
Regulation impact statement: Requiring a home loan ‘key facts’ document and standard terminology

Problem¹

1. The complexity of financial products available makes understanding the key features of a home loan and the choice of a home loan for consumers a difficult one. Timely and clear disclosure of information before a consumer applies for a home loan (precontractual disclosure) can also assist consumers in comparing different home loans and assessing home loan products. Improved precontractual disclosure can lead to better understanding and increase home loan choice for consumers, which may drive demand-side competition in the home loan market.
2. Complexity of precontractual disclosure for home loans can lead to poor decision making. Consumers may not understand the true cost of the credit contract and, as such, select a home loan that does not meet their needs and requirements. These observations are consistent with empirical research.
3. The 2010 Standing Committee of Officials of Consumer Affairs Simplification of Disclosure Regulation for the Consumer Credit Code (SCOCA Report) noted that only 6 per cent of test participants understood the true cost of home loan credit using the current method of disclosing home loan information.² Other empirical research has indicated that improved disclosure can convey complex home loan information to consumers more effectively.³
4. The problem of consumers not understanding key features of the home loan stems from several sources; complexity, different terminology, comparability, varied formatting and timing issues.

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¹ See Attachment A for glossary of terms.

² 2010 Standing Committee of Officials of Consumer Affairs Simplification of Disclosure Regulation for the Consumer Credit Code, pg 6

³ Lacko, J and Pappalardo, K “Improving consumer mortgage disclosures – an empirical assessment of current and prototype disclosure forms” (2007) US Federal Trade Commission’s Bureau of Economics 13 June 2007

Complexity

5. The range of features included in a home loan can make it difficult for consumers to understand the information and compare home loans based on the true cost of a loan, particularly where there are different interest rates and fee structures and the use of non-advertised discounting.

6. Moreover, when comparing different home loan products the information at the precontractual disclosure stage may not be tailored to the consumer's requirements. This means that the consumer may be comparing home loan information that is less relevant to their particular situation. For example, consumers may consider several different types of home loan products (such as fixed rate mortgage, adjustable rate mortgage, hybrid mortgage or interest-only mortgage). Each product could be suitable for the consumer but comparing the products would be complex given that they all have different information and features. An effective means of reducing complexity is to highlight key features of the home loan relevant to the consumer's particular situation.

7. The level of numeracy required to understand the document adds to complexity. In order to compare home loan products consumers may have to calculate costs or fees in order to compare and understand home loans. Data suggests that many individuals may not have the numeracy skills to perform complex calculations. The 2006 ABS Adult Literacy Survey indicated that numeracy levels were relatively low, with approximately 53 per cent of Australians assessed at Level 1 or 2.⁴

8. Making clear the costs and fees and charges in total dollar amounts would reduce the need for consumers to perform calculations in order to understand the cost of the home loan and to compare the home loan with other products.

Terminology

9. Closely linked to the issue of complexity is the different technical language associated with home loan contracts. Consumers may be unaware of, or not fully understand, the various fees and charges that apply to their mortgage products. This could be due to the range of different terms for the same issue, but also due to the technical nature of

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⁴ ABS Adult Literacy Survey 2006, pg 2. The scale of 1-5 used is based on proficiency measures, with Level 1 being the lowest level of literacy and Level 5 being the highest level of literacy. Level 3 is regarded by the survey developers as the "minimum required individuals to meet the complex demands of everyday life and work in the emerging knowledge-based economy."

the language. Many individuals may not have the literacy skills to understand home loan terminology. The 2006 ABS Adult Literacy Survey indicated that in most cases, Australian's level's of literacy fell into the Level 1 and Level 2 range, for prose literacy 46 per cent were Level 1 and Level 2 and for document literacy were 47 per cent Level 1 and Level 2.⁵

10. Currently, there is no standardised nomenclature for the features of these products, including fees and charges. Across the majority of precontractual home loan disclosure there continues to be a reliance on legal or technical language. This decreases the likelihood that a consumer will read a document and understand that document.

11. Standard terminology, descriptions and/or structure for fees and charges would make it simpler and clearer for consumers to compare fees and charges across institutions, and in particular the level of those fees and charges that are of interest to the consumer.

Comparability

12. Comparability of credit contract information to assist consumer comprehension has been identified as an issue warranting an appropriate policy response. Previous attempts to resolve this issue have included developing comparison rates.

13. Under the previous credit regulatory system, the Uniform Consumer Credit Code (UCCC) introduced the requirement for lenders to include in their advertising a "comparison rate", which includes both the interest rate and fees and charges relating to a loan.⁶ However there are problems with the comparison rate. It is calculated on a loan size of \$150,000 making it difficult to compare loans of a different value. It also does not include contingent fees that are charged only in certain circumstances.

14. The introduction of a mandatory comparison rate may have led to some lenders avoiding advertising interest rates to circumvent comparison rate requirements. Industry may have also restructured products so that most fees and charges could be included under the

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⁵ ABS Adult Literacy Survey 2006, pg 2. The scale of 1-5 used is based on proficiency measures, with Level 1 being the lowest level of literacy and Level 5 being the highest level of literacy. Level 3 is regarded by the survey developers as the "minimum required individuals to meet the complex demands of everyday life and work in the emerging knowledge-based economy.

⁶ Uniform Consumer Credit Code: Mandatory Comparison Rates Final Impact Statement, 7 May 2008

“unascertainable fees and charges”, which led to reduced transparency for consumers.⁷

Transparency

15. Lack of transparency can exacerbate information asymmetry where suppliers in the market have a better understanding than the consumer of the cost of credit and the terms of the home loan. This can compound the issue of poor understanding of credit.

16. Advertised mortgage interest rates typically do not include any interest rate discounts which are often available depending on the size of a loan, the loan-to-valuation ratio, profession of the borrower or other variables. Information on these discounts is not readily available and, in general, can only be obtained through a direct enquiry with a lender. The lack of transparency about these discounts makes it difficult for eligible borrowers to compare mortgage products.

Format

17. Understanding of the cost of credit is also determined by the format of the information. If the information is formatted in a simple manner it can improve consumer comprehension. In the United States formatting has been mandated to include a Schumer Box, which consists of a tabular format which clearly labels the relevant amounts or interest rate.⁸

18. At present there are no requirements for standardisation of formats and, as such, consumers may have difficulty in selecting the relevant comparable features of the credit contract. This can hinder their ability to understand and compare essential features of the credit contract.

19. Standardisation of formats and clearly labelling the essential information could enable a consumer to compare different credit contracts from a range of suppliers. Standardised formats would highlight and simplify the relevant information for consumers, which could avoid the information overload associated with lengthy precontractual disclosure documents.

Timing

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⁷ June 2008 Financial Services and Credit Reform Green Paper, pg 10

⁸ The Schumer Box is named after the US Senator Schumer who proposed that all important features of a credit contract be placed in a box on the front of the credit contract.

20. Timing of precontractual disclosure can determine the effectiveness of precontractual disclosure. Empirical cognitive testing and behavioural economics shows that consumers have greater comprehension when presented with information early in the decision making process.

21. The concept of 'early disclosure' has been considered previously in consumer policy; with the general understanding that early disclosure in the consumer credit context would be considered to be the timeframe upon first contact with a credit provider or credit assistance provider. For 'early' precontractual disclosure, consumers could be given the document to assist them in understanding key features of the home loan but also the compare different types of home loans.

22. Early disclosure also has a focus on assisting comparison, which can encourage demand-side competition. If consumers have a longer period in which to consider different types of home loans, it is likely that they will choose the product that is most appropriate and shop around.

23. There are different policy outcomes for "late" precontractual disclosure, where the policy focuses on ensuring consumer protection by informing them of their statutory rights. 'Late' disclosure would be considered to be the stage where the consumer has settled on a particular type of home loan and is to provide further information to that particular home loan.

Empirical evidence

24. Empirical studies show that simplified and timely disclosure can improve consumer comprehension of credit contracts as well as improve decision making processes, such as encouraging them to consider a wider range of options and choosing the right option for them.

Consumer cognitive testing - SCOCA Report

25. In December 2005 the Uniform Consumer Credit Code Management Committee released a consultation package, *Precontractual disclosure under the UCCC*, which included a proposed disclosure model to replace the UCCC disclosure model. Following the consultation, an independent consultant was commissioned to conduct research into precontractual disclosure, with the aim of developing an evidence-based disclosure model to meet the information needs of consumers and, where possible, provide consumers with a better understanding of the cost of credit.

26. Following the 2008 COAG decision to transfer responsibility for the regulation of consumer credit to the Commonwealth, it was agreed that the Commonwealth would consider the finding of the report as part of Phase 2 of the Consumer Credit Reforms. In mid-May 2010 the final

report was released, *Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign*. The report used an evidenced-based approach and tested various precontractual disclosure models through simulation, surveys, focus group discussions, qualitative research and comprehension testing. The study found that only around 6 per cent of participants understood the true cost of home loan credit using the UCCC method of disclosing home loan information.⁹

27. The study found that simplified precontractual disclosure greatly assisted consumers with improving their understanding of the cost of the credit contract, by simplifying the financial summary table accompanied by a set of standard terms or the loan contract. Final comprehension tests based on simplified disclosure found that questions about the cost of credit improved by factors of between 400 per cent and 1,800 per cent. The report tested several different disclosure formats on consumers and recommended disclosure model consists of a simplified Financial Summary Table of the key facts.

28. The research also tested an early disclosure model which summarises the key information into a one page, stand alone Financial Summary Table that is intended to be used early in the decision process. The report found that when exposed earlier to simple disclosure of key facts, consumers find comparison of products easier and make more informed choices.

29. Other studies also show that lengthy precontractual disclosure documents do not assist consumers and instead overloads them with information.¹⁰ Consumers generally focus on the headline information, such as amount repayable each month, interest rates and whether insurance is required.¹¹ Studies have also found that 41.09 per cent of participants found that the interest rate was most helpful in making their decision with only 1.59 per cent finding information from the supplier as a key factor.¹²

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⁹ 2010 Standing Committee of Officials of Consumer Affairs *Simplification of Disclosure Regulation for the Consumer Credit Code*, pg 6

¹⁰ Malbon, J “Taking Credit: A Survey of Consumer Behaviour in the Australia Consumer Credit Market” (1999) September Law School, Griffith University for the Consumer Credit Code Post Implementation Review Committee on behalf of the Ministerial Council on Consumer Affairs

¹¹ 92 per cent of low income consumers and 84 per cent of high income consumer said that they mainly took notice of the key features of the credit contract, Malbon, J “Taking Credit: A Survey of Consumer Behaviour in the Australia Consumer Credit Market” (1999) September Law School, Griffith University for the Consumer Credit Code Post Implementation Review Committee on behalf of the Ministerial Council on Consumer Affairs

¹² Ewing, S “The Effectiveness of Mandatory Comparison Rates” (2006) Swinburne Institute of Social Research

Behavioural economics research

30. Behavioural economics research, which combines economics and psychology, examines individual's comprehension of information. Findings from behavioural economics are consistent with empirical consumer comprehension cognitive findings.
31. The research indicates that an individual's behavioural biases are a barrier to understanding complex contractual information and that in most cases; individuals expect that lenders would act in their interests.
32. In particular, behavioural economics suggests that consumers are overly optimistic when assessing their capacity to repay or take on debt.¹³ Research also indicates that the quantity of information can overwhelm consumers, which can encourage consumers to ignore the precontractual disclosure information.

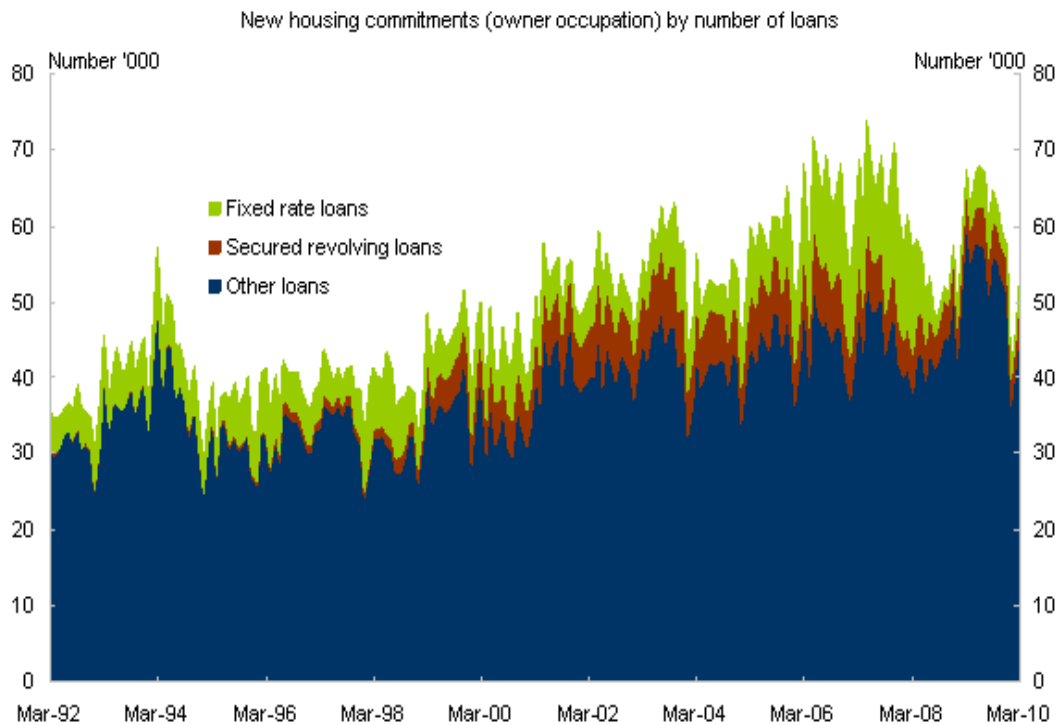
Scope and magnitude

33. Chart 1 shows the number of new housing commitments by number of loans from 1992 to March 2010.
34. The data is based on new loans as well as refinancing loans. The data shows that there are potentially a large number of consumers that could benefit from enhanced precontractual disclosure for home loans.

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¹³ Howells 2005 and Sheehan, G and Wilson, T and Howell, N Brotherhood of St. Laurence, "Coming to grips with credit contracts", November 2008

Chart 1: number of new housing commitments by number of loans ('000) from 1992 to March 2010



Context

Background to Australian precontractual disclosure

35. Consumer credit was the subject of reports and inquiries in Australia, starting with the 1969 Rogerson Report and the 1972 Molomby Report. Both of these reports were influenced by the US *Consumer Credit Protection Act 1968* (also known as the Truth in Lending Act), which focused on credit contract disclosure.

36. South Australia adopted the Consumer Transactions Act 1972, with other states following with their credit acts 12 to 15 years later. In particular the Credit Acts required standard-form information statements. In 1993 the Uniform Credit Laws Agreement led to the State-wide adoption of the Consumer Credit Code (the Code). The Code's disclosure regime was largely the product of research conducted by consumer affairs officials and comparing credit regulations in other countries. There were

also a number of academics calling for empirical research into precontractual disclosure.¹⁴

37. The Code underwent an extensive post-implementation review in 1999 (PIR) by the Ministerial Council for Consumer Affairs (MCCA). The review made recommendations to improve precontractual disclosure. In response to the PIR recommendations, MCCA publicly released a consultation package on January 2006 with amendments aimed at requiring credit providers to disclose key information in a clear and simple format.

38. In February 2007, the WA Department of Consumer and Employment Protection acting on behalf of the Uniform Consumer Credit Management Committee (UCCCMC) and the Standing Committee of Officials in Consumer Affairs (SCOCA) issued a tender for consultancy services for the 'Simplification of Disclosure Regulation-Consumer Credit Code'. The tender noted that "the key message arising out of consultation was that any changes to existing disclosure should be based on consumer testing".¹⁵

39. The final report was released in May 2010. The empirical research was based on a combination of comprehension testing, focus group discussions and cognitive interviews (see empirical research section).

40. With the transfer of responsibility for consumer credit regulation to the Commonwealth, the SCOCA report was considered as part of Phase 2 of the National Credit Reforms. The issue of precontractual disclosure was specifically addressed in the Phase 2 National Consumer Credit Green Paper (Green Paper), which sought industry feedback on the precontractual disclosure report recommendations. Specifically, feedback was sought on the costs and benefits to consumers and industry of the findings of the recommendations. The Green Paper suggested that the findings of the report may need to be reconsidered under the *National Consumer Credit Protection Act 2009* disclosure framework as the SCOCA report was conducted under the old UCCC regulatory context. The Green Paper also suggested that further precontractual disclosure requirements should be considered over a longer timeframe.

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¹⁴ SCOCA report pg 23-24

¹⁵ WA Department of Consumer and Employment Protection, Request for Consultancy Services for the Simplification of Disclosure Regulation-Consumer Credit Code, February 2007, pg 27

Australian regulatory context

41. The issue of simple and meaningful disclosure of credit contracts for consumers has been an ongoing policy objective, with various regulatory solutions developed to improve precontractual disclosure.

Precontractual disclosure under the Uniform Consumer Credit Code (UCCC)

42. Until 1 July 2010 the States and Territories regulated credit providers by the UCCC. Under the UCCC precontractual disclosure was only required for lenders under sections 17 and 18.

43. Responsibility for enforcing the UCCC lay with various State and Territory Fair Trading Authorities or Consumer Affairs Bodies. The UCCC precontractual disclosure requirements were designed to improve information about the full costs of credit. However, there were no timing and formatting requirements; or standardisation of terminology. The UCCC also prohibited ‘unjust’ terms in credit contracts, required the provision of ‘comparison rates’ in certain credit advertising, and covered such matters as default procedures and provision for hardship applications.

44. The 1999 Post-Implementation Review of the UCCC (PIR) noted that the requirement for precontractual disclosure was “generally seen as desirable by consumers... many respondents considered [the current] information to be too complicated”.¹⁶ The PIR made the recommendation that a simplified Schumer Box format containing key features should be adopted, with other information contained outside of the Schumer Box.¹⁷

45. The PIR also noted that early disclosure of key information would be of greater use for consumers.

National Consumer Credit Protection Act 2009

46. The *National Consumer Credit Protection Act 2009* (Credit Act), which commenced on 1 July 2010, has responsible lending conduct obligations and has a similar goal of improving disclosure for consumers.

47. The conduct obligations require licensees to ensure that before providing credit assistance or before a consumer enters into a credit contract that an assessment must be made as to whether the contract will be unsuitable for the consumer. The responsible lending conduct

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¹⁶ PIR 1999 pg 9

¹⁷ PIR 1999 pg 30

obligations also include precontractual requirements for credit providers in Chapter 3 of the Act and under sections 16 and 17 of the National Credit Code (Code).

48. Under sections 16 and 17 of the Code, precontractual disclosure documents provide information about a specific credit contract before the consumer enters into that contract. However, sections 16 and 17 were based on the UCCC model of precontractual disclosure and, as such, there are no requirements for formatting of the information or terminology used.

49. The Credit Act also has a slightly different emphasis on disclosure, with a view to improving accountability of licensees (See Appendix 1).

50. The responsible lending conduct obligations prescribe the type of information to be provided in a disclosure document and how the disclosure document will be provided to consumers when a credit contract will be entered into or when credit assistance is provided to consumers. The Credit Act disclosure requirements provide key information to consumers about the lenders and brokers, particularly related to commissions and fees and charges.

51. Specifically, the Credit Act responsible lending conduct obligations require any commissions received, either directly, or indirectly, to be fully disclosed as well as any fees incurred by the consumer. The obligations are designed to better inform consumers and prevent the provision of unsuitable credit contracts by:

- providing information about the licensee;
- disclosing key responsible lending conduct obligations;
- providing information about the rights of the consumer and procedures for dealing with a dispute;
- informing the consumer of their right to request a copy of the unsuitability assessment; and
- disclosing quotes for providing credit assistance.

52. Based on this framework, consumers are provided with substantial information to clarify the accountability and responsibilities of lenders and brokers. However, this type of precontractual disclosure information may not be as useful to consumers when attempting to understand and compare home loan products. For example, while commission structures disclosure could be useful to indicate the accountability of a broker or a lender; it does not clarify the true cost of

the home loan to the consumer as they are not paying that particular commission.

Overseas regulatory context

53. In the UK, the Financial Services Authority (FSA) has responsibility for regulating mortgages. The FSA Mortgage Conduct of Business (MCOB) rules came into effect from 31 October 2004. The MCOB lays great emphasis on providing consumers with intelligible information provided in a consistent format that will enable consumers to shop around, compare different products, and make informed choices. Every consumer must be given precontractual information, in a highly prescribed format - the Key Facts Illustration (KFI) - before they can apply for a particular loan.

54. The KFI is a short, straightforward document that sets out the key facts about a specific mortgage product in enough detail to allow comparisons to be made with other products. It is personalised to the consumer, so to produce a KFI the firm needs to have certain pieces of information, including: the loan amount required; the value of the property; and the term required. The KFI is of a similar form to the early disclosure model tested in the Uniform Consumer Credit Code Management Committee report.

55. A 2006 UK Mortgage Effectiveness Review conducted by the FSA found that Consumers find the KFI useful in helping them to decide whether a mortgage is right for them, compare mortgages and consider the risks of a mortgage product. The report considered that given the backdrop of a low level of financial capability in the population as a whole, it is encouraging that consumers are using the KFI in their decision-making process. The report found that consumers are using the KFI to better understand the risks and features of the mortgages they take out, including the affordability risks.

56. There has been an effort in the UK to standardise terminology, particularly in relation to fees on mortgage termination. For example, all fees payable due to early termination must be referred to as "Early Repayment Charges".

Objectives of Government action

57. The objectives are to assist consumer to better understand the cost of their home loan and, where possible, enhance comparability of the product.
58. Standard terminology, descriptions and/or structure for fees and charges would make it simpler for consumers to compare fees and charges across institutions, and in particular the level of those fees and charges that are of interest to them.
59. An additional Government objective is to foster demand-side competition within the home loan market and contribute to the economic efficiency of the banking sector by empowering consumers through improved transparency, reduced transaction costs (through time savings) and more appropriate product selection.
60. This will promote more competition among lenders, and thereby lowering the costs to borrowers and improving levels of service.
61. A final objective is to, where possible, minimise compliance and transitional costs for the home loan industry.

Options that may achieve objectives

62. The RIS has attempted to quantify the costs and benefits. However, the information to quantify costs and benefits associated with any changes to the status quo are not available. Where necessary, benchmark costs have been used to provide some quantification of costs and benefits.
63. In the absence of quantification of costs and benefits, qualitative analysis has been used on to assess the costs and benefits.

Option 1 - Status-quo: precontractual disclosure under the National Consumer Credit Protection Act 2009

64. Under this option, the currently regulatory context of the Credit Act would apply, which commenced on 1 July 2010. Responsible lending disclosure obligations will commence from 1 January 2011.

65. The objectives of the Credit Act disclosure regulations are to provide consumers with clear information about the costs related to a credit contract and the features and information regarding the commission and bonus structures for brokers. For lenders, the precontractual disclosure would be limited to the requirements under Section 16 and 17 of the National Credit Code (see current regulatory section and Appendix 1).

66. The Credit Act does not prescribe any formatting, simplification of terminology or information that could assist comparison of costs.

67. As such obligations contained the Credit Act, there would be no additional obligations imposed on industry or additional protections for consumers. Consumers would therefore not receive any additional assistance in terms of simplified precontractual disclosure.

Impact analysis

68. Under Option 1 there are some benefits for industry and for Government. There are significant costs for consumers.

69. For industry, there would be no costs associated with additional regulation. There would be reduced education costs associated with regulations and minimal IT or business system changes. However, these would be related to the ongoing Credit Act disclosure process and not to any further Government intervention related to proposals in this RIS.

70. For Government there would be no additional costs associated with developing a response, whether regulatory or non-regulatory. The costs would therefore be zero as there would be no changes or transitions required.

71. For consumers under Option 1 there would be no further changes to precontractual disclosure, this has significant costs for consumers.

72. Under Option 1, precontractual disclosure is focused on consumer protection, where accountability of licensees is one of the mechanisms to protect consumers. Consumer groups have suggested that the current Credit Act provisions may increase the accountability of lenders and brokers, but it does not provide clear and concise information about the cost of the credit contract. During Consumer Credit Reform consultations, consumer groups have suggested that commission-related

information may ‘overload’ consumers with information and cause further confusion. Indeed in most cases, the first piece of information that the consumer receives is the Credit Guide, which provides preliminary information about the lender or broker and disclosure of the key conduct obligations. This information may not be helpful in understanding the home loan product itself.

73. This means that consumers may not benefit from the potential financial gain from finding a more suitable home loan or making the right choice based on simpler precontractual disclosure. For example, by shopping around, consumers can make considerable savings on their home loan. If a borrower selects a \$250,000 home loan with the lowest advertised rate, over the 30 year life of the loan the borrower could save more than \$40,000 compared to a home loan with an interest rate equal to the benchmark average variable rate.¹⁸ Without improved disclosure, there could be a significant number of Australians that would not benefit from potential savings from choosing a better home loan based on simpler precontractual disclosure.

74. Additionally, the Credit Act does not contain provisions for how information should be formatted or presented to consumers. This means that lenders and brokers can provide information of varying formats, which can reduce comparability of home loans and even reduced understanding of the precontractual disclosure content.

75. Empirical research provides further evidence that there are significant gaps in consumer comprehension under the current disclosure model (Section 16 and 17 of the Code).¹⁹ Research has found low consumer comprehension of many standard features of credit contracts, including home loans. The SCOCA report finding that only 6 per cent of adult participants in the cognitive study understood the true cost of the home loan. If this was applied to the Australian community in general, this would mean that only 6 per cent of adults would understand the cost of credit.

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¹⁸ Based on advertised rates on 15 November 2010. The benchmark variable rate is the weighted average of the rates offered on full featured variable loans of approximately 100 big and small lenders around Australia.

¹⁹ O’Shea, P, Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign, UniQuest, March 2010.

76. **High level impact analysis table: Status-quo: precontractual disclosure under the *National Consumer Credit Protection Act 2009***

Stakeholder	Benefits	Costs
Industry (including lenders and brokers)	No additional compliance or transaction costs.	Potentially uneven playing field Less consumer mobility in the home loan market as consumer would not be aware of their products, or if they were, consumer may have difficulty in understanding the relative benefits of home loan product.
Consumers	No further change to the system	Ongoing difficulties in understanding home loans and critical features
Government (including regulators)	No further policy development costs No further regulatory changes	Costs associated with current levels of government assistance
Economy-wide benefits	No significant changes to the market No impact on cost of credit or service delivery associated with regulatory intervention	Less informed consumers, which can lead to a potentially less dynamic market Less consumer empowerment, which can reduce demand-side competitive tensions

Option 2 - Non-regulatory option: Self-regulation

77. An alternative option would be for Government to encourage industry to develop and implement an early disclosure document by amending the Code of Banking Practice and the Mutual Banking Code of Practice. For brokers this could include the Mortgage and Finance Association of Australia and the Finance Brokers Association of Australia codes of practice.

78. The Government could encourage industry to develop a document through targeted consultations. However, if this option was selected the exact process would be discussed with industry.

79. Under this option, provision of the key facts document would not be legislated but ASIC could still approve the provisions under the relevant codes of conduct. Under this option, there would be minimal Government intervention beyond consultations with industry to discuss the key facts document. There would be no further provisions or regulations developed for this option.

80. Additionally under this option, current online comparison websites would be used as the main means of comparison of interest rates. This could include comparison websites such as Cannex, Mozo, Infocity, Canstar and Ratecity.

Impact analysis

81. This approach relies on the current voluntary industry codes of conduct, of which there are several depending on the entity engaged in lending or brokering. Most industry codes of conduct have disclosure requirements in place, aimed at giving the consumer adequate information about the type of loan and the entity providing the loan or the credit assistance.

82. There are some benefits for industry under this approach.

83. In most instances, the industry codes of conduct provide a good benchmark for disclosure requirements. Industry would have control over the process and would develop a format that would balance consumer comprehension against industry requirements. Information provided by Cannex and Mozo could provide a useful benchmark.

84. However, there are some costs both for industry and consumers.

85. The industry costs associated with this option include the cost of breaching the self-regulation and the cost of developing the key facts document.

86. If a lender breaches the Code of Banking Practice, the Code of Banking Practice Code Compliance Monitoring Committee (CCMC) may report on the breach by identifying a non-compliant bank in its publicly

available annual report. A similar voluntary code system is in place for brokers and could also result in reputation risk. Under this option there would be no formal penalties applicable beyond an impact on reputational risk for the lender or the broker.

87. There are also costs of implementing a simpler precontractual disclosure document.

88. It is difficult to calculate the precise cost to industry of introducing the key facts document with a lowest competitor rate. However, the costs are expected to be relatively modest as the information contained with the key facts document should be readily available to home loan providers. However, some elements could be costly to implement, such as a comparator rate.

89. The cost of implementing the mandatory comparison rate (MCR) disclosure under the UCCC can be used as a broad guide for introducing a lowest competitor rate as the policy objectives are similar and the required effort by industry is largely similar.

90. The MCR was introduced in July 2003 with the objective of providing information to consumers to enable them to understand the true cost of a loan product and compare various loan products in order to select a product that best suited their budget and other borrowing needs. This is a similar objective to the key facts document. The expected costs to introduce a key facts document, including developing IT systems, training staff and roll-out costs, are estimated to be similar to the costs that were incurred for the MCR implementation.²⁰

91. The Mandatory Comparison Rates Final Impact Statement prepared for the Uniform Consumer Credit Code Management Committee in May 2008 reported the compliance costs affecting credit providers implementing the MCR requirements. The Australian Bankers' Association (ABA) estimated that the initial costs to comply with the MCR were approximately \$11 million across all ABA members.

92. Credit unions estimated the start-up compliance costs associated with the MCR regime to range from \$3,700 through to \$7,500 per credit union which represents an investment for the 166 credit unions ranging from \$0.614 million to \$1.245 million.²¹

93. Ongoing costs to credit providers to maintain the MCR requirements included maintaining IT systems, printing of schedules, changes to schedules, updating websites, staff costs and distribution of schedules. The ABA estimated annual recurring costs of \$1.5 million across ABA members.²² It is estimated that the ongoing compliance costs

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²⁰ Uniform Consumer Credit Code: Mandatory Comparison Rates, 7 May 2008, Pg 35

²¹ Uniform Consumer Credit Code: Mandatory Comparison Rates, 7 May 2008, Pg 35

²² Uniform Consumer Credit Code: Mandatory Comparison Rates, 7 May 2008, Pg 37

for the key facts document would be similar to the ongoing compliance costs for the MCR. Although some of these costs would be incurred in any event, irrespective of the introduction of the key facts document.

94. When the document is introduced, there may also be an increase in monitoring industry compliance. A benchmark for monitoring costs can be provided based on the cost of running the CCMC. The CCMC expenditure for the year ending 31 March 2009 was \$509,812.²³ Inclusive of the expenditure is consultant fees (\$36,419) and technology (\$13,522).

95. If a key facts document were developed for industry, it is likely that increased technology and consultancy costs would be required. The timeframe for developing such a product could be assessed against the timeframe for the SCOCA report which developed a similar format. The tender process started in February 2007 and the report was finalised in March 2010. This is almost a three year period. This could lead to considerable development costs.

96. There are no available precise IT or regulatory costs for this particularly document. The ABA claims that any changes to documentation would require a lead time of at least 8 to 12 months to prepare for IT release schedules.

97. For consumers, the benefits may be that they receive an innovative, market-driven disclosure solution. This could reduce regulatory red-tape and perhaps provide a document that more closely reflects market developments. If a product were developed and implemented this could encourage more shopping around, consumers can make considerable savings on their home loan. For example, if a borrower selects a \$250,000 home loan with the lowest advertised rate, over the 30 year life of the loan the borrower could save more than \$40,000 compared to a home loan with an interest rate equal to the benchmark average variable rate.²⁴ If this saving was applied to Chart 1 under the scope and magnitude section, it would indicate significant savings for consumers across the home loan industry.

98. Coverage under this option would be limited for consumers as it would only apply to lenders and brokers who are signatories to their respective voluntary codes of conduct. This has costs for consumers.

99. Consumers may be under the misapprehension that when they are receiving industry-code regulated disclosure from an entity that in fact may not be signatory to an industry code. For example, if a lender breached the Code of Banking Practice it would not be covered by the Credit

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²³ CCMC annual report 2008-09, pg 20

²⁴ Based on advertised rates on 15 November 2010. The benchmark variable rate is the weighted average of the rates offered on full featured variable loans of approximately 100 big and small lenders around Australia.

Act and would not be considered a contractual breach, against which borrowers can make a claim for damages which can only be awarded through the Court or through an external dispute resolution scheme (such as the Financial Ombudsman Service). This is the case for small business borrowers for example. A similar situation would exist for consumers if precontractual disclosure were implemented through codes of conduct and not covered by the Credit Act.

100. Additionally, if there was misconduct ASIC would have limited options for enforcement. It is likely that the only recourse for action would be the each codes misconduct procedures. As noted before an industry monitoring body could breach a lender, but the outcome of this would be limited to the impact on the entity's reputation.

101. There may also be delays in developing the document, which could limit benefits for consumers. Self-regulation may be less effective compared to regulatory intervention as there is a need to seek industry agreement for the regulation in order for it to be widely adopted and implemented. This can be an extended process if there are difficulties in reaching industry agreement, it may lead to delays in finalising self-regulation or delays in implementation.

102. **High-level impact analysis table: Non-regulatory option: Self-regulation**

Stakeholder	Benefits	Costs
Industry (including lenders and brokers)	<p>As industry would develop and implement the key facts document, the measure would more closely reflect industry practices. This could potentially reduce administrative and consultation costs.</p> <p>Better use of industry expertise, industry would also have greater ownership of the key facts document.</p>	<p>Potentially high compliance and transaction costs associated with changes to IT and business systems due to industry consultation and implementation costs to develop the document.</p> <p>Increased enforcement and monitoring costs.</p> <p>Industry may not be best placed to develop a document with the same policy outcomes.</p>
Consumers	<p>Potentially better understanding of cost of credit.</p> <p>Increased consumer empowerment.</p> <p>Potentially more opportunities to compare credit contracts.</p>	<p>Coverage would not be universal and would be contingent on entity being signatory to a industry code of conduct.</p> <p>A related problem would that consumer may misled into assuming that they have universal coverage.</p>
Government (including regulators)	<p>Avoids detailed and prescriptive regulation which could hinder product innovation or service delivery.</p> <p>Less regulatory and administrative complexity associated with regulatory intervention.</p>	<p>Lack of enforcement capacity, may undermine the strength of the system.</p> <p>Costs associated with current levels of government assistance</p> <p>Misconduct would be hard to enforce.</p>
Economy-wide benefits	<p>Increased consumer empowerment potentially driving demand-side competition.</p> <p>There may be slight efficiency gains if better informed consumers select home loans that are appropriate.</p>	<p>May be used to promote anti-competitive behaviour through establishing barriers to entry.</p>

Option 3 - Regulatory Option - National Consumer Credit Reform Phase 2 process and consideration of disclosure

103. Under Option 3 a key facts document would be progressed through Phase 2 of the National Credit Reforms and would be implemented through the Credit Act. If the key facts document were progressed through this option, it could take a further one to two years.

104. Under this option, it is likely that the key facts document will more closely resemble the proposed content and format of the SCOCA report. The SCOCA report did not consider providing information that could assist with comparison of interest rates.

105. It should be noted that the report was conducted in the context of the old UCCC credit regulation context. This means that subjects were only tested against precontractual disclosure in relation to credit providers (lenders) and not credit service providers (brokers). The new Credit Act disclosure obligations apply precontractual obligations on brokers and maintain the same precontractual obligations for credit providers.

106. The National Credit Reform Phase 2 Green Paper (Green Paper) noted that there are further issues that need to be considered in conjunction with the SCOCA report findings (see Background). The Green Paper did not propose to consider specific reform options.

Impact analysis

107. Under this option the key facts document would be mandated through Phase 2 of the Credit Reforms. There are different levels of impact analysis for consumers and for industry.

108. For consumers, mandating a key facts disclosure document could provide significant savings through encouraging shopping around; consumers can make considerable savings on their home loan. For example, if a borrower selects a \$250,000 home loan with the lowest advertised rate, over the 30 year life of the loan the borrower could save more than \$40,000 compared to a home loan with an interest rate equal to the benchmark average variable rate.²⁵ If this saving was applied to Chart 1 under the scope and magnitude section, it would indicate significant costs for consumers across the home loan industry.

109. For consumers and industry, the benefit of this approach is that a longer consultation process could potentially take place through Phase 2 of the Consumer Credit Reforms. This could give further consideration to

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²⁵ Based on advertised rates on 15 November 2010. The benchmark variable rate is the weighted average of the rates offered on full featured variable loans of approximately 100 big and small lenders around Australia.

the issue of precontractual disclosure (scheduled to commence on 1 January 2011).

110. Mandating the key facts document through Phase 2 of the Consumer Credit Reforms would be a longer process. As such, there would be a period where consumers would be receiving potentially ineffective disclosure. This could impact on consumers' decisions for a home loan, either through not understanding the credit contract or by choosing the wrong type of loan or through reduced opportunities for comparison of different home loans. In the absence of good consumer decision making, there could be considerable costs.

111. One potential issue related to improvements in transparency is that if competitor rates were included (aside from the information already provided by the market), then there could potentially be a convergence of costs and product availability. This could result in reduced consumer choice and possibly competition.

112. However, for this scenario to occur it would be necessary for all lenders to have similar goals with regards to the home loan market. In practice, different lenders may seek different shares of the home loan market or indeed may seek to expand their lending in the small business credit market. There are also other aspects of home loans, other than the interest rate, over which lenders can compete, such as customer service. As such, whilst a convergence of home loans could potentially occur due to greater transparency over costs, it may not be the likeliest scenario.

113. For industry the specific amount of compliance costs would be difficult to calculate as different elements would have specific compliance costs. It is assumed that Phase 2 would provide the basic key facts document, without additional information on market rates. The impact analysis is based on an estimate of assuming printing costs, and preparing a tailored precontractual disclosure document. Under this model, the government would undertake the costs of developing the product and awareness campaigns. It is not clear at this stage what the potential costs would be as the key facts document content is not finalised at this stage.

114. Under this option there would be changes to industry IT and business systems to suit one type of disclosure model (the current Credit Act) and then a further change if a decision is made to consider the SCOCA report findings. Additionally, the SCOCA report focused on 4 different types of credit products (home loans, credit cards, car loans and store cards). Under this process, it is likely that all four types of disclosure formats would be considered, this could increase costs and time associated with consultation and possibly implementation costs.

115. The cost of complying with a tailored precontractual disclosure document may be similar to that of the cost for preparing a Statement of

Advice (SOA)²⁶ under the Chapter 7 of the Corporations Act. The RIS for the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 noted that industry suggested that the cost of preparing a SOA is approximately \$260.²⁷ A key facts document may incur similar costs in terms of time used by lender or broker to produce the document. The unit cost of printing the key facts document would depend on the volume printed.

116. Beyond costs associated with further consultations, there would be no additional product development or awareness campaign costs for industry. Moreover, the additional industry costs of maintaining and training staff to use a lowest competitor interest rate would not apply, as the Phase 2 consumer credit reforms do not consider this measure. There are no IT or regulatory costs for banks available. However, as claimed by the ABA any changes to documentation would require a lead time of at least 8 to 12 months to prepare for IT release schedules.

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²⁶ The SOA is a similarly tailored document that outlines the financial advice given to the individual, the information on which it's based, how the financial adviser gets paid and any interests or relationships that could influence them. The key similarity with the proposed key facts document is that it is tailored financial advice, not general advice.

²⁷ This estimate is based on the time that a financial adviser would spend on documenting the individual's information and advice. It does not include the costs of making appropriate inquiries about the consumer or doing the associated analysis.

117. **High-level impact analysis table: National Consumer Credit Reform Phase 2 process and consideration of disclosure**

Stakeholder	Benefits	Costs
Industry (including lenders and brokers)	<p>As industry would develop and implement the key facts document, the measure would more closely mirror industry practices. This could potentially reduce administrative and consultation costs.</p> <p>Better use of industry expertise, industry would also have greater ownership of the key facts document.</p>	<p>Potential compliance and transaction costs associated with changes to IT and business systems.</p> <p>Industry consultation and implementation costs.</p>
Consumers	<p>Potentially better understanding of cost of credit.</p> <p>Increased consumer empowerment.</p> <p>Potentially better information with which to compare home loans.</p>	<p>Coverage would not be universal and would be contingent on entity being signatory to a industry code of conduct</p> <p>A related problem would that consumer may misled into assuming that they have universal coverage.</p>
Government (including regulators)	<p>Avoids detailed and prescriptive regulation which could hinder product innovation or service delivery.</p> <p>Less regulatory and administrative complexity associated with regulatory intervention.</p> <p>Misconduct would be easier to enforce using the Credit Act.</p>	<p>Lack of enforcement capacity, may undermine the strength of the system.</p> <p>Costs associated with current levels of government assistance.</p>
Economy-wide benefits	<p>Increased consumer empowerment potentially driving demand-side competition.</p> <p>There may be slight efficiency gains if better informed consumers select home loans that are appropriate.</p>	<p>May be used to promote anti-competitive behaviour through establishing barriers to entry.</p>

Option 4 - Regulatory option – requiring a home loan key facts document

118. Option 4 is similar to Option 3 in that the overall policy objectives are the same; that is simplify disclosure for consumers. However, there are two key differences.

119. Option 4 would accelerate the development and consultation process with a view to introducing legislation in the first sittings of parliament in 2011.

120. Option 4 would also consider more prescriptive requirements regarding the content and formatting of the precontractual disclosure document, namely providing information that allows for comparisons of interest rates. Option 4 would cover key features of the credit contract, in clear and concise English. It would have a standardised format and font size. Figures would be in total dollar amounts (which can be tailored according to the consumer's particular credit needs).

121. Another feature of Option 4 is that it aims to provide a personalised document. Consumer would be able to provide their credit requirements to the lender or broker, and this would be reflected in the document. Consumers will receive information that is directly relevant to their credit needs and objectives. The key facts document would be provided early on in the decision making process to enable consumers to shop around and compare offerings from a range of credit providers. This will help enhance portability and comparability of home loan information. At present, none of the precontractual disclosure documents provide this for consumers.

122. In particular the content could include:

- Standardised format similar to a Schumer Box;
- disclosure of the value of the loan, the all-in interest rate;
- the amount of interest the consumer will pay over the life of the loan (including how much per month based on various interest rate assumptions);
- mortgage exit fees;
- standardised terminology;
- requirement to disclose lowest published market rate available compared against the all-in interest rate offered by the particular lender; and
-
- on-going fees and charges.

123. Given the different potential policy outcomes between 'early' and 'late' precontractual disclosure, the early disclosure document could be mandated separately and prior to any other change in the precontractual disclosure regime. The key facts document would also include a requirement for lenders to clearly state the lowest market rate. A model would have to be developed to calculate the comparison rate for each competitor mortgage product depending on the loan amount, loan-to-value ratio and the term of the loan.

124. This option would be implemented in several stages, industry consultation, potentially including further consumer testing and legislated through the Credit Act to ensure that key facts document aligned with current credit disclosure policy. The impact analysis will address these steps in turn.

125. Option 4 would accelerate the development process of a key facts document. It would not be progressed through the Phase 2 of the Consumer Credit Reforms. Under this regulatory option the content and the formatting of the key facts document would have more detailed prescribed formatting and information.

126. The precise content and format of the key facts document would be the subject of discussions with key stakeholders, including industry and consumer groups regarding implementation arrangements, with a view to minimising compliance costs on the home loan industry. The consultation process could also consider how the key facts document would interact with other disclosure documents under the Credit Act.

127. The consultation process could also include further focus-group testing on the nature and the form of the document to ensure that the lay-out and information is useful and accessible for consumer. This initiative will progress in parallel with a similar disclosure initiative in relation to credit cards, announced by the Government as part of the *Fairer, Simpler Banking* election commitment. The Government will work with the industry in order to minimise any costs of compliance associated with this reform.

128. Using the Credit Act to implement the policy would mean that coverage would also be universal, all consumers would benefit as they would have access to external dispute resolution schemes for any misconduct related to precontractual disclosure. An additional benefit is that ASIC would have enforcement powers and could appropriately address any misconduct.

129. It is intended to have the legislation for the key facts document in place for introduction in the first sittings of Parliament in 2011.

130. The method of rolling out would be subject to consultation with industry. Given that this process would be developed in consultation with industry, there are no benchmarks for systems development, roll-out

policies and procedures and training for relevant staff. A public awareness campaign could be implemented through ASIC. The costs involved with this will be finalised based on further consultations and once the policy framework is set.

Impact analysis

131. Option 4 would require Government intervention. In most cases, a preferable option would be for the market to develop a solution, as suggested by Option 2. However, the key issue is that the objective is to simplify disclosure for consumers and improve comprehension and transparency. It is not clear whether industry is best placed to fully achieve this objective.

132. In this case, Government intervention may be necessary to achieve a balance between market dynamics and consumer needs. In particular as consumers may not have sufficient market power to achieve adequate precontractual disclosure.

133. Requiring a prescribed early, personalised precontractual disclosure key facts document would impose compliance costs on industry. The specific amount of compliance costs would be difficult to calculate as different elements (such as a lowest competitor rate for example) would have specific compliance costs. As such the impact analysis is based on an estimate of assuming printing costs, and preparing a tailored document with a lowest competitor rate.

134. The cost of complying with a tailored precontractual disclosure document may be similar to that of the cost for preparing a SOA under the Chapter 7 of the Corporations Act. The RIS for the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 noted that industry suggested that the cost of preparing a SOA is approximately \$260 based on the estimated time that an adviser would spend on documenting the individual's information and advice. A key facts document may incur similar costs in terms of time used by lender or broker to produce the document. The unit cost of printing the key facts document would depend on the volume printed.

135. The ABA claim that changes to documentation require a lead time of at least 8 to 12 months to prepare for IT release schedules that are already pre-booked to maximum capacity (due to the current volume of regulatory reform and other system changes). The ABA suggested that there are certain timeframes in their IT systems which are more amenable to wholesale changes to IT and business systems. The precise training, implementation and roll-out costs would be made available through consultation to finalise the content and format of the key facts document.

136. Overall compliance costs for industry would be expected to be similar, although slightly higher than those outlined for Option 2 – Self-Regulation.

137. Despite the costs, under Option 4 there are some benefits for industry. It would provide a level playing field for all entities and would allow credit providers to advertise the key home loan features more clearly. Credit providers that offer more competitive products will be able to clearly signal this under a standardised precontractual disclosure document. This is a key difference with Option 2, where coverage would be limited for consumers as it would only apply to lenders and brokers who are signatories to their respective voluntary codes of conduct.

138. Another benefit for industry is that monitoring and compliance costs would be provided by the Government. There would still be some monitoring costs associated with the voluntary codes of conduct, but the impact would be smaller than if industry were to implement all monitoring activities.

139. Under Option 4 industry would not have to develop the product themselves and it is anticipated that the costs would be relatively low.

140. There would be some maintenance costs for Option 4, mainly related to IT systems, printing of schedules, changes to schedules, updating websites, staff costs and distribution of schedules. As noted previously, the ABA estimated annual recurring costs of \$1.5 million across all ABA members.²⁸ It is estimated that the ongoing compliance costs for the key facts document would be similar to the ongoing compliance costs for the MCR.

141. One potential issue for consumers is that improvements in transparency could lead to a convergence of costs and product availability as competitors would have greater awareness of each other's products. For this scenario to occur it would be necessary for all lenders to have similar goals with regards to the home loan market. In practice, different lenders may seek different shares of the home loan market or indeed may seek to expand their lending in the small business credit market.

142. For consumers, improved disclosure could lead to improved comprehension rates of the cost of credit and perhaps increase the SCOCA Report estimated 6 per cent comprehension rate. As noted before, if a borrower selects the appropriate loan it could lead to significant savings for them based on the example of a \$250,000 home loan with the lowest advertised rate, over the 30 year life of the loan where the borrower could save more than \$40,000 compared to a home

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²⁸ Uniform Consumer Credit Code: Mandatory Comparison Rates, 7 May 2008, Pg 37

loan with an interest rate equal to the benchmark average variable rate.²⁹ This indicates a significant savings for consumers across the home loan industry.

143. Importantly, there would be universal coverage for consumers as the key facts document would be implemented through the Credit Act. Consumer would benefit from the enhanced dispute resolution mechanisms, court arrangements and remedies.

144. High-level impact analysis table: Regulatory option – requiring a home loan key facts document

Stakeholder	Benefits	Costs
Industry (including lenders and brokers)	Even playing field, all entities are required to provide similar forms. Reduces possibility for unfair advantage from regulatory arbitrage amongst industry. Potentially reduces need for self-regulation system, which would reduce costs related to monitoring and compliance costs.	Potentially high compliance and transaction costs associated with changes to IT and business systems and meeting regulatory requirements. Less costs associated with consultation and product development costs.
Consumers	Universal access to simple and tailored precontractual disclosure. Potentially better understanding of cost of credit and opportunities to compare credit contracts. Increased opportunities for consumer empowerment.	Industry associated costs may be passed on to the consumer in the form of increased cost of credit or fees or charges.
Government (including regulators)	Even playing field, robust precontractual disclosure requirements.	Costs associated with current levels of government assistance. Increased regulatory and administrative complexity associated with regulatory intervention. Consultation and implementation costs.

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²⁹ Based on advertised rates on 15 November 2010. The benchmark variable rate is the weighted average of the rates offered on full featured variable loans of approximately 100 big and small lenders around Australia.

Economy-wide benefits	Increased consumer empowerment potentially driving demand-side competition. There may be slight efficiency gains if better informed consumers select appropriate home loans.	Initial transition costs may translate into increased cost or fees imposed on consumers. This could impact on fostering demand-side competitive pressures.
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Consultation

145. Consultation on the issue of simplification of precontractual disclosure has been an on-going process, with responses to consultations focussing on the same issues. There have been several rounds of consultation processes held, with industry providing useful feedback.

Post-Implementation Review of the UCCC 1999

146. In August 1998 the Standing Committee started consultation processes for the Post-Implementation Review (PIR). Although the PIR was conducted over 12 years ago, the regulatory context is still relevant as section 16 and 17 of the UCCC were replicated in the National Credit Code. Moreover, submissions and respondents to the PIR had similar recommendations and suggestions to the policy objectives of a simplified pre-contractual disclosure document for home loans. The issues paper was the main consultation document, submissions were sought from stakeholders on the issues detailed in the paper.

147. Between 23 October 1998 and 24 December 1998 the PIR project team received 33 submissions from key stakeholders, including consumer groups (CCLS New South Wales, Consumer Credit Legal Service), industry stakeholders (Wizard Finance, Statehealth Credit Union Limited, Super Members Home Loans) as well as industry representations (Australian Bankers Association, Finance Brokers of Tasmania Pty Ltd, Small Business Development Corporation).

148. The Standing Committee approved substantive research on the impacts of disclosure on the market place through a telephone survey, additional data was collated and focus group tested. The data was considered to be of sufficient statistical validity. Section 1 of the Issues Paper asked whether it is possible for disclosure information to be presented more simply and yet still comply with requirements of the UCCC. Section one also asked about the format, timing and key information content.

149. Submissions were broadly supportive of simplified disclosure, both from industry and consumer group. In particular, the response from consumer groups was that it would be desirable to have simplified disclosure.³⁰

150. The PIR recommended³¹:

- 1) the financial table should be converted to a simplified to a Schumer Box containing essential financial information;

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³⁰ 1999 UCCC PIR pg 9

³¹ 2005 Precontractual Disclosure and the Uniform Consumer Credit Code Consultation Package 2005, Ministerial Council for Consumer Affairs (MCCA), pg 2

- 2) other essential information should be provided outside the box and consumers must be informed that other important information is contained in the credit contract; and
- 3) the UCCC should be amended to clarify fees and charges.

151. These recommendations are reflected in the overall policy objectives for pre-contractual disclosure outlined in this RIS.

Uniform Consumer Credit Code Management Committee consultations 2005

152. In December 2005 the Uniform Consumer Credit Code Management Committee (UCCCMC) consultations released the consultation package, *Precontractual disclosure under the Uniform Consumer Credit Code*, which include a 'proposed disclosure model' to replace the UCCC disclosure model, the format of which is similar to the proposed key fact document.

153. The consultation was based on the December 1999 PIR Final Report, focussing on two issues: whether the disclosure requirements have resulted in the provision of useful information to consumers when making choices between credit products and credit providers and whether disclosure information could be presented more simply and yet still comply with the requirements of the UCCC.

154. Submissions in response to the consultation generally supported the overall framework and design of the proposed disclosure model.

155. Following consultations with stakeholders from the consumer credit industry, UCCCMC determined that the need for any further changes to the existing UCCC precontractual disclosure should be identified through consumer testing and research into disclosure models, particularly the timing of precontractual disclosure.

156. The outcome and research from the tender are outlined under this empirical research SCOCA report section in this RIS.

House of Representatives Standing Committee on Economics Inquiry into Competition in the banking and non-banking sectors 2008

157. The inquiry received evidence on a range of issues and found that in addition to the credit reforms related to disclosure and there that is a need in Australia for some form of standardised key facts document

similar to the UK model. The Committee suggested that this could assist consumers to effectively compare home loans.³²

158. The inquiry received 60 submissions, with six submissions commenting on the need for simplified precontractual disclosure and two submissions commenting on the need for standardised terminology. Some industry members were supportive of a key facts document³³ as well as the standardised terminology.³⁴

National Credit Reform

Consumer Credit Stakeholder Consultations

159. The Consumer Credit Reforms main industry consultation group comprises of the banking, mortgage brokering industries and consumer groups. The industry consultation group meet on a monthly basis. This approach has ensured industry input into the consultation process. It is in this context that the SCOCA Disclosure Report and issues related to mandating formats for precontractual disclosure have been discussed.

160. It was agreed that under Phase 2 of the Consumer Credit Reforms – which considered precontractual disclosure – that consultations should occur through the main industry consultation group.

161. Industry consultations focussing on Phase 2 commenced in December 2009 and continued throughout 2010 (except during the caretaker period). During this time, most key stakeholder groups were present at the consultations.

Consumer Credit Green Paper process

162. The National Credit Reform Phase 2 Green Paper, released on 7 July 2010, sought broad industry feedback on the precontractual disclosure report recommendations. The feedback during industry group consultation consultations was incorporated into the Consumer Credit Green Paper.

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³² Report Inquiry into Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics, November 2008, pg xvii

³³ Fujitsu Consulting submission to the Inquiry into Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics 2008.

³⁴ Mates Rates Mortgages submission to the Inquiry into Competition in the banking and non-banking sectors, House of Representatives Standing Committee on Economics 2008 and transcript to the inquiry: <http://www.aph.gov.au/hansard/rep/commtee/R11145.pdf>

163. Over 55 submissions were received during the Green Paper consultation process, including from industry, consumer groups and industry representative groups.

164. However, a simplified disclosure document was not specifically recommended by the Green Paper. As such, responses to the Green Paper only provided high-level comments on the nature of precontractual disclosure.

165. In its submission to the Green Paper, the Australian Bankers Association (ABA) noted that there were certain IT and business system issues that would need to be taken into account regarding precontractual disclosure changes. The ABA noted that new responsible lending disclosure obligations will commence for credit providers and credit assistance providers on 1 January 2011. The ABA suggests that the new disclosure regime be monitored for 12 to 24 months before further changes to precontractual disclosure requirements are contemplated.

166. From an implementation perspective, the ABA submission stated that any changes to documentation would require a lead time of at least 8 to 12 months to prepare for IT release schedules and that most IT schedules are pre-booked to maximum capacity. The submission also noted that banks stop any IT system changes from mid-November to January of each year to allow the IT systems to function at full capacity to account for seasonal shopping.

Conclusion and recommended option

167. Four options are considered:

- Option 1: Maintaining status quo;
- Option 2: Self-regulation;
- Option 3: Regulation through the Phase 2 of Consumer Credit Reforms; and
- Option 4: Regulation through mandating a key facts document.

168. Based on issue of stakeholder interests, timing and the proposed content of the key facts document, the preferred option is Option 4. This option achieves the Government objectives for improved consumer understanding of home loan costs and would assist consumers.

169. Option 4 would create a level playing field for all entities. Credit providers that offer more competitive products will be able to clearly signal this under a standardised precontractual disclosure document.

Implementation and review

170. There would be two steps for implementation of Option 4, the targeted consultation process and changes to the Credit Act.

Targeted consultation

171. First, further targeted consultations will take place over a three week period (this could also include further focus-group testing). The consultation process would take place through the Consumer Credit Industry Stakeholder Consultation Group. The precise format for consultation and consumer testing would be decided on in conjunction with industry. However, it is the intent that consumer groups and industry representatives will be able to provide comment on the proposed content and format for the key facts document. Whether this will occur through formal submissions or discussion will be decided on once the policy is option is finalised. The consultation group would provide input to potential transitional and practical issues that may need to be addressed to implement the proposal.

172. Issues that will be consulted on include the use of certain sized text, prescribed wording, sections and terminology would be consulted and possibly consumer tested. Using the main industry consultation group would ensure that all key stakeholders dealing with consumer credit are

properly consulted and will produce a more robust product. Focus-group testing could examine more closely what types of information and the format that should be included in the key facts document, and perhaps the interaction with the Credit Act's additional disclosure objectives.

173. Consultations will also examine how the regulations of the key facts document will take place. The measure could be regulated by ASIC in a similar way to that adopted in the UK, where the FSA regulates mortgage and home finance products.

Changes to the Credit Act

174. The key facts document would be introduced by amendment to the *National Consumer Credit Protection Act 2009* and where needed further consumer credit regulations.

175. When the key facts document content and format is finalised, a more developed RIS will be provided with the introduction of the legislation in the first sittings of Parliament in 2011.

176. The legislative process – depending on drafting resources – could take up to six months. It is intended that the key facts document will be introduced in the first sittings of Parliament in 2011. State referral would not be required in this instance, as the type of credit product, home loans, is addressed under Section 5 of the National Credit Code. State referral has therefore already been provided for this issue.

177. The review process for the key facts document would be decided on at a later date. But the effectiveness of the proposed measure and legislative amendments would be informally monitored by Treasury and then reviewed after a sufficient period of time had elapsed.

APPENDIX:

**Appendix 1: National Consumer Credit Protection Act 2009
precontractual disclosure requirements**

Document	Obligation	Purpose	Explanation of obligations
Credit Guide (CG)	Credit providers (CP) Credit assistance providers (CA) Credit representatives (CR)	To provide consumer with preliminary information about the CP, CA and CR. Information that should be provided is conduct obligations of licensee, key rights of the consumer. For CA the information needs to include the possible nature and size of fees and charges that the consumer may incur as well as commissions. Applies to credit leases as well.	For CA the credit guide must be given to the consumer as soon as practicable after it becomes apparent to the CA that they will provide credit assistance to the consumer. It is anticipated that this could occur as early as the first communication. If CA gives the consumer CP CG, there is the expectation that there is no need to provide it to the consumer again. For CP, it is envisaged that precontractual disclosure required as required by the Code. For the CP, it is anticipated that the timing could be as soon as the consumer is likely to enter into a credit contract. For CR, they must give CG to consumer at same time as CG of licensee they represent.
Quote for providing credit assistance (quote)	CA	The quote advises the consumer of maximum cost of the CA's services, also includes estimates incurred by consumer or out of credit contract. Possibility that final quote will be less. Quote clarifies with consumer whether or not the costs will be incurred by consumer regardless of whether the credit is obtained.	The quote must be provided before credit assistance is provided. The quote needs to be signed and date before credit assistance is provided. These requirements also apply to credit leases.
Credit proposal disclosure document (CCPD)	CA	The document provides the consumer with estimates of fees and commissions relating to the credit contract.	CA must at the same time as providing credit assistance provide the CCPD.

		Applies to credit leases as well.	
Precontractual disclosure statement	CP	The document provides the consumer with financial information specified by regulations. Applies to credit leases as well.	The CP must provide the document before the contract is entered into or before the debtor makes an offer to enter into the contract, depending on what comes first. It may be that the pre contractual statement can be the proposed contract document. In this case section 17 information requirements would apply.
Credit proposal disclosure document (CCPD)	CA	The document provides the consumer with estimates of fees and commissions relating to the credit contract. Applies to credit leases as well.	CA must at the same time as providing credit assistance provide the CPDD.