Issue 3 | December 2015

CONTENTS

Welcome to the FinCoNet Newsletter

Welcome to the third 2015 edition of the FinCoNet newsletter.

The FinCoNet Annual General Meeting was held on 14-15 October 2015 in Cape Town, South Africa and served to highlight risks to consumers from inappropriate sales incentives and increased use of online and mobile payments.

The documentation and presentations used at the FinCoNet AGM are available for download on the FinCoNet website.

A FinCoNet Communiqué was released following the AGM, the full text of which can be found at the end of this Newsletter.

In Focus

In Focus…

New FinCoNet Member – The Central Bank of Brazil (Banco Central do Brasil - BCB)

The Brazilian bank regulator and supervisor officially joined the FinCoNet in 2015, after a looser engagement through exchanges of information and participation in meetings since 2012.

In Brazil, consumer protection regulation is enforced by several authorities:

The General Consumer Protection Law is enforced by the National System for Consumer Protection, which is coordinated by the National Consumer Secretariat (Senacon). Its scope of application includes financial products and services;

Financial market authorities issue specific regulations regarding their respective area of competence:

- *BCB for banking activities and non-banking financial institutions activities concerning, in the latter case, extension of loans, payments schemes and foreign exchange operations;*
- *CVM (Securities and Exchange Commission) for capital market activities and products;*
- *SUSEP (Private Insurance Superintendence) for insurance activities and products, as well as for open private pension funds;*
- *PREVIC (National Complementary Pension Superintendence) for closed pension funds.*

A number of departments within the BCB deal with consumer protection issues:

- *Financial System Regulation Department, responsible for drafting regulatory proposals to be submitted to the board of directors and to the National Monetary Council;*
- *Conduct Supervision Department, in charge of assessing financial institutions' conduct and enforcing the respective regulation;*
- *Institutional Relations Department, responsible for taking consumers complaints and overseeing their handling by financial institutions.*
- *Financial Education Department, which develops financial inclusion and financial education policies.*

Main topics related to the promotion of responsible, adequate and fair business conducts from financial and payment institutions, e.g.: ombudsman structure; transparency, disclosure and suitability requirements; products and services fees; credit and wage portability; and banking agents.

The Conduct Supervision Department was created in 2012 in order to establish a hybrid approach – two units dedicated to prudential supervision and one for conduct supervision, each of them featured with same level of institutional relevance and support.

In terms of conduct supervision, there are two current priorities related to financial institutions' corporate governance: (i) the ability to deal with consumer's complaints, not only solving individual situations, but finding and addressing root causes; and (ii) incentives, especially compensation structures and accountability for misconduct.

The representatives of the BCB at FinCoNet are the Head of Conduct Supervision Department, Andréia Lais de Melo Silva Vargas, and the Head of Financial System Regulation Department, Silvia Marques de Brito e Silva.

For more information, please visit the webpage of the Central Bank of Brazil www.bcb.gov.br.

Current Issues Forum

The IAIS adopts an Issues Paper on Conduct of Business in Inclusive Insurance.

Contributor: Peter van den Broeke, IAIS Secretariat

The International Association of Insurance Supervisors (IAIS) - the standard setter for the insurance sector – has adopted an Issues Paper on Conduct of Business in Inclusive Insurance. This paper deals with the fair treatment of customers in inclusive insurance markets. The term inclusive insurance refers to all insurance products aimed at the excluded or underserved market. The IAIS wants to contribute to creating greater access to insurance for these excluded and underserved markets by providing guidance to insurance supervisors. Proper guidance can overcome unnecessary barriers for market development by disproportionate regulation and supervision. The IAIS recognizes that in inclusive insurance the fair treatment of customers is very important. The confidence in insurance in these markets hangs in a fragile balance. Any unfair treatment might tip the scale and make people turn away from insurance.

The paper that was adopted on 11 November 2015, gives an overview of the issues in respect of conduct of business in inclusive insurance markets that affect the extent to which customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. Recognizing the increased vulnerability of the typical customer in this market segment this paper intends to promote the understanding of these particular issues among regulators and supervisors and other organizations and parties with an interest in this area.

For that purpose the paper starts with a description of the features of the inclusive insurance market to get an appreciation of how the concept of fair treatment of the customer plays out in an inclusive insurance market. This includes the profile of the typical inclusive insurance customer, the country-specific legal framework and roles of customer organizations and insurance associations / authorities, the business and distribution models that are typical for inclusive insurance markets and the digital means of interaction between insurer and policyholder that often characterize inclusive insurance business and distribution models. The paper subsequently discusses the various elements of the inclusive insurance life cycle and presents the issues that have been identified from a conduct of business perspective. The term “life cycle” refers to the specific elements of an insurance product from its development as a product, its distribution, disclosure of information, customer acceptance, premium collection, and claims settlement to the handling of complaints by the insurer. The paper also includes observed responses by supervisors to the identified issues.

As the paper identifies some of the major issues in conduct of business in the inclusive insurance area it is expected that it will prompt further initiatives to address these issues. Possible initiatives are the development of specific guidance on the use of digital technology and on product approval in inclusive insurance.

The paper will be available on the IAIS website (www.IAISweb.org) under "Supervisory Material".

For further information please contact Peter van den Broeke at the IAIS Secretariat (peter.vandenbroeke@bis.org)

Preserving consumers from illicit financial flows – Supervisory challenges

Contributor: Anne-Françoise Lefèvre, Policy Analyst at FATF Secretariat, on secondment at the Financial Affairs Division of OECD working on financial consumer protection issues. - The opinions and arguments employed in this article do not necessarily reflect the official views of FATF Secretariat and member jurisdictions.

The anti-money laundering/combating the financing of terrorism (AML/CFT) risk mitigation process includes the application of preventive measures to banking customers. Preventing banks from being used as a channel for financial crime, in particular money laundering and terrorist financing, is an important area for the protection of financial markets from abuses and illicit financial flows. This could threaten the soundness of some firms, and potentially the stability and the sustainability of markets, and could also directly affect individual consumers, with potential impacts on the integrity of their transactions, the availability of their assets or the protection of their deposits. This is an area which consequently requires close supervisory oversight.

Many areas of contact exist between financial consumer protection requirements and AML/CFT requirements, which might require coordination between relevant supervisors, for example: do financial consumer protection and financial integrity requirements always pursue consistent and mutually reinforcing objectives, or can they be competing? Are there circumstances when one objective should/could supersede the other? Can consumers' rights stop when financial integrity of markets is at stake? The debate is exacerbated in the current context, where financial institutions operate in a post-financial crisis environment, face heightened regulatory/supervisory scrutiny and enforcement activity, with terrorist threat at a high point in a number of countries.

The AML/CFT international framework

AML/CFT international standards (known as "Recommendations") are defined by the Financial Action Task Force (FATF). FATF is an inter-governmental body established in 1989 and comprises 34 member jurisdictions and 2 regional associations. FATF has a global outreach through collaboration with 8 regional bodies ("FATF-Style Regional Bodies", FSRBs)[1].

The FATF Recommendations, revised in 2012, set standards for national AML/CFT regulation and supervision, covering a broad range of financial service providers, as well as certain non-financial businesses and professions at risk of exploitation for financial crime (e.g. casinos, notaries, dealers in precious metals). They also call for countries to adopt a range of criminal law enforcement measures, to establish financial intelligence units to receive, analyse, and disseminate suspicious transaction reports, to ensure the transparency of legal persons and arrangements and to facilitate international cooperation between competent authorities.

AML/CFT measures have to be implemented following a risk-based

[1] www.fatf-gafi.org

approach. This allows countries to adopt a flexible set of measures, in order to apply preventive measures that are commensurate to the nature and level of their risks, and target their resources and efforts more effectively, focusing on higher risks.

All FATF and FSRB jurisdictions have committed to implementing the FATF Recommendations. Peer reviews of each member are conducted on an ongoing basis to assess levels of implementation of the FATF Recommendations.

Customer Due Diligence at the intersection between financial consumer protection and financial integrity

One of the core AML/CFT preventive requirements is that financial institutions know who their customers are and the intended nature and purpose of the business relationship. This helps determine the customer AML/CFT risk profile, and put in place relevant risk management measures. At the same time, information on customers help financial institutions understand their customers better, thereby enabling them to design better products and offer better customer service in general. In particular, this will assist in providing customers with suitable recommendations, and products or services that best suit their needs.

In this context, supervisors need to be aware of three main areas of potential interplay between financial consumer protection and financial integrity:

- Customer privacy and data protection

Following the FATF risk-based approach, banks should gather a sufficient and appropriate level of information about the customer in relation to the product, service or advice sought, and with regard to the nature and level of the AML/CFT risk that the customer presents.

In some individual cases, consumers consider that they are submitted to an over-extensive "know your customer" (KYC) process, perceived as intrusive and going beyond what would be expected from a bank. This can be due to the existence of an objective risk-aggravating factor in the risk profile of a given customer, for example a transaction with a foreign country which is listed as high(er) risk according to the risk mitigation system of the bank. Information and education of consumers would be key to avoid misunderstandings and explain the rationale and benefits of the bank's approach.

Data protection critical issues include the need to securely protect consumers' data, which is enshrined in FATF Recommendations. The possibility of exchanging customers' information within a financial group has created tensions in some jurisdictions: it is required by FATF Recommendations, but is prevented in some countries due to data protection principles. Dialogue at national level between competent authorities is necessary to find constructive and mutually beneficial solutions

- Financial inclusion

Applying an overly cautious approach to AML/CFT safeguards can have the unintended consequence of excluding legitimate consumers and businesses from the formal financial system. This would be the case for example when a formal proof of residence is required from low-income people living in slums. Financial consumer protection and financial integrity policies share the same objective in this area, as inclusion increases the ability to apply and enforce both consumer protection norms and AML/CFT rules.

The development of risk-sensitive AML/CFT frameworks, as required by the 2012 FATF Recommendations, will be a key step for countries that wish to build a more inclusive formal financial system, and give access to appropriate financial services to a larger proportion of the population, including the most vulnerable and unserved groups. Global standard-setting bodies, including

FATF, and international organisations such as the OECD, are actively involved in the work of the G20/Global Partnership for Financial Inclusion[2] to close the financial access gap, in particular through proportionate approaches to regulation and supervision for financial inclusion.

- "De-risking" of classes of customers

There has recently been a growing reported trend towards banks exiting jurisdictions or terminating or restricting business relationships with customers or categories of customers perceived as having a high money laundering/terrorist financing risk. The result is that in some jurisdictions, a number of individuals and organisations (for example NGOs) would be unable to access finance and banking services. Some predict that the potential ensuing lack of competition in some markets could expose consumers to increased costs.

For FATF, it is a misconception to characterise this situation exclusively as an AML/CFT issue, as evidence shows that it is the result of various drivers, such as concerns about profitability, prudential requirements, anxiety after the global financial crisis, and reputational risk[3]. FATF is interacting with international bodies conducting projects and surveys on this topic (such as the Financial Stability Board/World Bank, the International Monetary Fund, the Basel Committee on Banking Supervision) to better understand its scale and implications. The FATF Recommendations require financial institutions to terminate customer relationships, on a case-by-case basis, where the money laundering and terrorist financing risks cannot be mitigated. Supervisors should make sure that banks do not adopt a strategy of total avoidance of higher-risk categories of customers, but apply stronger risk management and controls.

Conclusion

Combating financial crime, especially AML/CFT, is an important policy issue both from a financial consumer protection and financial integrity perspective. This is a fast moving and closely scrutinised field in the current recovery context where banks face heightened regulatory attention and enforcement initiatives.

Financial consumer protection supervisors need to keep aware of developments, and of the interaction between safeguarding the interests of consumers and preserving the integrity of banking markets. Coordination and cooperation with authorities in charge of the supervision of AML/CFT rules have to be operational at national level, and the dialogue ongoing.

FinCoNet could be a vehicle through which financial consumer protection supervisors share experiences, communicate and promote best practices, and exchange views and ideas on existing or upcoming challenges related to the implementation of AML/CFT requirements.

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[2] http://www.gpfi.org/subgroup-regulation-and-standard-setting-bodies

[3] http://www.fatf-gafi.org/documents/news/derisking-goes-beyond-amlcft.html

Dealing with household indebtedness: the Portuguese approach

Contributor: Pedro Dias, Banco de Portugal

Since 2013, Portugal has had in force a legal and regulatory framework for the prevention and settlement of arrears on credit agreements entered into with household customers, which adopts a very comprehensive approach.

Back in 2008, Banco de Portugal started a reflection on the principles that should guide credit institutions when dealing with customers in payment difficulties to promote responsible lending standards throughout the entire life cycle of the credit relationship. The Banco de Portugal approach to responsible lending goes beyond the process through which credit institutions make their decision to provide credit, it also entails a set of standards to be observed by credit institutions during the lifetime of credit agreements. Thus, responsible lending also encompasses the management of pre-arrears and arrears.

The Portuguese model to deal with pre-arrears and arrears on credit agreements aims to be a comprehensive, non-intrusive and structural approach. Comprehensive because it covers all types of credit agreements held with household customers, such as mortgages and consumer credit, and applies to all borrowers facing difficulties in meeting their credits, whether or not they are already in arrears on their financial obligations. Non-intrusive because, under its wide scope, this model does not establish specific obligations on credit institutions to refinance or renegotiate credit agreements. Instead, credit institutions are required to implement internal systems and procedures to deal, in an efficient and responsive manner, with customers in payment difficulties. The legal and regulatory model in place also aims to establish structural and durable standards to be observed by credit institutions in the prevention and settlement of arrears.

Credit institutions are required to implement internal procedures and IT tools to ensure permanent and systematic monitoring of credit agreements and the early detection that customers are entering into financial distress, for instance, through access to a credit register database. When such signs are identified by the credit institution, or the customer alerts the lender of financial problems, credit institutions are obliged to take immediate action in order to assess the customers' financial situation and, if viable, renegotiate monthly payments to an affordable amount.

Prompt action is also required following failure by customers to pay their credit obligations. No later than 60 days following the breach of an instalment, credit institutions shall put in place a standardised procedure that frames the negotiation between the credit institution and the borrower to find the settlement of arrears on a pre-litigation stage. The negotiation process abides by a series of deadlines which compel the parties to be efficient and responsive. Credit institutions have 30 days to assess customers' financial situation and propose appropriate solutions, and the parties should be able to conclude negotiations within 90 days. As long as the negotiation is ongoing, customers are protected against judicially enforced debt recovery from credit institutions but they may lose such protection if they do not cooperate in the process.

As the model adopts a framework based on direct negotiation between the credit institution and the customer, the information asymmetry between the two parties is dealt with through a network of entities dedicated to providing advice and assistance to customers in payment difficulties. The assistance network is composed of private and public legal entities accredited by the General-Directorate for Consumers, following the opinion of Banco de Portugal. The services provided by these entities to customers are free-of-charge. However, in order to limit their liability, the assistance network entities are not allowed to act on behalf of customers or to intervene when a judicial proceeding is ongoing.

The provision of information to customers on their rights and obligations under this new legal and regulatory framework has also been considered. Credit institutions are required to provide general information on this in a prominent area of their websites, in accordance with the minimum requirements set out by Banco de Portugal. Detailed information on the rights and obligations of customers in pre-arrears or arrears is also available on the Bank Customer website[4], managed by the Banking Conduct Supervision Department of Banco de Portugal. Additionally, Banco de Portugal participates in several initiatives to inform the public on the legal and regulatory regime, many of which are organised countrywide by the assistance network.

Banco de Portugal also gives major attention to the supervision of the legal and regulatory framework. Credit institutions are required to report to Banco de Portugal on the internal procedures implemented to ensure compliance with the legal and regulatory requirements and any subsequent changes introduced therein. Credit institutions are also obliged to report, on a monthly basis, a set of quantitative data related to the implementation of the regime, including the number and the outcome of the negotiation procedures initiated with customers in arrears. The analysis of this data allows Banco de Portugal to assess the implementation of these legal tools and the evolution of households' non-performing credit.

Additionally, in order to monitor compliance by credit institutions with the legal and regulatory framework, Banco de Portugal carries out regular on-site and off-site inspections. "Mystery shopping" inspections are carried out in various branches to check if customers who take the initiative of informing credit institutions of their payment difficulties are receiving complete and accurate information on their rights and obligations. Complaints' handling by Banco de Portugal is also a key source of information. Whenever irregularities are found, Banco de Portugal makes use of its enforcement powers to determine immediate correction of the irregular practices or procedures, which may include the sanction of offending credit institutions.

Another innovative feature of this legal and regulatory framework is that it commits to Banco de Portugal the responsibility to perform a regular assessment of its implementation. For that purpose, Banco de Portugal takes into consideration not only the quantitative data reported by credit institutions, but also qualitative feedback received from different stakeholders, including credit institutions, the assistance network entities, consumer protection organisations and the general public. Banco de Portugal gives public accountability of such assessment by disclosing its main results in the annual and semi-annual Banking Conduct Supervision Reports.

[4] Bank Customer Website: http://clientebancario.bportugal.pt. A brochure on this subject is available in English and may be downloaded from the Bank Customer Website at http://clientebancario.bportugal.pt/pt-PT/Publicacoes/Brochuras/BrochuraIncumprimento/Paginas/BrochuraIncumprimento.aspx.

Credit institutions and consumer protection organisations agree that the implementation of this legal and regulatory framework had a positive impact and that it contributes to the promotion of responsible lending standards on the management by credit institutions of household credit agreements in pre-arrears and arrears. Credit institutions became more pre-emptive and swift to respond to customers facing payment difficulties.

They also consider that the creation of a level playing field in this area is a positive consequence for the market. Consumer protection organisations stress the fact that it has facilitated greater communication and negotiation between the two parties.

From a supervisory perspective, the most important outcome is that credit institutions developed a "customer oriented vision", instead of a "product oriented approach", which means that they have now coordinated structures to manage all customers' liabilities towards the institution.

Banking fees in Canada: patterns and trends

Contributor: Teresa Frick, Financial Consumer Agency of Canada (FCAC)

In recent years, service charges in the financial sector have been the subject of growing interest among a wide variety of stakeholders. As Canada's banks have grown and prospered, questions have been raised about the competitiveness of the fees levied on consumers' deposit accounts. The Government of Canada's economic policy has traditionally emphasized competition as the primary way to ensure fair prices in the marketplace. The relatively high level of concentration observed in Canada's banking sector creates the perception that the market for financial services is not as competitive as it could be; and by extension, there is some concern that a lack of competition might be contributing to fees that are less than optimal for consumers. The Financial Consumer Agency of Canada (FCAC) therefore conducted some research to ascertain the state of banking fees in Canada.

The principal finding of our research is that the increases in the monthly fees levied on consumers' deposit accounts have been quite moderate. More precisely, the monthly fees levied on banking plans increased below the rate of inflation. However, there were significant increases in the variable fees for transactions that exceed the limits of a consumer's plan or are not covered by it. These findings support the need for financial literacy tools that can help consumers to make informed choices about the banking plans that best suit their needs.

Deposit accounts offer a range of additional services beyond those covered by fixed monthly fees. For example, consumers might withdraw money from another bank's automated banking machine (ABM), send money to a friend using an email money transfer, or rely on overdraft protection to ensure that their pre-authorized mortgage payment is made on time.

We found that variable fees are relatively widespread. Approximately one-third of consumers surveyed had paid them at least once during the past year. Email money transfers and using another financial institution's ABM are two of the most common sources of variable fees. Younger consumers and those with lower monthly transaction limits are more likely to pay variable fees. Consumers who are less knowledgeable about the terms of their

banking plan are also more likely to report paying variable fees.

The use of overdrafts is fairly common. Roughly one-third of consumers surveyed indicated that they had a negative balance in their deposit account at least once in the past year but most were rarely overdrawn, meaning that they occasionally had a negative balance, but not on a regular basis. Canada's large banks charge between 19 and 22 percent interest rate annually on overdrawn balances.

However, interest rates are not the primary concern for consumers when using overdraft. The fees are. These fees can be as high as $5.00 for every transaction that creates or increases a negative balance in a consumer's account. This means that a consumer who creates an overdraft of $25 and then increases it twice with two additional $25 debit purchases could pay $15 in overdraft fees plus interest, if they were overdrawn for only five days.

Most consumers said that they have overdraft protection just in case they need it or because their financial institution recommended it. Very few consumers said that they have overdraft protection because they are having trouble making ends meet or because they lack access to other types of credit. Contrary to expectations, we did not find that low-income consumers are more likely to use overdraft, possibly because they have a harder time getting credit approval for overdraft protection.

In sum, we found that the evolution of banking fees did not entirely conform to our expectations. The fee increases on monthly banking plans have been moderate, whereas the charges associated with variable fees have increased significantly. While extra fees are relatively prevalent, consumers can effectively manage the charges associated with ancillary services by becoming more knowledgeable about their banking account plan and by choosing a plan suited to their day-to-day banking needs. However, one expectation was realized as younger consumers and those with lower monthly transaction limits are more likely to pay variable fees. It will be important to expand our definition of banking fees in future research to assess the evolution of other charges and to continue our efforts to educate consumers about the options available to them in their everyday banking choices.

The Central Bank of Ireland introduces enhanced protections for SME borrowers

Contributor: Colm Henry, Central Bank of Ireland

The Central Bank of Ireland has recently undertaken a review of its Code of Conduct for Business Lending to Small and Medium Enterprises 2012 (the 'SME Code'), and will shortly introduce a number of new and enhanced protections for SME borrowers.

The SME Code was introduced in March 2009 to support business lending to small and medium enterprises. In 2011, a limited review of the SME Code was carried out, focusing on the 'Financial Difficulties' section. The objectives of the SME Code are:

- To facilitate access to credit for sustainable and productive business propositions;
- To promote fairness and transparency in the treatment of SMEs by regulated entities; and
- To ensure that when dealing with financial difficulties cases, the aim of a regulated entity will be to assist borrowers to meet their obligations, or otherwise deal with the situation in an orderly and appropriate manner.

The SME Code provides protections for SME borrowers when dealing with regulated entities in relation to credit under a range of headings, including applications for credit facilities, declining/withdrawing credit facilities, financial difficulties, provision of information and complaints handling. The Central Bank of Ireland has reviewed the SME Code to enhance its existing consumer protection framework. As part of the review process the Central Bank of Ireland published a public consultation paper and engaged extensively with a variety of relevant stakeholders.

The SME Code will be replaced by a set of regulations, to come into effect during the course of 2016. The new SME regulations will provide for the following key requirements:

- Appropriate training of staff - Lenders must provide appropriate training on an on-going basis to staff concerned with relevant activities under the regulations;
- Annual meetings - Borrowers must, on an annual basis, be offered the option of a meeting with the lender, to include a review of their credit facility agreements, security held by the lender and alternative arrangements, where relevant. A borrowers is also entitled to request a regulated entity to perform a credit review;
- Greater transparency for borrowers around the application process – Lenders will be required to publish on their website, or otherwise make available to borrowers, specified information including information in relation to the application process, the relevant timelines and information about Government support schemes;
- Reasons for decline in writing - Where declining a credit application, a lender will have to provide the borrower with the reasons for decline in writing and these must be specific to the borrower's application;
- Greater protections for guarantors – The regulations will include specified warning statements to be provided to guarantors to highlight the potential consequences for the guarantor of providing a guarantee;
- Engagement with borrowers in arrears and financial difficulties - Lenders will be required to contact and engage with borrowers in arrears or financial difficulties and with borrowers that are concerned about going into arrears or financial difficulties;
- Expanded grounds for appeal and an internal Appeals Panel - The regulations will expand the grounds for internal appeals by borrowers that are available under the existing SME Code. For instance, borrowers will be entitled to appeal a decision to refuse a credit application. Lenders will also be required to have an internal Appeals Panel comprising of at least two decision makers who have not been involved in the borrower's case previously and who have sufficient background knowledge and expertise to conduct the appeal. (A borrower that is not

satisfied with a lender's decision to refuse to grant credit may also apply to the Credit Review Office. The Credit Review Office is a statute-based office established in 2010 which provides an independent review of a participating lender's decision. While the opinion of the Credit Review Office is not binding, participating lenders have respected and complied with its recommendations).

Given the important role of SMEs in the Irish economy, it is essential that the rules placed on regulated entities dealing with SMEs remain relevant, fit for purpose and facilitate access to credit. SME borrowers must have confidence in regulated entities, whether seeking credit or in the event that they find themselves in arrears or financial difficulties. These regulations will strengthen the existing framework by introducing specific requirements, to be complied with by regulated entities, which address the needs and concerns of SME borrowers identified as part of the review process.

The Central Bank of Ireland expects to publish the regulations on its website in December 2015, together with a feedback statement on its public consultation and a guide for SMEs on what the new regulations mean for them.

Review of the laws that apply to payday loans and consumer leases in Australia

Contributor: Melanie Spong and Richard McMahon, Australian Securities and Investments Commission

The Australian Government has commenced an independent review of the effectiveness of the laws that apply to small amount (payday) loans and consumer leases by the end of February 2016. A consultation paper has been issued and stakeholder roundtables were conducted in early November 2015. A draft report for comment is expected to be issued around the end of the year.

Background - payday loans and consumer leases in Australia

Consumer credit, including payday loans of less than $2,000 for a term of between 16 days and 12 months, is regulated by ASIC under the National Consumer Credit Protection Act 2009. In addition to the normal consumer credit obligations,[5] payday loans are subject to tailored rules intended to mitigate particular risks associated with those products, including high costs and multiple loans leading to a spiral of debt for the consumer. These additional protections include:

- statutory presumptions that a small amount loan will be unsuitable (and therefore prohibited) if either:

[5] These include a licensing obligation for lenders, assistance providers and intermediaries, as well as responsible lending obligations.

- the consumer is in default under another small amount loan; or

- the consumer has had two or more other small amount loans in the last 90 days;

- a cap on loan fees and charges (including an additional limit on total costs for consumers who default)
- protections for consumers who receive 50% or more of their income as Government benefits;
- a prohibition on charging an establishment fee if any of the credit is to refinance another small amount loan;
- a requirement to obtain and consider account statements covering the 90 days prior to the assessment;
- a warning statement to be displayed advising consumers of the alternatives to a small amount loan; and
- a prohibition on credit contracts for $2,000 or less that have a term of up to 15 days (referred to as 'short term loans').

The review is also considering the rules that apply to consumer leases, which are contracts for the hire of goods for a fixed term of more than four months where the consumer has no right or obligation to purchase the goods. Consumer leases are subject to different requirements to credit contracts such as payday loans, although in practice they serve a similar purpose. A notable difference is that there is no statutory limit on the maximum amount that consumers can be charged under a consumer lease (unlike credit contracts, which are subject to caps on costs).

ASIC's work

The payday lending and consumer leasing industries have been strong areas of focus for ASIC since we obtained responsibility for consumer credit in 2010. We have focused on these products because payday loans and consumer leases have risks for financially vulnerable consumers, who are often targeted by payday lenders and lessors.

On 30 October ASIC released its submission to the independent review, which outlines the work we have done and the significant outcomes we have achieved in relation to payday loans and consumer leases. This includes two recent public reports that highlighted ongoing issues:

Payday loans

In March 2015 ASIC released Report 426 Payday lenders and the new small amount lending provisions, which included the findings of our industry-wide review of compliance with the tailored rules. Our review found that the presumptions regarding loan unsuitability were not preventing repeat borrowing in the way intended by Parliament. Our compliance review also found systemic weaknesses in lenders' documentation and record keeping, including around the issue of the consumer's requirements and objectives.

We found better levels of compliance with more objective obligations, such as the requirement to obtain 90 days of account statements, the repayment limits for persons on Government benefits and the cap on costs.

Consumer leases

Due to the use of consumer leases by vulnerable consumers, along with our

continuing concerns about the poor conduct of some lessors, we reviewed the costs charged by lease providers for household goods. Our findings were published in Report 447 Cost of consumer leases for household goods in September 2015.[6]

We found that the amounts charged by different lessors for comparable goods vary significantly and can have an extremely high overall cost compared with the cost of the item leased.[7] The same lessors often charge significantly different amounts for the same goods: persons on Government benefits were charged more than the advertised costs, and were often charged significantly more under a consumer lease than the maximum amount they would have paid if they had obtained a small amount loan and purchased the item.

ASIC's recommendations

ASIC's submission to the independent review noted that the current payday lending rules are a significant improvement over the previous state-based regulatory regime. However, we have identified a number of areas where there are options for change worthy of consideration.

Clearer limits on repeat lending

ASIC recommended replacing the statutory presumptions that loans are unsuitable (and therefore prohibited) in certain circumstances with clear prohibition that limits the number of payday loans (or amount of credit) that can be obtained in a given period. This suggestion is consistent with our findings that compliance amongst payday lenders is greater for objective, 'bright line' rules.

Our view is that a prohibition be supported by a mandatory, real-time payday lending database that can give lenders a 'yes/no' answer about whether a prospective loan would be prohibited. This would simplify compliance for industry relative to the current presumptions.

General anti-avoidance provision

ASIC suggested that the credit legislation contain a general anti-avoidance provision. ASIC's work on avoidance in the payday lending and consumer leasing sectors is resource intensive, and we have not observed a significant deterrence effect to date. We anticipate that an anti-avoidance provision would allow us to better address avoidance behaviour (including in ways that may have industry-wide impact).

Cost limits for consumer leases

There is currently no limit on the costs that can be charged on consumer leases. This has led to regulatory arbitrage, where lessors structure their arrangements as consumer leases in order to avoid cost restrictions that apply to credit contracts. We support a cap on costs for consumer leases to provide for more consistent treatment for similar products, such as consumer leases and payday loans. ASIC's view is that cost restrictions will also prevent the offering of very high-cost leases to vulnerable and disadvantaged consumers.

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[6] A summary of the enforcement action ASIC has taken against consumer lease providers is in the Appendix to this report.

[7] We observed one consumer who paid an effective interest rate of 884%.

In light of the similarities between payday loans and consumer leases, as well as our experience with the tailored payday lending rules, we recommend that some rules be extended to consumer leases. We support the extension of:

- the requirement to provide a warning statement; and
- restrictions on repayments from consumers who receive more than half their income in Government benefits.

ASIC looks forward to the review's report on the effectiveness of the laws that apply to the payday lending and consumer leasing sectors.

FINCONET COMMUNIQUE

DATE: 26 October 2015

FinCoNet highlights risks to consumers from inappropriate sales incentives and increased use of online and mobile payments.

At its Annual General Meeting, hosted by the Financial Services Board of South Africa, FinCoNet members examined the negative impact inappropriate sales incentives can have on responsible lending practices. Findings from a recent survey of 23 jurisdictions highlighted a number of practices by lenders which contributed to unsuitable or irresponsible lending. FinCoNet will, over the coming months, be publishing a report based on the findings of the review, to be used as the basis for the development in 2016 of guidance on how to promote effective supervisory approaches to help address these issues.

FinCoNet members also considered the risks to consumers, including security risks, associated with the increased use of online and mobile payments by consumers. FinCoNet will be progressing work on this important topic and plans to publish a report in 2016 following the completion of review in order to help supervisory authorities in their role of protecting the interests of consumers.

At the meeting members also shared experiences on a range of consumer protection issues across countries and how supervisory authorities were dealing with those issues including, consumer over-indebtedness, transparency of disclosures by banks including fees and charges, access to basic financial services, developing a consumer focused culture, challenges of new technologies, consumer complaints and cross border co-operation.

FinCoNet has been created in response to the growing focus on financial consumer protection worldwide, with a particular reference to banking and credit, and the need for greater collaboration, interaction and sharing among supervisory authorities in order to protect the interests of consumers of financial services.

FinCoNet

Established in 2013, FinCoNet is an international organisation of supervisory authorities which have responsibility for financial consumer protection. It is a member based organisation and has been set up as a not-for-profit association under French law.

FinCoNet promotes sound market conduct and strong consumer protection through efficient and effective financial market conduct supervision.

Each member of FinCoNet has responsibility for and an interest in protecting the interests of consumers of financial services. FinCoNet seeks to enhance the protection of consumers and strengthen consumer confidence by promoting robust and effective supervisory standards and practices and by the sharing of best practices among supervisors. It also seeks to promote fair and transparent market practices and clear disclosure to consumers of financial services.

FinCoNet's initial focus is on banking and credit consumer issues.

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