CONSULTATION PAPER 330

Using the product intervention power: Continuing credit contracts

July 2020

About this paper

This consultation paper sets out ASIC's proposal for using our product intervention power in Pt 7.9A of the *Corporations Act 2001* (Corporations Act) in relation to a class of financial products. We are seeking the views of interested stakeholders, including industry and consumers, on our proposal.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 9 July 2020 and is based on the Corporations Act and the *National Consumer Credit Protection Act 2009* (National Credit Act) as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive, or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on exercising the product intervention power. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by **Thursday 6 August 2020** to:

Senior Manager, Financial Services Group
Australian Securities and Investments Commission
Level 7, 120 Collins Street
Melbourne VIC 3000
email: product.regulation@asic.gov.au

What will happen next?

ASIC will review and consider all submissions made before determining appropriate regulatory action.

A Background to our proposal

Key points

This section sets out the background to our proposal to use the product intervention power under Pt 7.9A of the Corporations Act to address significant detriment arising from a particular class of financial products.

ASIC's product intervention power

1 The product intervention power is a proactive way for ASIC to intervene where a product has resulted in, or will or is likely to result in, significant detriment. This power was introduced by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* by making amendments to the Corporations Act and National Credit Act.

Note: See Regulatory Guide 272 *Product intervention power* (RG 272) on how ASIC can use the product intervention power.

2 This consultation paper seeks feedback on a proposal to use ASIC's product intervention power under Pt 7.9A of the Corporations Act. Under the Corporations Act, ASIC can intervene in relation to financial products as defined by the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

ASIC's proposal

3 Subject to this consultation, we propose to use our product intervention power under Pt 7.9A of the Corporations Act to address the significant detriment that has resulted from, or will or is likely to result from, a class of financial products, namely continuing credit contracts, being made available to retail clients.

4 For a description of this class of financial products, see Section B of this paper. Our proposal seeks to impose a cost cap on the total fees that can be charged in relation to continuing credit contracts.

B A class of financial products available to retail clients

Key points

This section identifies the class of financial products to which the proposed product intervention order relates, namely, continuing credit contracts.

A financial product under the ASIC Act: A continuing credit contract

5 As noted in paragraph 2, ASIC can make a product intervention order in relation to financial products covered by the ASIC Act.

6 A continuing credit contract, including a contract which purports to rely on the continuing credit exemption, is a financial product under s12BAA(7)(k) of the ASIC Act, as a 'credit facility' within the meaning of reg 2B of the Australian Securities and Investments Commission Regulations 2001.

7 Under s204 of the National Credit Code (Sch 1 of the National Credit Act), 'continuing credit contract' means a credit contract under which:

(a) multiple advances of credit are contemplated; and

(b) the amount of available credit ordinarily increases as the amount of credit is reduced.

8 Under s6(5) of the Code, the National Credit Code and the National Credit Act do not apply to the provision of credit under a continuing credit contract, if the only charge that is or may be made for providing the credit is a periodic or other fixed charge that does not vary according to the amount of credit provided.

9 However, the National Credit Code applies if the charge:

(a) is of a nature prescribed by the regulations for the purposes of this subsection; or

(b) exceeds the maximum charge (if any) so prescribed.

Note: In this paper, we refer to s6(5) of the Code as the 'continuing credit exemption'.

10 Regulation 51 of the National Consumer Credit Protection Regulations 2010 (National Credit Regulations) specifies the prescribed maximum charges in relation to a continuing credit contract, for the purposes of the continuing credit exemption: see Table 1.

Table 1: Maximum account charges permitted under the continuing credit exemption

Item	If…	The prescribed maximum charge is…
1	the debtor is not already a party to a continuing credit contract with the credit provider, or an associate of the credit provider, when the continuing credit contract is entered into	(a) for the period of 12 months commencing when the debtor enters into the continuing credit contract—$200; and (b) for any subsequent period of 12 months during which the continuing credit contract is in effect—$125.
2	both of the following apply when the continuing credit contract (the *new contract*) is entered into: (a) the debtor is already a party to a continuing credit contract with the credit provider, or an associate of the credit provider, or was such a party within the previous 12 months; (b) neither the credit provider nor the associate of the credit provider is an [authorised deposit-taking institution]	(a) for the period of 12 months commencing when the debtor enters into the new contract—nil; and (b) for any subsequent period of 12 months during which the new credit contract is in effect—nil.

Source: Regulation 51 of the National Credit Regulations

A class of financial products: Continuing credit contracts

11 ASIC is aware of a class of financial products—namely, continuing credit contracts as defined in s204 of the National Credit Code (see paragraph 7)—that is available, or is likely to be available, for acquisition by issue to persons who are retail clients.

Note: In this paper, we refer to ‘continuing credit contracts’ as the relevant class of financial products to which this proposed product intervention order relates.

12 Subject to consultation, ASIC considers that continuing credit contracts when issued to retail clients in certain circumstances, have resulted in, or will or are likely to result in, significant detriment to these clients, as discussed in Section C.

C Significant detriment to retail clients

Key points

This section discusses the significant detriment we seek to address by the proposed product intervention order relating to continuing credit contracts.

What is 'significant detriment'?

13 ASIC can make a product intervention order if, among other things, we are satisfied that a financial product, or a class of financial products, has resulted in, or will or is likely to result in, significant detriment to retail clients: see s1023D of the Corporations Act.

14 The legislation sets out the criteria that we are required to take into account in considering whether a financial product, or a class of financial products, has resulted in, or will or is likely to result in, significant detriment to retail clients. These are:

(a) the nature and extent of the detriment;

(b) without limiting paragraph 14(a), the actual or potential financial loss to retail clients resulting from the product;

(c) the impact that the detriment has had, or will or is likely to have, on retail clients; and

(d) any other matter prescribed by the regulations (see s1023E(1) of the Corporations Act).

15 We may also consider other factors: see s1023E(2) of the Corporations Act.

Significant detriment and continuing credit contracts

16 ASIC is aware of continuing credit contracts that have been issued by BHF Solutions Pty Ltd (BHFS) to retail clients in the following circumstances:

(a) BHFS provides loans under a continuing credit contract and charges a fixed fee for each advance of funds under the contract, up to a maximum of $120 in a 12-month period;

(b) an associate of BHFS, Cigno Pty Ltd (Cigno), enters into a services agreement with retail clients, and charges various fees for, including but not limited to, the following services:

(i) fast-track processing to obtain the loan from BHFS and transfer the funds to the client on the same or next day;

(ii) collection of payments from retail clients, including loan repayments due to BHFS and payments due to Cigno;

(iii) forwarding of loan repayments and BHFS' lender fee to BHFS;

(iv) ongoing management and administration of the continuing credit contract and services agreement; and

(c) the fees and charges imposed under the continuing credit contract and services agreement in total exceed the maximum charges prescribed by the continuing credit exemption and reg 51 of the National Credit Regulations.

17 Neither Cigno nor BHFS holds an Australian credit licence (credit licence) or is a member of the Australian Financial Complaints Authority (AFCA).

18 Under its services agreement, Cigno charges the following fees:

(a) financial supply fees ($13 + a percentage of the loan amount);

(b) account-keeping fees ($5.95 per week);

(c) default fees ($79 per default);

(d) change of payment fees ($22 per change); and

(e) drawdown fees (if applicable).

19 On Cigno's website it advertises, among other things, 'Payday Loans', 'Centrelink Loans', 'Bad-Credit Loans', 'No-Credit Loans', 'Loans for Unemployed People', 'Emergency Loans' and 'Fast Cash Loans'. ASIC understands that these advertised loans on Cigno's website refer to the continuing credit contracts issued by BHFS that are made available to retail clients.

Note: See cignoloans.com.au as at 8 July 2020.

20 These continuing credit contracts are issued by BHFS in a way that:

(a) does not give retail clients access to external dispute resolution schemes such as AFCA;

(b) is without a credit licence, which means retail clients do not have the consumer protections under the National Credit Act;

(c) is without properly testing whether retail clients can afford the repayments as the providing entities do not appropriately consider the expenses of each retail client;

(d) has high fees payable on default, which creates a financial incentive to offer credit to retail clients who are unable to meet repayments; and

(e) results in further financial hardship due to the high cost compared to the amount of credit provided.

21 The following case studies give examples of the impact of these continuing credit contracts on retail clients.

Case study 1

Client A used Cigno's services to apply for and obtain a continuing credit contract from BHFS for a loan of $350 in September 2019.

Client A was only able to make $150 in repayments over the next three months.

In that time period, Client A was charged almost $1,100 in fees, including almost $300 in upfront fees (lender fee and financial supply fee), almost $80 in ongoing account-keeping fees, and $720 in default fees (including change of payment fees). By December 2019, Client A still owed Cigno and BHFS over $1,200.

In total, the overall repayments were approximately 410% of the original loan amount.

Case study 2

Client B used Cigno's services to apply for and obtain a continuing credit contract from BHFS for a loan of $250 in September 2019.

Client B was charged almost $1,000 in fees, made up of over $215 in upfront fees (lender fee and financial supply fee), almost $80 in ongoing account-keeping fees, and $685 in default fees (including change of payment fees).

Client B was only able to make $309 in repayments and as at December 2019 still owed Cigno and BHFS over $900.

In total, the overall repayments were approximately 490% of the original loan amount.

Case study 3

Client C used Cigno's services to apply for and obtain a continuing credit contract from BHFS for a loan of $250 in January 2020.

Client C's source of income was a Centrelink disability support pension. The loan was used to pay for medical expenses.

Client C was charged over $400 in fees, including over $200 in upfront fees (lender fee and financial supply fee), $35 in ongoing account-keeping fees, and $180 in default fees (including change of payment fees).

Client C made $380 in repayments within 12 days of obtaining the loan, and as at mid-February 2020 still owed Cigno and BHFS over $290.

In total, the overall repayments were approximately 270% of the original loan amount.

Case study 4

Client D used Cigno's services to apply for and obtain a continuing credit contract from BHFS for a loan of $150 in October 2019.

Client D was charged over $570 in fees, including over $140 in upfront fees (lender fee and financial supply fee), $47 in ongoing account-keeping fees and over $380 in default fees over a two-month period.

In total, the overall repayments were approximately 480% of the original loan amount.

Client D is a single mother receiving Centrelink benefits and was unable to afford any repayments. She has since been subject to collection calls from the external debt collection agency who is attempting to recover the debt of over $720 on Cigno's behalf.

22 ASIC is aware that the continuing credit contracts currently issued by BHFS have:

(a) a target market where demand is driven mostly by low-income households experiencing significant financial distress, which require small amounts of credit to meet basic living and essential household expenses;

(b) been issued to a significant number of retail clients, comprising a significant overall portfolio of lending; and

(c) a high default rate.

23 Subject to consultation, ASIC considers that continuing credit contracts, issued in the way described in paragraphs 16–22, have resulted in, or will or are likely to result in, significant detriment to retail clients due to:

(a) the overall high cost of both the continuing credit contract and the services agreement, relative to the loan amount, which many retail clients cannot afford;

(b) the significant number of retail clients who have been issued this product; and

(c) the particular target group of retail clients the product is issued to, many of whom are vulnerable and suffering from financial instability and hardship.

24 ASIC understands the impact that the significant detriment has on vulnerable retail clients includes:

(a) exacerbating existing financial stress;

(b) increasing their inability to meet basic living expenses on an ongoing and prolonged basis;

(c) increasing their inability to improve their financial position;

(d) disempowering retail clients and exacerbating financial exclusion;

(e) undermining retail clients' financial capability and resilience; and

(f) increasing the stress, anxiety and further negative physical and mental health outcomes caused by financial difficulty.

25 ASIC is also concerned that the significant detriment ordinarily resulting from the issue of continuing credit contracts may be further exacerbated by the current economic situation as a result of the COVID-19 pandemic.

26 With recent data from the Australian Bureau of Statistics (ABS) showing an increase in the unemployment rate to 7.1% and the number of unemployed people increasing by 85,700 in May 2020, we are concerned there may be a further increase in demand by retail clients for this class of financial product, which may result in additional significant detriment.

Note: See ABS, 6202.0 Labour force, Australia, May 2020, released 18 June 2020.

27 As noted in paragraph 19, these continuing credit contracts issued by BHFS are marketed by Cigno to individuals who receive Centrelink payments, are unemployed or otherwise require emergency cash.

D Our proposal

Key points

This section outlines our proposal to use ASIC's product intervention power in relation to continuing credit contracts.

ASIC's proposal to address significant detriment

28 Subject to this consultation, we propose to use our product intervention power under Pt 7.9A of the Corporations Act to address the significant detriment that has resulted from, or will or is likely to result from, the class of financial products, namely continuing credit contracts being issued to retail clients.

29 Under this proposal, ASIC would make an industry-wide product intervention order by legislative instrument to prohibit credit providers and their associates (including directors of such entities) from issuing continuing credit contracts in circumstances where total fees exceed the maximum permitted under the continuing credit exemption and reg 51 of the National Credit Regulations.

30 While ASIC is only currently aware of BHFS issuing continuing credit contracts in these circumstances, ASIC considers it is likely that other entities may make available continuing credit contracts in this way in the future.

31 We note that these continuing credit contracts appear to have been introduced into the market following ASIC's previous product intervention order relating to short term credit made on 12 September 2019.

Note: See ASIC Corporations (Product Intervention Order—Short Term Credit) Instrument 2019/917 and related product intervention order notice.

32 ASIC notes that the short term credit facilities that were the subject of ASIC's previous product intervention order were provided and/or managed by Cigno, BHFS, Gold-Silver Standard Finance Pty Ltd, and MYFI Australia Pty Ltd (now known as Fi-Fit Services Pty Ltd).

The impact of ASIC's proposal

33 The intervention in our proposal would be likely to have the following impact on retail clients:

(a) *Increased use of small amount credit contracts*—Some retail clients may obtain a small amount credit contract rather than obtain a continuing credit contract, where the credit provider considers the loan is not unsuitable under the National Credit Act.

These retail clients would benefit from being provided with finance with the statutory protections under the Act.

(b) *Reduced access to credit*—Some retail clients may be unable to access small loans when they need credit and may not be eligible for a small amount credit contract.

These retail clients may experience financial hardship. However, their overall level of debt will be lower as it will not include the amounts charged under the class of financial product (continuing credit contracts) which exceed the cost caps in the continuing credit exemption. It should therefore be less difficult for some of these retail clients to resolve their financial difficulties in other ways, rather than by seeking continuing credit.

34 In ASIC's preliminary view, our proposal will produce the best outcomes for retail clients. It will protect retail clients from significant detriment by prohibiting the issue of continuing credit contracts in circumstances where credit providers and their associates charge fees that exceed the maximum permitted under the continuing credit exemption and reg 51 of the National Credit Regulations.

35 We are seeking stakeholders' views on this proposal before deciding whether or not to make a product intervention order to address the identified significant detriment to retail clients.

36 The draft product intervention order is included as an attachment to this paper so that stakeholders can comment on it and the impact it may have.

37 If we proceed with our proposal, we intend to monitor the impact of the order by assessing changes in the continuing credit market to see whether businesses develop new products that warrant further intervention, and to inform our decision about whether the order should be extended in the future or be made permanent.

38 The purpose of this consultation is to allow interested and affected parties to provide comment, opinions and supporting evidence which ASIC will consider before making a decision on whether to make a product intervention order in relation to the identified class of financial products.

Use of the product intervention power: Continuing credit contracts

Proposal

D1 We propose to make a product intervention order by legislative instrument under s1023D(3) of the Corporations Act to prohibit credit providers and their associates (including directors of such entities) from issuing continuing credit contracts except in accordance with a condition which limits the total fees that can be charged: see the draft product intervention order in the attachment to this paper.

Your feedback

D1Q1 Do you consider that continuing credit contracts, when issued to retail clients in the way described in paragraphs 16–22, have resulted in, or will or are likely to result in, significant detriment to retail clients? If so, please provide any relevant evidence which supports your views.

D1Q2 Do you consider that continuing credit contracts, when issued to retail clients in the way described in paragraphs 16–22, have resulted in, or will or are likely to result in, significant detriment other than, or to a greater or lesser extent than, that identified by ASIC? If other or greater detriment, how should the proposed product intervention order be expanded to address this detriment? Please provide any evidence which supports your views.

D1Q3 Are you aware of entities other than Cigno and BHFS that are issuing, or likely to issue, continuing credit contracts in the way described in paragraphs 16–22?

D1Q4 Do you agree with our proposal to make an intervention order by legislative instrument prohibiting credit providers and their associates (including directors of such entities) from issuing continuing credit contracts in circumstances where total fees exceed the maximum permitted under the continuing credit exemption and reg 51 of the National Credit Regulations? Please provide details of why, or why not.

D1Q5 What alternative approaches could ASIC take that would achieve our objectives of preventing the detriment to retail clients identified in this paper?

Key terms

Term	Meaning in this document
ABS	Australian Bureau of Statistics
AFCA	Australian Financial Complaints Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
BHFS	BHF Solutions Pty Ltd
Cigno	Cigno Pty Ltd
continuing credit contracts	The relevant class of financial products to which this proposed product intervention order relates Note: For the definition of 'continuing credit contract', see s204 of the National Credit Code.
continuing credit exemption	Means the exemption in s6(5) of the National Credit Code
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit provider	Has the meaning given in s5 of the National Credit Act
financial product	A facility through which, or through the acquisition of which, a person does one or more of the following: • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) Note: This is a definition contained in s763A of the Corporations Act: see also s763B–765A.
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
National Credit Regulations	National Consumer Credit Protection Regulations 2010
reg 51 (for example)	A regulation of the National Credit Regulations (in this example numbered 51), unless otherwise specified
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations 2001

Term	Meaning in this document
s204 (for example)	A section of the National Credit Code (in this example numbered 204), unless otherwise specified
short term credit facility	A financial product covered by both: • s12BAA(7)(k) of the ASIC Act; and • s6(1) of the National Credit Code