financial institution to have a designated contact point with clear procedures for handling customer complaints, including complaints submitted verbally.[155]

Good practice observation 23: Consumer access to internal dispute resolution

Consumers are able to complain directly to the credit provider or credit intermediary if they consider that there has been a breach of a responsible lending obligation. Credit providers are required to have in place suitable processes to handle and mediate complaints, including the capacity to modify or amend a consumer credit contract or agreement as necessary.

External dispute resolution

Consumers may seek redress against a regulated institution for a breach of the responsible lending obligations through bodies that act as independent, non-judicial third parties that assist in dispute resolution, such as an ombudsman or complaints body.

[154] Le code de la consommation (France), article R311-5 I 7, referred to by article L311-18.
[155] World Bank, *Good practices for financial consumer protection*, June 2012, Common Good Practice 25, p. 9.

The World Bank considers it good practice for consumers to have access to an affordable, efficient, respected, professionally qualified and adequately resourced mechanism for dispute resolution, such as an independent financial ombudsman or an equivalent institution with effective enforcement capacity.[156]

Half of the jurisdictions surveyed (50%) indicated that they had an ombudsman or complaints body.

The survey identified that ombudsman and complaints body decision making and determinations are generally not made public. However, alternative dispute resolution often provides a cheaper and more streamlined option for consumers in comparison to judicial action. Consumer access to more cost-effective dispute resolution methods, such as an independent ombudsman or complaints body, can facilitate consumer actions.

Generally, a consumer is only expected to seek redress through an independent ombudsman or complaints body dispute resolution process once they have made an official complaint to the credit provider or credit intermediary and exhausted the internal dispute resolution process.

Typically, a consumer has the right to complain about a financial loss, material inconvenience or material distress that is attributable to an act or omission by, or on behalf of, the regulated institution – including irresponsible lending.

A complaints body or ombudsman may be set up through industry self-regulation or as a statutory body, and usually has an ability to hand down binding decisions on the credit provider or credit intermediary For example, in Norway the Finansklagenemnda (Financial Complaints Board) is an industry-based dispute resolution body designed to settle disputes between financial institutions and their customers. The Finansklagenemnda is under supervision of the Ministry of Legal Affairs, and the board has members from the industry and the government agency Forbrukerrådet (Consumer Council).[157]

In other jurisdictions, this is through a mandated legislative mechanism, such as in the United Kingdom, where the Financial Ombudsman Service is the statutory dispute-resolution body set up by the *Financial Services and Markets Act 2000* (UK).

Good practice observation 24: Consumer access to independent dispute resolution

Consumers are able to access an independent complaints body or ombudsman that can make binding decisions on a credit provider or credit intermediary in relation to a breach of a responsible lending obligation. However, this decision does not preclude the consumer from seeking legal action if they do not agree to the terms of the decision.

[156] World Bank, *Good practices for financial consumer protection*, June 2012, Common Good Practice 26, p. 9.
[157] *Financial Contracts Act* (Norway), s4.

Regulatory complaints

Many jurisdictions allow consumers to complain directly to the regulator. In Portugal, a consumer can present a complaint against credit institutions directly to Banco de Portugal.[158] A complaint can be presented via a written communication (e.g. letter, email, fax) or through an online form available at a dedicated website to banking customers developed by Banco de Portugal: www.clientebancario.bportugal.pt.

However, where other alternatives such as an ombudsman exist, a consumer may be encouraged to exhaust other avenues first. For example, in Saudi Arabia, consumers are able to complain to SAMA, but are required to complain to their bank first.

As noted previously, many regulators do not follow up individual complaints, but may use complaints to inform broader supervisory actions. However, some jurisdictions enable their primary regulator to seek civil or criminal penalties, including on behalf of the consumer in relation to a specific breach or allegation of a responsible lending provision. In Australia, ASIC can pursue administrative, civil and criminal penalties in relation to specific breaches or allegations of responsible lending. In certain situations, ASIC may also pursue civil actions on behalf of a consumer or class of consumer.

Good practice observation 25: Complaints mechanism for primary regulator

Consumers are able to complain directly to the primary regulator about a breach or allegation of a breach of the responsible lending obligations. The primary regulator has the capacity to consider specific breaches or allegations, seek suitable administrative or enforcement actions, and facilitate consumer redress where appropriate.

Judicial action

Many jurisdictions enable individual consumers to initiate formal judicial action against credit providers or credit intermediaries for breaches of responsible lending obligations.

In South Africa, a consumer is entitled to approach the courts and request that the specific credit agreement be declared reckless.[159] The court may set aside all or part of the consumer's rights and obligations under the credit agreement, or suspending the force and effect of that credit agreement. If the court considers the consumer over-indebted at the time of the court proceedings, the court may suspend the force and effect of that credit agreement until a date determined by the court and restructure the consumer's obligations under any other credit agreements.

[158] The Legal Framework of Credit Institutions and Financial Companies (Portugal), article 77.º-A.
[159] *National Credit Act 2005* (South Africa), s137(3).

In some instances, the regulator may escalate a matter to the courts on behalf of a consumer. For example, in South Africa, the NCR is empowered to investigate complaints and, where appropriate, refer matters to and appear in front of the National Consumer Tribunal.[160]

In most jurisdictions, court proceedings are public in nature and judgements or orders of the court will generally be made public.

Certain jurisdictions also allow consumers to initiate a mass claim or class action against a credit provider or credit intermediary for irresponsible lending where common allegations or concerns exist among a large or specified number of consumers – for example, in the Netherlands and South Africa.

Consumers may obtain a range of outcomes as a result of court action. Courts may set aside all or part of the consumer's obligations under a credit contract, or suspend the force and effect of the credit contract where the regulated institution has breached the law, including the terms and conditions of the contract. For example, in the United Kingdom, along with fines and injunctions, courts may in certain circumstances alter a credit agreement, reduce the amount a consumer is required to pay, order the credit provider to refund money to the consumer, or impose additional conditions on the credit provider.[161]

Good practice observation 26: Consumer access to legal redress

Consumers are able to take legal action against a credit provider or credit intermediary for a breach of the responsible lending obligations. Courts and tribunals are able to undertake a variety of actions to provide consumer redress where a breach is found – including setting aside all or part of the consumer's obligations under the credit contract or agreement, providing compensation, or imposing other conditions on the credit provider or credit intermediary.

Case study: Consumer rights (Australia)

In Australia, the National Credit Act codifies a number of consumer rights. Through a consumer's ability to initiate court action in respect of potential breaches of responsible lending provisions, a consumer is able to:

- seek compensation – a consumer may apply to the court for compensation in relation to any loss or damage suffered as a result of a contravention on the national credit regime, including irresponsible lending. A consumer may also seek compensation through the regulated institution's internal dispute resolution process or an external dispute resolution scheme;
- seek a contract variation – a consumer may apply to the regulated institution to have their credit contract varied on the grounds of financial hardship;

[160] *National Credit Act 2005* (South Africa), s5 and 137.
[161] *Consumer Credit Act 1974* (UK), s140A.

- have the contract reopened – a consumer (or the regulator on a consumer's behalf) may seek to have a contract reopened on the grounds that the contract (in part or as a whole) or a change to the contract is unjust; and
- have fees or interest rates altered – a consumer (or the regulator on a consumer's behalf) may seek to have fees or an interest rate reviewed on the grounds of unconscionability.

The National Credit Act provides for a three-tier dispute resolution process for consumer redress.

Initially, a consumer can access the licensee's internal dispute resolution process. If the consumer is not satisfied with the resolution offered during the internal dispute resolution process, the consumer may access the licensee's external dispute resolution scheme.

It is a licensing condition that regulated credit providers and credit intermediaries are members of an ASIC-approved external dispute resolution scheme. These schemes are a free, independent and informal alternative to the court process, the determinations of which are binding on licensees. However, the determinations are not binding on a consumer. As such, a consumer retains the right to seek redress through the court system.

Consumers can make a report to ASIC about a breach of a responsible lending obligation. ASIC assesses the seriousness of the alleged misconduct, particularly its market impact. ASIC will decide whether to pursue the misconduct based on the regulatory benefits, taking into account a range of factors including whether the misconduct is wide-spread or part of a growing trend, whether enforcement action will send an effective message to the market, and whether an alternative course of action may be more appropriate. If ASIC pursues a matter further, it can result in them taking legal action for a breach of the law, including seeking redress on behalf of a consumer or class of consumer.

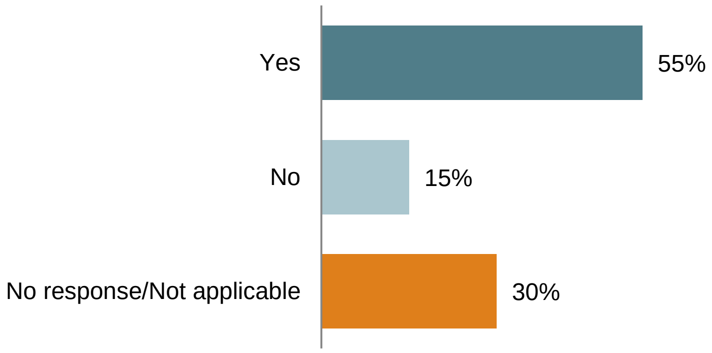
Challenges and reforms

Supervisory challenges

The survey also sought information from jurisdictions on any challenges that they may face in enforcing responsible lending obligations.

A majority of jurisdictions (55%) indicated that they had experienced, at a minimum, some difficulties in enforcing existing responsible lending obligations.

Figure 25: Percentage of jurisdictions that reported challenges in enforcing responsible lending obligations



Practical operation of the regulatory framework

A majority of jurisdictions who experienced challenges in enforcing responsible lending obligations noted that they have encountered some difficulties in the practical operation of the regulatory framework.

Some jurisdictions identified that their legislative frameworks did not support a responsible lending regime or the regulation of consumer credit.

Where a responsible lending regime did exist, a number of problems were identified including:

- unclear provisions that have left too much room for interpretation, making the responsible lending provisions difficult to apply and enforce – including the lack of specific benchmarks concerning the verification of creditworthiness of the consumer;
- difficulties with supervisory powers, including limitations within current breach reporting requirements and inadequate sanctions;
- insufficient resourcing of the primary regulator to take adequate action in relation to responsible lending; and
- an overlap and blind zones between the primary regulatory and other supervisory bodies.

Financial literacy

A number of jurisdictions noted that consumers may not have an adequate level of financial literacy, which complicated the enforcement of responsible lending provisions.

A lack of financial literacy may affect a consumer's knowledge of their rights and obligations. For example, consumers may not realise that a practice by a regulated institution was contrary to law, guidance or industry codes, or may not realise how they can complain (or may be reluctant to do so).

The survey identified that consumers who are the subject of irresponsible lending may not have the financial means to bring or initiate an application before the courts, even where they possess requisite financial literacy.

This also affects the ability of the primary regulator to appreciate or become aware of potential breaches of responsible lending obligations, making effective enforcement difficult.

Financial vulnerability of consumers

A small number of jurisdictions identified the financial vulnerability of consumers affected when enforcing the responsible lending obligations.

It was noted that a proportion of consumers are attempting to procure loans irrespective of whether they are capable of repaying them. In some instances, these consumers are failing to make full and accurate disclosure to the regulated institutions as to their incomes (including living expenses and discretionary earnings). It was recognised that this behaviour was likely to be a sign of financial vulnerability of the individual consumer.

In some instances, credit providers may have inadvertently provided credit irresponsibly due to inaccurate disclosure by consumers, and would not have provided credit if full and accurate disclosure had occurred. Alternatively, it may be difficult to enforce responsible lending obligations in this situation, where credit providers or credit intermediaries sought to take advantage of the consumer’s financial vulnerability due to the consumer’s lack of full or accurate disclosure.

Avoidance techniques

A proportion of jurisdictions also highlighted that some regulated entities were restructuring their business models or adopting reactive and creative interpretations of responsible lending legislation in order to avoid having to meet its requirements.

This can be through structuring the product so it does not fall within the relevant definitions of ‘consumer credit’ or specific responsible lending provisions, including interest rate caps. Avoidance activity has been identified as particularly prevalent in the payday lending or short-term lending market, where more vulnerable consumers may seek to obtain credit.

For example, in Australia, ASIC has encountered entities employing sham transactions (e.g. the sale and repurchase of diamonds) in order to avoid the application of consumer credit regulatory regime, including responsible lending – in particular, the fee and interest rate cap on small amount loans. The Netherlands also highlighted potential avoidance techniques by car companies who offer 0% loans by buying a car with short-term credits to avoid their obligations.

Regulatory reforms

A significant majority of jurisdictions (75%) have also highlighted that they were in the process of developing or implementing regulatory reforms to promote responsible lending. These reforms generally involve expanding the scope of responsible lending requirements or improving on existing legislation.

In some instances, this was a result of international or regional standards that are being implemented across the European Union. For example, a number of jurisdictions within the European Union cited the implementation of the MC Directive as a key reform being implemented. This includes additional rights for consumers, a requirement for credit providers to furnish consumers with a standardised information sheet and measures against misleading advertising. The MC Directive is designed to put an end to the excesses that precipitated the financial crisis, by providing additional protections for consumers, and promote standardised practices that will enable credit providers to access customers throughout the European Union.[162]

Canada is currently consulting on the development of a comprehensive financial consumer code, as part of a government commitment to better protect consumers of financial products and ensure they have the necessary tools to make responsible financial decisions. The financial consumer code is primarily a process by which the Canadian Government will modernise its current consumer protection framework. The review is directed at improving on the existing consumer protection framework and adapting it to the needs of current and future consumers in a rapidly evolving and innovative financial marketplace. The principle of responsible lending is being considered in the context of the review.[163]

[162] European Commission, *Statement by Commissioner Michel Barnier following agreement in trilogue on the Mortgages Directive* (MEMO/13/365), memo, 22 April 2013.
[163] Department of Finance (Canada), *Canada's Financial Consumer Protection Framework: Consultation paper*, webpage, 3 December 2013, www.fin.gc.ca/activty/consult/fcpf-cpcpsf-eng.asp.

Appendix: Primary regulators by jurisdiction

Jurisdiction	Primary regulator(s)
Australia	Australian Securities and Investments Commission (ASIC) Australian Prudential Regulation Authority
Belgium	Federal Public Service – Economy
Burundi	Bank of the Republic of Burundi
Canada	Financial Consumer Agency of Canada Office of the Superintendent of Financial Institutions (OSFI)
China	People's Bank of China China Banking Regulatory Commission
France	Autorité de Contrôle Prudentiel et de Résolution (ACPR)
European Union	N/A
Germany	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Ireland	The Central Bank of Ireland
Japan	Financial Services Agency
Luxembourg	Commission de Surveillance du Secteur Financier
Norway	Finanstilsynet
The Netherlands	Autoriteit Financiële Markten De Nederlandsche Bank
Portugal	Banco de Portugal
Saudi Arabia	Saudi Arabian Monetary Agency (SAMA)
Singapore	Monetary Authority of Singapore (MAS)
South Africa	National Credit Regulator (NCR)
Spain	Banco de España
United Kingdom	Financial Conduct Authority (FCA) Prudential Regulation Authority
Uganda	Bank of Uganda

Glossary

Term	Meaning
ACPR	Autorité de Contrôle Prudentiel et de Résolution (France)
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Germany)
CC Directive	Consumer Credit Directive 2008/48/EC (EU)
consumer credit	Credit provided to individual consumers for personal, domestic or household purposes, and not business purposes.
Consumer Credit Agreements Regulations	European Community (Consumer Credit Agreements) Regulations 2010 (Ireland)
Consumer Protection Code	Consumer Protection Code 2012 (Ireland)
credit intermediary	A person or entity who is a conduit between a credit provider and a consumer seeking to obtain credit (e.g. a broker or an adviser, or an agent of the credit provider or consumer)
credit provider	A person or entity that provides consumer credit. They can also be known as a 'creditor' or 'loan provider'
credit register	A credit register (otherwise known as a credit bureau) is a repository of credit relating information about a consumer. Information from the register or bureau may be known as a credit report
EBA	European Banking Authority
ESIS	European Standard Information Sheet
FCA	Financial Conduct Authority (UK)
FinCoNet	International Financial Consumer Protection Organisation
FSB	Financial Stability Board
FSB Residential Mortgage Principles	FSB, *Principles for sound residential mortgage underwriting practices*
G20	Group of 20
G20 Consumer Protection Principles	*G20 high-level principles on financial consumer protection*
IOSCO	International Organization of Securities Commissions
jurisdiction	A jurisdiction that responded to the survey
LTI ratio	Loan-to-income ratio

LTV ratio	Loan-to-value ratio
MAS	Monetary Authority of Singapore
MC Directive	Mortgage Credit Directive 2013 (EU)
National Credit Act	*National Consumer Credit Protection Act 2009* (Australia)
NCR	National Credit Regulator (South Africa)
OECD	Organisation for Economic Co-operation and Development
OSFI	Office of the Superintendent of Financial Institutions (Canada)
SAMA	Saudi Arabian Monetary Authority
SECCI form	Standard European Consumer Credit Information form
survey	FinCoNet Survey on Responsible Lending

FOI 4133
Document 2

Australian Securities
and Investments Commission

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24 April 2020

Ms Anna Bligh AC
Chief Executive Officer
Australian Banking Association

By email: s 47F

Dear Ms Bligh

Regulatory approach to lending during Coronavirus (COVID-19) pandemic

I refer to your letter dated 9 April 2020, which sets out a number of matters on which the Australian Banking Association (ABA) seeks guidance from the Australian Securities and Investments Commission (ASIC), as well as requests for relief under s203A of the National Credit Code.

I will respond to each of these matters but at the outset express ASIC's support for the members of the ABA taking a flexible and facilitative approach to customers during this challenging time. We encourage ABA members to continue to work closely with their customers to develop options that provide both short-term assistance to customers experiencing difficulty due to COVID-19 and also longer-term viability post COVID-19.

Application of responsible lending obligations

As you have noted in your letter, in the current circumstances there is a need to support how customers manage their commitments on existing credit products as well as to ensure the continued flow of credit in the economy. We agree with your comment that the desire to provide credit must be balanced with taking the appropriate steps to ensure decisions made today will not have an adverse impact on customers over the longer term.

Responsible lending obligations are not a barrier to agreeing contract changes in response to hardship situations

The ABA, and some individual lenders, have described a number of different options for reducing short-term repayment obligations of consumers experiencing financial hardship, including changing the repayment terms from principal and interest (P&I) to interest only (IO), 6 month repayment deferrals with capitalisation of interest, and extending the term of the loan. We confirm our view that changes of this kind can typically be achieved through variations to the existing contract, as opposed to entry into a new contract on different terms. As you are aware, the responsible lending obligations only apply before a contract is entered into or a credit limit under an existing contract is increased. Accordingly, we consider these obligations will not be triggered for variations of the kind described.

While capitalisation of interest may result in an increase to the balance of a credit contract, that does not necessarily involve an increase to the credit limit under the contract. We note that under s3(2) of the National Credit Code interest charges under the contract are taken not to be a part of the 'amount of credit' and so are not included as part of the maximum amount of credit that is provided under the contract.

One option referred to for home loan customers includes debt consolidation to reduce total repayments across a wider credit portfolio. While this may be an appropriate strategy for some borrowers, this kind of response is more likely to involve an increase to the credit limit under the home loan and may significantly increase the consumer's exposure to loss of their home. If there is an increase in the credit limit under the home loan as a result of the debt consolidation, the responsible lending obligations will apply.

New lending

We note that the government has made temporary changes to the test for when responsible lending will apply. That is, responsible lending obligations do not apply in circumstances where credit is provided to existing customers who operate a small business and a part of the credit provided will be used for the purposes of that business.

For those loans where responsible lending will continue to apply, we consider there remains sufficient flexibility for lenders to take a range of actions to reduce the difficulty likely to be experienced by significant numbers of consumers. We are conscious of the importance of responsible lending obligations in providing key protections so that short-term assistance does not become a longer-term, unmanageable burden for consumers. Managing these objectives (including flexibility, providing assistance and reducing the risk of harm) is likely to require a nuanced approach in many circumstances and we welcome the opportunity to further discuss with you and members various options as this situation evolves.

You have sought clarification of whether it is appropriate for lenders making unsuitability assessments to make certain assumptions, including:

(a) that income of persons adversely impacted by COVID-19 economic conditions are likely to regain previous income within a reasonable period after restrictions are removed;

(b) any deterioration in asset values is unlikely to be permanent; and

(c) that the consumer's requirements and objectives relating to their COVID-19 impacted financial position is likely to be a prominent consideration.

In general, we note that the effect of the current economic conditions on asset values may be temporary, and it may be reasonable in some circumstances to assume that asset values will improve in the longer term. We note that assets are not generally the primary basis for an assessment of a consumer's capacity to meet loan repayments (other than where those assets contribute to income), and that assumptions about the value of assets are less likely to result in a failure to identify that a loan is unsuitable. However, this will depend on whether, and in what circumstances, it is anticipated assets will be used to meet repayment obligations. We recognise that the value of assets may be a more general commercial consideration for lenders in relation to their own credit risk modelling and policy application.

We agree that the consumer's requirements and objectives during this period are likely to be affected by the current situation. Our revised (*December 2019*) guidance about requirements and objectives on RG 209 focusses on communicating with the consumer to understand the consumer's requirements and objectives, including by identifying their priorities, and so enabling an assessment of whether the credit contract meets those requirements and objectives. There is no impediment to high priority being given to meeting a shorter-term funding need. The guidance recognises that in some circumstances consumers may be prepared to make significant short term changes to their lifestyles that they would not ordinarily be willing to make. However, the consumer's longer-term requirements and objectives should also be considered, with regard to the length of the loan to be entered.

We note that the consumer's income is a key consideration affecting capacity to meet financial obligations. The position outlined by the ABA involves making assumptions about a consumer's income (that it will return to pre-COVID-19 levels) without any regard to the consumer's actual circumstances which may indicate that such a recovery is more likely or less likely. While we agree that ensuring the ongoing flow of affordable credit is important, it is also important that provision of new credit is not based upon assumed changes where these are unlikely to be met, and which will result in unmanageable debt burdens for consumers.

There may be a range of circumstances that lenders can consider when assessing the consumer's current and likely future capacity to meet repayment obligations under the terms of the loan – including:

- availability of immediate repayment deferral periods for managing current obligations;

- eligibility for Government support (e.g. through the JobSeeker or JobKeeper programs);
- whether the consumer's employer has registered for the JobKeeper subsidy – this may, for example, provide an indication of ability and intention to reemploy the consumer (conversely, not accessing the subsidy may be an indication that the consumer will not be reemployed, or the business itself will not continue);
- if the consumer's employer is not accessing JobKeeper subsidies because of its size/nature (e.g. local council, university, larger business or insufficiently affected turnover), whether the employer is able to provide any assurance about prospects of reemployment.

There may be different individual circumstances that will affect the lender's consideration of what the consumer's likely financial position will be, such as previous employment history, qualifications and the industry of ordinary employment. We consider lenders should seek to form a justifiable view of what is likely, based on their understanding of the circumstances affecting the particular consumer.

If a lender does rely on assumed changes to the consumer's financial position, consideration should be given to how the lender will respond if the assumed recovery does not in fact occur or only over an elongated period. For example, the lender may need to consider whether it would be prepared to provide hardship arrangements for an additional period to give the consumer a further opportunity to recover their financial situation.

Application of the obligation to act efficiently, honestly and fairly

We agree that application of the general obligations set out in s47 of the *National Consumer Credit Protection Act 2009* (NCCP Act), including the obligation to act in an efficient, honest and fair way, may be affected by the circumstances in which a licensee is operating that are beyond its control, including the broader economic conditions. For example, in the current circumstances and given the volume of hardship applications being made to the banks, it will not necessarily be unfair to take longer in processing some of the applications for hardship than would otherwise be the case.

This obligation should not be regarded as a barrier to offering consumers appropriate hardship arrangements. Hardship arrangements ordinarily do not reduce the amount ultimately payable by the consumer and may result in a larger amount being paid for credit in the longer term. On its own, this increased cost would not suggest a failure by the lender to act fairly.

We consider that fairness to the consumer may involve advising the consumer of different available options that may assist and the longer-term implications for the consumer, to enable an informed decision to be made. Lenders should determine the best way to achieve this kind of fair treatment having regard to the circumstances. It may be unfair to encourage the consumer to undertake a particular contract change that reduces risk exposure for the lender (such as through debt consolidation) but ignores longer term priorities for the consumer.

Disrupted property settlements

We have previously confirmed the industry view that the responsible lending obligations do not apply to require a further unsuitability assessment to be completed after entry into a credit contract, even if there are significant changes to the financial situation that was considered before entry into the contract. Accordingly, the responsible lending obligations do not raise a barrier for proceeding with 'in-flight' property transactions where there is a change of circumstances between entry into the loan and drawdown of funds on settlement of the property transaction.

The lender may elect to terminate the contract before providing any credit if the credit contract allows the lender to take that path. This is a commercial decision for the lender to make in accordance with the terms of its contract.

We expect the obligation to act in a way that is efficient, honest and fair may affect how the lender chooses to exercise their discretion to terminate the contract, rather than funding it. For example, the lender may consider it appropriate to discuss the changed circumstances with the consumer, determine what flow on effects the decision will have in relation to the property transaction (e.g. loss of deposit, loss of home, potential contractual liability for the consumer) and whether it is fair in all the circumstances to terminate the contract.

We understand that some lenders may be concerned that they would be at risk of breaching the obligation to act efficiently, honestly and fairly if they proceed to fund a home loan in these circumstances, and immediately offer hardship arrangements such as repayment deferrals.

In the current circumstances we would not consider that proceeding to fund the loan and offer immediate hardship arrangements would be an indication of a failure to act efficiently, honestly and fairly.

Approach to procedural requirements under the Code for making contract changes

The ABA has requested that ASIC give class relief under s203A of the National Credit Code that gives exemptions from or modifications to a number of provisions that affect the process of changing contract terms, providing written documents to consumers and executing contracts and guarantees.

ASIC's powers under s203A of the National Credit Code are more limited than its ordinary relief powers under other parts of the NCCP Act and the Corporations Act. These powers are limited to a power to exempt a person or contract from specified provisions of the Code. ASIC does not have a power to modify provisions in the Code.

Electronic transactions

In relation to electronic transactions, the ABA has sought an exemption from s187 of the National Credit Code. That provision provides that specified kinds of contracts may be made in accordance with the *Electronic Transactions Act 1999* (ET Act), and that requirements in the Code to give or record information in writing may be met in accordance with the ET Act.

An exemption from this provision would not be effective to disapply the procedural requirements in the ET Act and Regulations. This is because:

- An exemption can only switch off a requirement or prohibition. As s187 does not impose any requirements on lenders (but rather permits use of electronic communication), it is not possible to give an exemption. If this provision were disapplied, it would instead have the effect that lenders do not have the option of providing written documents in an electronic form.

- The requirements to be met for using electronic communications are contained in the ET Act and Regulations, in relation to which ASIC does not have any relief powers.

While we note the ABA's reference to relief given under the Corporations Act to enable a 'publish and notify' approach (using modification powers under that Act), we are unable to take similar action in relation to the Code provisions as ASIC does not have a modification power under the Code.

Given these restrictions on our powers, we do not consider that ASIC can provide relief from these procedural matters. However, we acknowledge that strict compliance may be difficult due to the number of hardship requests to be managed and the widespread social distancing measures. ASIC will take a facilitative approach to support lenders to make their best endeavours to comply with the procedural requirements (i.e. form of documents and timeframe for giving documents) and will not take action in relation to strict failures to comply where lenders have made reasonable efforts to comply in the circumstances. We note that this position does not affect the legal rights of debtors and guarantors under provision of the Code, or the legal validity of documents executed in a way that is contrary to the ET Act and Regulations.

Approach to substantive requirements under the Code

The ABA has requested that ASIC give class relief under s203A of the National Credit Code that gives exemptions from:

- the guarantor notice and acceptance requirements in s61 of the Code, where liabilities are increased due to repayment deferral of up to 182 days.
- the requirements in s71 and s73 of the Code to give written notice with particulars of changes to a credit contract resulting from a repayment deferral of up to 182 days.

Guarantor notice and acceptance requirements

The ABA appears to be seeking relief on the basis that this requirement creates a barrier to the offer of repayment deferrals. We do not agree that the provision of appropriate hardship arrangements is dependent upon the guarantee being extended. This provision restricts circumstances in which a guarantor's liabilities can be increased as a result of a change to the credit contracts. It does not require that the guarantor's consent be obtained before a contract change is made.

An exemption from this requirement would involve a transfer of additional credit risk from the lender to the guarantor without the guarantor's knowledge or consent. We note that guarantors are likely to be individuals who may also be in financial positions that are impacted by COVID-19. Removal of their right to refuse to accept an extension to their guarantee to provide further security to the lender, would involve a risk of significant consumer harm.

However, as noted above, we consider that it is appropriate to take a facilitative approach to use of electronic communications if the lender chooses to seek an extension to the guarantee.

Written notice documenting contract changes

The ABA seeks an extension of existing relief (in s71(2) of the Code and ASIC class order [CO 14-41]) to cover 182-day repayment deferrals. The existing relief removes the requirement for written notice documenting contract changes due to 'simple arrangements', being a change that defers or otherwise reduces the obligations of a debtor for a period not exceeding 90 days.

As these deferrals are proposed as a response to hardship situations, it is not clear why such changes would be made by agreement under s71 of the Code, rather than the prescribed framework for hardship notices. We note that under s72(1) of the Code a hardship notice is given if 'a debtor considers that he or she *is or will be* unable to meet his or her obligations under a credit contract' and gives notice of that inability (*emphasis added*).

We consider it would be inappropriate to give an exemption from the requirements in either s71 or s73 of the Code. The provision of a written description of the changes made is important to enable consumers to understand the effect of the change on their obligations. For example, so they are aware of what their changed repayment obligations are, when those obligations commence, frequency of repayments, changes that will be made to their credit balance through capitalisation of interest, and changes that will be made to the term of their loan. Relief would involve a real risk of consumers not being properly informed about the obligations with which they must comply, once the deferral period ends.

However, as noted above, we consider that it is appropriate to take a facilitative approach to the timeframes for complying with these requirements and use of electronic communications.

In addition to the views outlined in this letter, ASIC is publishing guidance on our website to address the main questions raised about compliance in the current circumstances. This guidance will highlight matters we consider are particularly important when dealing with hardship requests at this time.

Thank you again for your proactive approach to addressing challenges likely to be faced by your members and their customers in the current environment. We are happy to meet to discuss our comments or any other proposed approaches you may be considering.

If so, my executive assistance s 22 @asic.gov.au) will be able to assist with coordinating diaries.

Yours sincerely

Sean Hughes
Commissioner

FOI 4133
Document 3

5/05/2020

Issues raised on the regulatory approach to lending during COVID-19

Issue	ASIC position*
Australian Banking Association	
How should lenders apply RLOs in COVID-19 impacted circumstances?	s 47E(d)
Is it reasonable for lenders to consider: – Customer is likely to regain their previous income within a reasonable period after restrictions are removed and conditions ease.	

Is it reasonable for lenders to consider: – Any deterioration in asset values during the pandemic are unlikely to be permanent.	s 47E(d) [redacted]
Is it reasonable for lenders to consider: – A borrower's requirements and objectives relating to their COVID-19 impacted financial position are likely to be a prominent consideration in meeting RLOs in amending existing credit or extending new credit	
Will the below forms of assistance trigger RLO requirements or breach other NCCP Act requirements such as the obligation to act efficiently, honestly and fairly under s47(1)(a) of the Act or under s912A(1)(a) of the Corporations Act? – Deferral of home loan repayments, including capitalising interest – Changing P&I loan to IO during COVID – Refinancing a customer with a reset loan term – Undertaking an overall approach of debt consolidation across consumer's credit portfolio	

	s 47E(d)
How to proceed with property settlements if there is a deterioration in the borrower's financial situation post loan approval, in particular job loss.	
NCC Variation Rules Request that ASIC issues a legislative instrument under NCC s.203A(3) exempting: – NCC s61(1) requires a guarantor notice and acceptance process for changes to the credit contract and NCC s61(2)(d) provides this is not required for 90-days deferrals. → Extend to also exempt 182-day deferrals (to cover the 6-month loan deferrals) – NCC s71 requires that on any agreed change to a credit contract, the credit provider must give written notice of the change within 30 days. ASIC Class	

Order CO14/41 currently exempts 90-day deferrals. → Extend 30-day notice period to 90 days to deal with large increase in agreed changes caused by COVID-19 → No written notice needs to be given for 182-day deferrals → No written notice needs to be given for any other change made pursuant to a credit provider's public announced policy of relief for its customers.	s 47E(d)
NCC Hardship Rules Request ASIC issue a legislative instrument under NCC s.203A(3) to extend period to 90 days: – NCC s72(2) allows a credit provider to request more info from the debtor response to a hardship request. Both parties must respond within 21 days of each other. – NCC s72(5) sets out the time period with which the hardship request must be dealt. – NCC s73 requires that on any change to a credit contract under hardship process, the credit provider must give	

written notice of change within 30 days.	s 47E(d)
Banking Code of Practice (BCoP) Seeks expedited approval from ASIC under s1101A of the Corporations Act to amend BCoP to address ambiguity on the scope of the diligent and prudent banker obligation in emergency scenarios.	

s 47E(d)