



ASIC

Australian Securities & Investments Commission

REPORT 191

Response to submissions on CP 115 Responsible lending

February 2010

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 115 *Responsible lending* and details our responses in relation to those issues.

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.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

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A Overview/Consultation process

- 1 Chapter 3 of the *National Consumer Credit Protection Act 2009* (National Credit Act) imposes responsible lending obligations on Australian credit licensees (credit licensees). These obligations apply to both credit providers (e.g. lenders, such as banks, credit unions and finance companies) and credit assistance providers (e.g. mortgage or finance brokers).
- 2 The key concept is that credit licensees must not enter into a credit contract with a consumer, suggest a credit contract to a consumer or assist a consumer to apply for a credit contract if the credit contract is unsuitable for the consumer.
- 3 In order to meet the responsible lending obligations, credit licensees must:
 - make reasonable inquiries of the consumer about their financial situation, and their requirements and objectives;
 - take reasonable steps to verify the consumer's financial situation; and
 - based on these inquiries and the verification, make a preliminary assessment (if they are providing credit assistance) or a final assessment (if they are a credit provider) of whether the credit contract is 'not unsuitable' for the consumer.
- 4 In addition, if the consumer requests it, the credit licensee must provide to the consumer a written copy of the preliminary assessment or final assessment.
- 5 In Consultation Paper 115 *Responsible lending* (CP 115), we consulted on proposals about the conduct we expect of credit licensees in order for them to comply with the responsible lending obligations.
- 6 CP 115 set out proposals in three areas:
 - the level of inquiries ASIC would expect of a licensee when conducting reasonable inquiries about the consumer and verifying that information;
 - the type of issues the licensee should take into account when making an assessment that the credit contract is 'not unsuitable' for the consumer; and
 - the guidance ASIC should provide in relation to the requirement for the licensee to provide, at the consumer's request, a copy of the assessment that the credit contract is 'not unsuitable' for the consumer.
- 7 This report highlights the key issues that arose out of the submissions received on CP 115 and our responses to those issues.

- 8 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 115. We have limited this report to the key issues.
- 9 For a list of the non-confidential respondents to CP 115, see the Appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under 'CP 115'.

Responses to consultation

- 10 We received around 40 responses to CP 115 from a wide variety of sources including a range of banks, brokers, industry bodies, consumer representative groups and private citizens. We are grateful to respondents for taking the time to send us their comments.
- 11 Generally, there was support for our overall proposed approach to administering the responsible lending obligations; however, respondents raised concerns in relation to particular expectations set out in our proposed guidance. Although there was quite wide support for the concept of 'scalability', there were concerns about some of the factors we identified that could be taken into account: see paragraphs 23 and 24 of CP 115.
- 12 The main issues raised by respondents related to:
- the level of inquiries expected of a licensee when conducting reasonable inquiries about the consumer;
 - the difficulty of obtaining and verifying information, and whether the requirement to take 'reasonable steps to verify' information should be scalable;
 - the difference in our expectations of credit providers and credit assistance providers in meeting the responsible lending obligations; and
 - our expectations about the content of the written assessment of whether the credit contact is 'not unsuitable'.
- These issues are discussed in the following sections.
- 13 We have refined the proposed guidance in CP 115 to take into account the feedback in the submissions we received. Our final guidance is in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

B Proposed guidance about reasonable inquiries

Key points

Respondents were generally supportive of our proposal that the obligation to conduct reasonable inquiries be scalable (i.e. licensees should conduct appropriate inquiries depending on the circumstances).

Many submissions offered suggestions about how our guidance could be further improved. This feedback fell into two broad groups. The first group thought that the guidance should include more consumer protection mechanisms, while the second group thought the guidance at times went beyond what the legislation required of licensees.

Making reasonable inquiries

Scalability of the reasonable inquiries obligation

- 14 In CP 115, we proposed to give guidance that the obligation to make reasonable inquiries is scalable—that is, what a credit licensee needs to do to meet these obligations will vary depending on the circumstances. We stated in CP 115 that ‘scalable’ means that the obligation varies depending on the circumstances, including the potential impact on the consumer of entering into an unsuitable credit contract, the complexity of the credit contract and the financial literacy of the client.
- 15 Respondents were very supportive of our proposal that the obligation to conduct reasonable inquiries be scalable, stating that it would allow licensees to conduct appropriate inquiries depending on the circumstances.
- 16 Feedback about how the guidance could be improved generally fell into two main groups. Some respondents recognised the usefulness of scalability, but stated that further guidance aimed at protecting consumers was necessary. For example, some of these respondents suggested we require a minimum level of inquiries in all cases, or clarify the guidance further to make it clear that just because a loan is small in value does not mean that inquiries can always be ‘scaled down’ (as even small loans can cause financial difficulties for some consumers).
- 17 The other main group of responses noted that some of the guidance appeared to require more than was required of licensees under the National Credit Act, and suggested improvements to allow the guidance to operate successfully in a commercial context.

- 18 For example, some of these respondents noted that the National Credit Act does not require licensees to assess the ‘financial literacy’ of consumers. These submissions highlighted the difficulty of being able to determine financial literacy.
- 19 Other respondents argued that scalability should also consider other characteristics of the consumer. For example, reasonable inquiries should take into account whether the consumer is new to the licensee or is an existing customer.

ASIC’s response

Many submissions contained very useful comments about how we could improve our guidance, and we have refined our final guidance (in RG 209) to take into account the feedback we received. For example:

- We have clarified that the scalability of the reasonable inquiries obligation does not simply mean that licensees should make more inquiries as the value of the credit contract increases. It is also important to consider the value of the credit contract relative to the consumer’s capacity to repay. This guidance is intended to illustrate that even small loans can cause financial difficulties for some consumers: see Table 3 in RG 209.
- We have clarified our guidance about a consumer’s capacity to understand the credit contract, and we have used this language instead of ‘financial literacy’: see Table 3 in RG 209.
- We have also clarified that whether a consumer is an existing customer is a factor that is relevant to scalability (i.e. a credit provider may be able to make fewer inquiries of a consumer where the consumer is an existing customer because the credit provider will already hold information about the customer): see Table 3 in RG 209.

What inquiries should licensees make?

- 20 CP 115 lists factors that illustrate inquiries that credit licensees could make when determining how to meet their obligation to make reasonable inquiries about a consumer’s financial situation, requirements and objectives. Respondents were mostly supportive of our proposed guidance on the inquiries that licensees should make—however, some respondents sought clarity on specific aspects. In particular, some wanted greater emphasis that the factors listed in paragraphs 23 and 24 of CP 115 were not ‘checklists’ but non-exhaustive factors that could be taken into account depending on the situation, including the consumer’s circumstances.
- 21 Some respondents sought further clarification on the meaning of some of the factors listed in paragraphs 23 and 24 of CP 115.

ASIC's response

We have clarified our guidance to make it clear that the factors listed in RG 209.27 and RG 209.28 are not intended to be checklists. Licensees would not be expected to make all these inquiries in all cases. It is up to individual licensees to assess what inquiries it is reasonable for them to make in the circumstances: see RG 209.24–RG 209.26.

Processes to ensure that reasonable inquiries are made

- 22 CP 115 proposed guidance that credit licensees would need to have processes in place to ensure that reasonable inquiries are made of the consumer. Most respondents agreed with our proposals for ensuring that licensees have sufficient processes to ensure that they make reasonable inquiries. However, there was some resistance to some of the proposals, such as the adequate supervision of employees of the licensee. Some respondents stated that requiring compliance staff to be placed in regional offices imposes too great a burden, and argued that they already had an effective centralised compliance structure.
- 23 One submission recommended that we remove the requirement to place compliance staff at various geographical locations, but instead focus on the licensee having robust compliance measures in place across their distribution channels.
- 24 Some respondents stated that the guidance appeared to assume that the processing of all credit contracts occurred under face-to-face environments, which did not reflect real-world practices where automated procedures were often used. Respondents stated that the inquiries being suggested in CP 115 would require substantial changes to existing procedures and slow down the processing of applications for high-volume credit products (such as credit cards). A few respondents stated that they would no longer be able to provide certain credit products under these requirements.

ASIC's response

We have clarified our guidance to emphasise that adequate supervision of employees can occur in a number of ways, including having compliance staff in regional offices, but other methods of supervision are also possible—for example, regular audits of staff in regional offices or using centralised credit application assessment systems: see RG 209.32–RG 209.34.

We have also clarified that licensees can meet their responsible lending obligations using either a face-to-face or online approach: see RG 209.35–RG 209.37.

Verification of information provided by a consumer

- 25 Most respondents agreed with our guidance in relation to taking reasonable steps to verify information about a consumer's financial situation. Some respondents wanted further clarification about whether the requirement to take reasonable steps to verify information is scalable. Other respondents sought greater clarification about the interaction between the obligations of credit assistance providers and credit providers, especially in relation to duplication of processes.

ASIC's response

We have amended our guidance to clarify that the obligation to take 'reasonable steps to verify' information is scalable—that is, what amounts to reasonable verification will depend on the circumstances. We have also added guidance about how the obligations between credit assistance providers and credit providers interrelate: see RG 209.38 and RG 209.44–RG 209.47.

C Assessment of unsuitability

Key points

The majority of respondents agreed with our proposed guidance on the assessment of unsuitability. However, a number of respondents sought clarification of the proposed guidance, and others voiced concern about the language used to describe the requirement to assess a consumer's requirements and objectives (referred to as the 'fitness for purpose' test in CP 115).

Forming a view that a credit contract is 'not unsuitable'

- 26 Generally, there was broad support for our proposed guidance about the steps that we expect licensees to take in forming a view that a credit contract is 'not unsuitable'. Concerns about our guidance primarily related to particular details of our proposals—however, on the whole, there was support for the overarching principles. We have discussed these issues below.

Assessing whether a credit contract meets a consumer's financial situation (i.e. the capacity to repay without substantial hardship)

- 27 Most respondents agreed with our proposed guidance on assessing a consumer's capacity to repay a credit contract.
- 28 Most respondents also agreed with our proposed guidance in relation to substantial hardship, although feedback varied on how the guidance could be further clarified. Some respondents were concerned about the meaning of the term 'substantial hardship' and sought further clarification or guidance from us. One respondent requested that we provide a list of factors a licensee could consider to determine whether there would be substantial hardship for a consumer in entering a credit contract. Other respondents agreed that we should not attempt to define the meaning of 'substantial hardship', and suggested that the regulatory guide should acknowledge that it will require further judicial consideration.
- 29 There was some criticism directed towards the consultation paper's reference to fixed poverty standards, such as the Henderson Poverty Index. These submissions recommended that we should not refer to fixed thresholds, stating that they may fail to accurately reflect a person's actual expenses or lifestyle.

ASIC's response

We have not attempted to define the meaning of 'substantial hardship' in RG 209. However, we have include guidance that a consumer can be assumed to be exposed to substantial hardship if their disposable income is below an amount based on an objective indicator, such as the Henderson Poverty Index. This is to recognise that although many credit licensees may use the Henderson Poverty Index as a reference point, they also add a margin to this index in acknowledgement that the index is often too low to usefully indicate actual living costs: see RG 209.64.

Assessing whether a credit contract meets a consumer's requirements and objectives (fitness for purpose)

- 30 There was general support for our proposals in relation to determining a consumer's requirements and objectives. However, some respondents disagreed with the terminology used to describe this obligation (i.e. 'fitness for purpose'). Some respondents argued that this proposal went beyond the requirements of the legislation.
- 31 Some respondents stated that some credit contracts have no single purpose—in particular, credit cards—making it impossible to determine fitness for purpose.

ASIC's response

The use of the term 'fitness for purpose' was not intended to increase the threshold from what is required under the legislation when determining a consumer's requirements and objectives. However, to avoid future confusion on this issue, the terminology in RG 209 reflects the terminology used in the National Credit Act and no longer refers to 'fitness for purpose'.

In relation to credit cards, we have included reference to the Explanatory Memorandum to the National Consumer Credit Protection Bill 2009, which acknowledges that credit cards have a 'general purpose' (although it would still be relevant to determine the limit the consumer requires on the credit card): see RG 209.29.

Switching and refinancing

- 32 In general, the majority of respondents agreed with our proposed guidance on switching and refinancing. There were some concerns in relation to switching, primarily relating to the factors a licensee could take into account when suggesting or providing a switching loan. In particular, some respondents stated that a lender should be able to consider non-monetary benefits, such as:

- (a) branches located closer to the customer;
- (b) dealing with the staff of a particular lender; and
- (c) consolidating a number of credit products with the one provider.

33 Again, there was concern raised about a lender's ability to access certain information (particularly in relation to the existing loan) when advising a consumer about switching. In particular, these submissions noted that it may be difficult to obtain all associated fees and costs, such as exit fees.

ASIC's response

Our guidance acknowledges that switching or refinancing may be appropriate for non-monetary reasons, such as convenience. We have also clarified that, where the original loan is with another credit provider, the credit licensee can obtain information about exit fees, etc, from the consumer directly: see RG 209.75–RG 209.76.

D Guidance about the written assessment that a credit contract is ‘not unsuitable’

Key points

The majority of respondents generally agreed with our proposed guidance on providing the consumer with a written assessment that the credit contract is ‘not unsuitable’.

Some respondents thought that we should provide a template document to illustrate the information the written assessment should contain, while other respondents sought a less prescriptive approach.

- 34 Most respondents generally agreed with our proposed guidance on the content of the written assessment that a credit contract is ‘not unsuitable’.
- 35 Some respondents expressed concern about what we would expect the content of the written assessment to include. A few respondents suggested that we should provide an example of a written assessment that lenders could use as a template.
- 36 Some respondents argued that the written assessment should be simple and factual, and be no more than a record that the credit licensee has conducted reasonable inquiries. Conversely, other respondents submitted that the assessment would be useless if it did not include customer-specific facts. Some respondents provided examples of information that they believed should be included in the assessment.
- 37 Almost all respondents who commented on the issue said that the written assessment was a new requirement and would involve a degree of cost to implement.

ASIC’s response

The majority of respondents agreed with our proposed guidance, and we have, therefore, left the guidance relatively unchanged, apart from clarifying a number of technical questions that were asked in submissions.

Our guidance takes a ‘middle path’ between the divergent views expressed in submissions (i.e. some respondents sought more prescription about what the written assessment should include, while others sought less): see Section D of RG 209.

E Other comments by respondents

Key points

Respondents provided various useful comments outside of the issues discussed in the consultation paper. A key issue raised related to further clarification of responsibilities of credit assistant providers.

- 38 Many respondents sought further clarity about the division of responsibilities between credit assistant providers and credit providers, with some stating that we may need to issue separate guidance to avoid confusion between the two. Some respondents suggested that we should consider creating separate regulatory guides for credit assistance providers and credit providers; others stated that we should create separate sections in the one guide.
- 39 In relation to this issue, some respondents were concerned about the credit application process—in particular, the potential for a substantial amount of duplication of tasks between credit assistant providers and credit providers.

ASIC's response

We have clarified our guidance to make it clearer how the responsible lending obligations apply to credit providers and credit assistance providers: see for example Tables 1, 2 and 4, RG 209. We have also included guidance to reduce duplication of processes between these two groups of licensees, where appropriate: see RG 209.44-209.47.

Appendix: List of non-confidential respondents

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- Abacus – Australian Mutuals
 - Aussie
 - Australia and New Zealand Banking Group Limited
 - Australian Bankers' Association
 - Australian Finance Conference
 - Australian Finance Group
 - Australasian Retail Credit Association
 - AXA Financial Planning and Charter Financial Planning (joint submission)
 - Bank of Queensland Limited
 - Brotherhood of St Laurence
 - Challenger
 - Consumer Action Law Centre
 - Consumer Credit Legal Service (WA)
 - Credit Ombudsman Service Limited
 - Dun & Bradstreet
 - Financial and Consumer Rights Council Inc.
 - Financial Counsellors' Association of Queensland Inc.
 - Financial Ombudsman Service
 - Financial Planning Association of Australia
 - Financial Sector Union of Australia
 - GE Capital Finance Australasia Pty Ltd
 - Insurance Council of Australia Limited
 - Liberty Financial Pty Ltd
 - Min-it Software and Financiers Association of Australia (joint submission)
 - Mortgage & Finance Association of Australia
 - National Financial Services Federation
 - Payment Cards Industry Taskforce
 - Principled Mortgage Investments Ltd
 - Short-Term & Bridging Finance Association
 - Therese Wilson
 - Westpac Group
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