ASIC

Australian Securities & Investments Commission

REPORT 264

Review of micro lenders' responsible lending conduct and disclosure obligations

November 2011

About this report

This report sets out the findings of a review of loans not involving real property provided by micro lenders between July and December 2010, with a specific focus on the responsible lending and disclosure requirements.

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- 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.

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Disclaimer

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

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Executive summary

1 The *National Consumer Credit Protection Act 2009* (National Credit Act) commenced in July 2010, imposing licensing requirements and responsible lending obligations on credit providers and persons providing credit assistance to:

(a) make reasonable inquiries into a consumer's requirements and objectives;

(b) make reasonable inquiries into a consumer's financial situation;

(c) take reasonable steps to verify a consumer's financial situation;

(d) assess whether a proposed credit contract will not meet the consumer's requirements and objectives; and

(e) assess whether a consumer will be unable to meet their obligations under a proposed credit contract without substantial hardship.

2 The holder of an Australian credit licence (a credit licensee) must keep a record of all material that forms the basis of an assessment of whether a credit contract will be unsuitable for a consumer. The material must be in a form that will enable the credit licensee to give the consumer a written copy of the assessment if requested: see Pro Forma 224 *Australian credit licence conditions* (PF 224), condition 17.

3 To help industry prepare for the responsible lending obligations, in February 2010 ASIC issued Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

4 Under the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* (Transitional Act), the responsible lending obligations were introduced in two stages. From 1 July 2010, these obligations commenced for persons providing credit assistance (e.g. mortgage brokers) and micro lenders. The obligations commenced for authorised deposit-taking institutions (ADIs), such as banks and credit unions, and registrable corporations under the *Financial Sector (Collection of Data) Act 2001* (generally comprising large non-bank credit providers) on 1 January 2011.

Note: See paragraphs 22–25 for discussion of the definition of 'micro lender'.

5 The National Credit Act contains the National Credit Code, which replicates the previous state and territory-based law relating to consumer credit, the Uniform Consumer Credit Code (UCCC). The provisions about disclosure in the National Credit Code are in substance the same as those that were contained in the UCCC. However, there have been some enhancements to these provisions, such as the implementation of a new requirement for credit providers to issue a direct debit default notice should a consumer's direct debit be unsuccessful.

6 Given concerns raised previously about the conduct of credit providers offering loans with a repayment date of the consumer's next pay (payday loans) and short-term loans of small amounts, we decided to do an early assessment of micro lenders' compliance with the responsible lending obligations. Further, because the disclosure provisions have effectively been in place for some time, we saw the benefit, as the new consumer credit regulator, in assessing industry's current compliance and understanding of its disclosure obligations.

What we did

7 The purpose of our review was to gain an understanding of how micro lenders were meeting their responsible lending and disclosure obligations under the National Credit Act in the first six months of the regime. For our initial review, we selected 28 micro lenders. This group comprised entities that we identified as:

(a) at higher risk of non-compliance with the responsible lending and disclosure obligations based on information held by ASIC; or

(b) part of a sample of micro lenders operating across Australia, including regional areas.

8 We obtained from the selected micro lenders details of the consumer credit they had provided between July and December 2010. These details included the loan amounts, terms of the loan, the purpose of the application and default information.

9 The selected credit providers reported that a total of 34,877 credit contracts were entered into for this period. Of these, 19,246 contracts related to credit provided purely over the internet, while 72 contracts related to car finance. By including contracts entered into over the internet and contracts for a specific purpose (i.e. car finance), we had a wider base over which to identify industry practices generally in the sample group of lenders.

10 We initially reviewed the details of these loans to identify factors that raised a greater risk of non-compliance with the responsible lending and disclosure obligations. This process sought to identify loans and/or credit providers that warranted a detailed review.

11 Following this process, we obtained and reviewed 168 files from 19 micro lenders who offered loans for credit provided between July and December 2010. These 168 files included 19 loans offered by micro lenders over the internet and 8 loans offered for car finance.

12 We then reviewed the 168 files to assess the processes and record keeping undertaken by micro lenders. The focus of our review was not on assessing

whether a credit contract was unsuitable for an individual consumer; therefore, no findings were made in that regard.

What we found

Finding 1: Awareness of obligations

13 We found that micro lenders were generally aware of the responsible lending and disclosure obligations.

Finding 2: Changes to practices

14 Since the commencement of the National Credit Act, the microfinance industry has changed its practices. Individual micro lenders have become licensed, developed responsible lending policies and procedures, put in place internal dispute resolution (IDR) procedures, and joined external dispute resolution (EDR) schemes. To become licensed, micro lenders have met a 'fit and proper person' requirement (as have key individuals in these businesses) and developed compliance plans. Further, many individuals in the microfinance industry have gained a qualification, a Certificate IV in Financial Services (Credit Management). Many licensees have joined an industry association and signed up to receive ASIC policy alerts to ensure they remain up to date with the new laws.

15 Over the review period, micro lenders continued to assess their responsible lending practices and may have updated their procedures in response to the experience they gained from working under the new provisions and answering ASIC's inquiries.

Finding 3: Practices observed

16 Files reviewed generally recorded micro lenders' inquiries into a consumer's requirements and objectives, inquiries into and verification of a consumer's financial situation, and assessment of whether a consumer would be able to meet their obligations under the proposed credit contract without substantial hardship. For example:

(a) all files reviewed displayed a basic level of inquiry into the immediate purpose of the loan (e.g. personal use);

(b) inquiries into and recording of the consumer's income level and source of income were generally undertaken using forms such as a loan application, a financial assessment and/or an income and expenditure statement. Payslips, statements from Centrelink or credit reports were also found on the files for nearly all the micro lenders reviewed;

(c) most files reviewed contained a statement about the consumer's income and/or expenditure; and

(d) generally the files reviewed contained a copy of a bank statement.

17 In addition to those assessments, the micro lenders reviewed met their pre-contractual disclosure obligations under the National Credit Code in most instances. The majority of micro lenders reviewed were aware of the new direct debit default notice requirements.

Finding 4: Potential compliance risks

18 We note that our review was undertaken in relation to practices that took place over the first six months of the new responsible lending regime and that practices during that period were changing both as a result of our work and the actions of micro lenders seeking to update their procedures as they gained experience working with the new provisions. However, we identified instances where micro lenders were at risk of not being able to demonstrate that they had met their responsible lending and disclosure obligations.

19 Examples of issues we identified in files reviewed are set out in the table below. We encourage micro lenders to review their processes and procedures in light of these findings to ensure they are able to demonstrate that they are meeting their responsible lending and disclosure obligations.

Table 1: List of findings on potential compliance risks

Finding 4.1: Purpose of loan	We reviewed files where micro lenders had not recorded a purpose for the loan beyond 'personal use'. Maintaining details on file about the specific use of the individual loan (e.g. car repairs) reduces the risk of micro lenders not being able to demonstrate that they have made reasonable inquiries about a consumer's requirements and objectives: see paragraphs 63–65.
Finding 4.2: Verifying financial situation	We identified instances where micro lenders held limited documentation verifying the consumer's financial situation. Best practice for inquiring into and verifying the financial situation for micro lenders was obtaining a payslip, bank statement, Centrelink statement or credit report to verify information collected from the consumer, and keeping a copy of all relevant documents on file: see paragraphs 70–73.
Finding 4.3: Verifying consumer's expenses	We saw files where micro lenders had not recorded verification of the consumer's expenses. Having limited information showing inquiries into and recording of a consumer's expenses on file increases the risk of micro lenders not being able to demonstrate that they have taken reasonable steps to verify a consumer's financial situation: see paragraphs 74–76.

Finding 4.4: Conflicting information	We observed some files where micro lenders had not clarified conflicting information. When information provided by a consumer is inconsistent with other information held on file, further verification of and recording the consumer's actual living expenses reduces the risk of micro lenders not being able to demonstrate that they have taken reasonable steps to verify a consumer's financial situation: see paragraphs 77–78.
Finding 4.5: Assessment of financial hardship	On occasion, micro lenders did not record how they had calculated a consumer's ability to meet repayments on the proposed credit contract without suffering substantial hardship Recording how a consumer's ability to repay the proposed credit contract was assessed reduces the risk of micro lenders not being able to demonstrate that they have assessed the consumer's ability to repay the credit contract without substantial financial hardship: see paragraphs 79–83.
Finding 4.6: Contract terms	We observed instances where micro lenders had terms in their credit contract addressing the suitability of the contract. A term in the credit contract that requires a consumer to effectively declare the loan is suitable does not negate the need for a micro lender to take steps to meet its responsible lending obligations and ensure the consumer is not entering into credit contracts that are unsuitable: see paragraphs 84–85.
Finding 4.7: Information statement	We reviewed files where micro lenders did not appear to provide consumers with an information statement that complied with the legislative requirements: see paragraph 88.
Finding 4.8: Direct debit default notices	Many micro lenders have commenced issuing direct debit default notices. We saw some files where there was no evidence that a direct debit default notice had been issued. In other files, the notice issued did not comply with all the legislative requirements: see paragraphs 89–90.

Further work

20 We are following up directly with the micro lenders reviewed about specific concerns. We will also raise the issues identified with industry bodies and will continue to work with them to assist their members in meeting these requirements.

21 We have been undertaking a number of other reviews of responsible lending conduct in various areas of the credit industry. We intend to consider the findings from these reviews and liaise with relevant stakeholders to determine what further guidance, if any, may be required in RG 209.

A Background

Key points

Before the introduction of the National Credit Act, concerns were raised about the lending practices (or lack thereof) of micro lenders.

The National Credit Act contains responsible lending obligations that require credit providers and credit assistance providers to make reasonable inquiries into and verifications of a consumer's financial situation, to assess whether the consumer will be able to comply with their financial obligations without substantial hardship.

The purpose of our review was to gain an understanding of how micro lenders were meeting their responsible lending and disclosure obligations.

We used a risk-based and sample method to select micro lenders for our review.

What is a micro lender?

22 Credit providers in Australia may be described as falling into two broad categories:

(a) *those regulated by APRA*—including banks, credit unions, finance companies and building societies; and

(b) *those not regulated by APRA*—including lenders providing payday loans and lenders providing short-term loans of small amounts (micro lenders).

23 The term 'micro lender' has been used in many different contexts and is not defined in legislation. The National Financial Services Federation, an industry body of the microfinance industry, describes micro lending as loans that have a slightly longer duration than a payday loan (typically 2–4 weeks), averaging between 3–12 months, and for amounts of $500 or more.

24 In draft legislation released by the Australian Government in August 2011, small amount contracts are described as contracts for $2000 or less that run for less than two years.

25 In this report, the term 'micro lender' is used for lenders who provide loans not involving real property, such as short-term loans of small amounts and payday loans.

26 When applying for an Australian credit licence (credit licence), credit provider applicants are asked to identify which activities best describe their intended business from the following list:

(a) assignee of debts;

(b) bank;

(c) credit union or building society;

(d) door-to-door or telephone sales of goods and services;

(e) lenders mortgage insurer;

(f) lessor;

(g) other lender;

(h) property developer or real estate agent;

(i) responsible entity of a managed investment scheme;

(j) securitisation manager or securitisation trustee;

(k) seller of goods by instalments;

(l) seller of real property by instalments; or

(m) other.

27 Of the 1164 entities that had applied for authorisation as a credit provider at the time of our review, 848 (73%) identified their business activity type as 'other lender'.

28 For our review, we selected 19 entities from the 848 who had identified themselves as 'other lender'. We reviewed a range of micro lenders, including those lending over the internet or via the telephone, those lending money for car finance, those offering short-term loans of small amounts and those offering payday loans.

29 Of the 19 micro lenders reviewed, only 3 of the 19 did not have an internet presence, while 4 of the 19 operated from more than one premises.

30 The majority of micro lenders reviewed (16 of the 19) offered loans of terms not more than 12 months, while 6 micro lenders offered credit for amounts of $1500 or less. While a small number of the lenders did offer credit card contracts or home loans, none of the files reviewed were for those credit products.

Legislation and guidance

31 In July 2010, the National Credit Act introduced a number of statutory obligations for credit providers and persons providing credit assistance. These included licensing requirements, general conduct obligations and specific responsible lending obligations.

32 The previous state- and territory-based UCCC contained a provision enabling individual consumers to apply to a court to have an individual credit contract reopened if the credit provider knew, or could have ascertained by reasonable inquiry at the time the contract was entered into, that the consumer could not pay without substantial hardship. While this

may have provided a general incentive for credit providers to ensure consumers were not financially over-committed, the National Credit Act's responsible lending provisions impose much more specific obligations on both credit providers and credit assistance providers to ensure a credit contract is not unsuitable for a consumer.

33 Among the responsible lending obligations is the requirement for credit providers and credit assistance providers to make reasonable inquiries in order to assess whether a contract will be unsuitable for a consumer. Under the Transitional Act, the requirements for reasonable inquiries and assessments were introduced in two stages.

34 From 1 July 2010, these obligations commenced for credit assistance providers (e.g. mortgage brokers) and micro lenders other than ADIs and registrable corporations under the *Financial Sector (Collection of Data) Act 2001* (generally comprising large non-bank credit providers).

35 These obligations subsequently commenced for ADIs and registrable corporations on 1 January 2011.

36 Generally speaking, the responsible lending obligations that commenced on 1 July 2010 applied to a population comprised of credit assistance providers (e.g. mortgage brokers) and smaller micro lenders.

Responsible lending obligations

37 Before providing credit, the credit provider must make an assessment about whether the proposed credit contract will be unsuitable. The contract will be unsuitable for the consumer if, at the time of the assessment, it is likely that:

(a) the consumer will be unable to comply with their financial obligations under the contract, or could only comply with substantial hardship; or

(b) the contract will not meet the consumer's requirements or objectives.

38 To demonstrate that an assessment has been undertaken, a credit provider must:

(a) make reasonable inquiries about the consumer's requirements and objectives in relation to the credit contract;

(b) make reasonable inquiries about the consumer's financial situation; and

(c) take reasonable steps to verify the consumer's financial situation.

39 There are significant civil and criminal penalties that apply to contraventions of these responsible lending obligations.

40 Credit providers who do not satisfy their responsible lending obligations place themselves at increased risk of civil action by consumers seeking compensation for any loss or damage they may have suffered as a result, regardless of any actions that we may take.

41 Credit licensees must keep a record of all material that forms the basis of an assessment of whether a credit contract will be unsuitable for a consumer. The material must be in a form that will enable the licensee to give the consumer a written copy of the assessment if requested: see PF 224, condition 17.

42 ASIC released RG 209 in February 2010which sets out our expectations about compliance with the responsible lending obligations of the National Credit Act and provides examples to help credit licensees understand their obligations.

43 The inquiries and verification a credit licensee must undertake to satisfy their responsible lending obligations are scalable—that is, what a licensee needs to do to meet its obligations will vary depending on the circumstances: see RG 209.17–RG 209.18. For example, we expect for a more basic credit contract, such as a short-term loan of a small amount (i.e. one that is small *relative* to the person's capacity to repay), that credit licensees would need to make less detailed inquiries than for a mortgage (where this is a significant amount that is approaching the limit of a person's capacity to repay without substantial hardship).

Disclosure obligations

44 The National Credit Code incorporates the disclosure provisions of the UCCC, designed to establish truth in lending, with some enhancements to these obligations. A credit provider is required to make pre-contractual disclosures in the form of a statement setting out those matters included in the contract document, and to provide an information statement about the consumer's statutory rights and obligations. The matters that must be included in a contract document are prescribed and ensure that consumers are given the cost of the credit.

45 Under a new provision in the National Credit Code, the credit provider must give the consumer a direct debit default notice within 10 business days of a default occurring if:

(a) a debtor authorises payment of an amount for a credit contract by direct debit;

(b) a default occurs; and

(c) it is the first occasion that the default occurs.

Guidance on other obligations

46 We have provided guidance on a number of the other obligations under the National Credit Act, including Regulatory Guide 203 *Do I need a credit licence?* (RG 203) and Regulatory Guide 205 *Credit licensing: General*

conduct obligations (RG 205). These guides and other guidance are available on our website at www.asic.gov.au.

Purpose of our review

47 The purpose of our review was to assess how micro lenders were meeting their responsible lending and disclosure obligations under the National Credit Act and the National Credit Code.

48 Before the introduction of the National Credit Act, concerns were raised about the lending practices (or lack thereof) of lenders who were not prudentially regulated. There have been several government-funded reviews of the short-term lending market over the past decade identifying concerns with lending practices. These include *Payday lending in Victoria* (Dean Wilson, 2002) and *Payday loans: Helping hand or quicksand? Examining the growth of high-cost short-term lending in Australia, 2002–2010* (Zac Gillam and the Consumer Action Law Centre, September 2010).

Methodology

49 We used a risk-based and sample method for the selection of micro lenders. A sample of lenders from across Australia, including regional areas, was selected, together with a selection of micro lenders that, in our view, posed a greater risk of non-compliance with the responsible lending and disclosure obligations based on information held by us at that time.

50 Information held by ASIC included complaints and intelligence ASIC had received directly from consumers, consumer advocates and those working in industry, together with data from the states and territories, which previously regulated consumer credit.

51 We selected 28 entities for initial review and contacted each one to explain the review that we were undertaking. We requested a statement from each lender containing loan details, such as the loan amount, terms of the loan, the purpose of the application and default information, for the period from 1 July 2010 to 31 December 2010.

52 A total of 34,877 loans were reported to us. The number of loans provided by each of the entities in the relevant period varied significantly, ranging from four loans to several thousand.

53 We initially reviewed the loan details to identify factors that raised a greater risk of non-compliance with the responsible lending and disclosure obligations. These factors included instances where loans were topped up and/or rolled over, being viewed as a possible indication that the borrower might not have

been in a financial situation to repay the proposed loan without substantial hardship.

54 Other indicators which highlighted possible concerns over responsible lending compliance included the advertising of loan products, such as offers proposing 'no credit checks' or stating 'credit impaired welcome', and loans falling into default soon after being entered into.

55 During this initial review process, no view was formed about compliance with the responsible lending and disclosure obligations. Rather, this process sought to identify loans and/or credit providers that warranted a detailed review.

56 Following the above process, 168 consumer files from 19 micro lenders were selected for further review. For more details about the micro lenders selected for our review, see paragraphs 28–30.

B Key findings

Key points

Our review found that many micro lenders were generally aware of their responsible lending and disclosure obligations and have changed their practices since the commencement of the National Credit Act.

We identified some instances where micro lenders were at risk of not being able to demonstrate they had met their responsible lending and disclosure obligations.

57 Since the commencement of the National Credit Act, the microfinance industry has changed its practices to respond to the new obligations. Individual micro lenders have become licensed, developed responsible lending policies and procedures, put in place IDR procedures, and joined EDR schemes.

58 Further, many individuals in the microfinance industry have gained a qualification, a Certificate IV in Financial Services (Credit Management). Many licensees have joined an industry association and signed up to receive ASIC policy alerts to ensure they remain up to date with the new laws.

59 Our review found that, while micro lenders were generally able to demonstrate they were meeting their responsible lending and disclosure obligations, there were occasions where the micro lenders reviewed were not consistent in their approach to and/or record keeping for their obligations.

60 Our review was undertaken in the first six months of the new consumer credit regime. As such, many lenders were still testing and updating their responsible lending procedures at the time of review. We found that micro lenders had responded to the introduction of responsible lending provisions by further developing their existing business practices.

61 Micro lenders generally recorded their inquiries into a consumer's requirements and objectives, their inquiries into and verification of a consumer's financial situation, and their assessment of whether a consumer would be able to meet their obligations under the proposed credit contract without substantial hardship.

Consumers' requirements and objectives

62 The Explanatory Memorandum to the National Credit Act (Explanatory Memorandum) states at paragraph 3.138 that:

> consideration of what is reasonable will depend on the circumstances. Generally, the minimum requirement for satisfying reasonable inquiries about the consumer's requirements and objectives will be to understand the purpose for which the credit is sought and determine if the type, length, rate, terms, special conditions, charges and other aspects of the proposed contract meet this purpose or put forward credit contracts that do not match the consumer's purpose.

Purpose of the loan

63 All files reviewed displayed a basic level of inquiry into the immediate purpose of the loan (e.g. personal use). However, there were files reviewed that did not contain sufficient information to identify whether the micro lender made any further inquiries into the consumer's requirements and objectives for the individual loan.

64 Almost all of the micro lenders reviewed used an application form that included a question about the purpose of the loan. However, our review found some instances where there was no information to show that the micro lender had undertaken inquiries about, for example:

(a) the timeframe for which the loan was required;

(b) the amount needed for the loan; and

(c) the purpose for which the loan was sought.

65 Maintaining details on file as to the specific purpose of the individual loan (e.g. car repairs) reduces the risk of micro lenders not being able to demonstrate that they have made reasonable inquiries into a consumer's requirements and objectives.

Inquiry into and verification of financial situation

66 The National Credit Act requires credit providers to make reasonable inquiries into, and take reasonable steps to verify, a consumer's financial situation, to ensure that the consumer can meet their obligations under the credit contract without substantial hardship.

67 The Explanatory Memorandum states at paragraph 3.139:

> **Example 3.6**
>
> A consumer applies for a short term, small amount loan to meet an urgent expense. It is assumed that the consumer in this situation does not have savings and therefore that the ability to meet the repayments is entirely from future income. The purpose of the loan (for example, to meet rent or

utilities bills) and the inquiries into the borrower's financial circumstances indicate that there is very little discretionary expenditure that could be reduced in order to free-up income or meet high interest payments or fees. Reasonable inquiries to make an assessment of the consumer's capacity to repay the loan would include recent payslips and bank statements confirming details of pay dates and amounts, number of dependents, time employed, period at home address and other factors that influence the consumer's capacity to repay.

68 RG 209.42 notes that, in some circumstances, taking reasonable steps to verify information should involve making additional inquiries about the consumer where:

(a) the information that a consumer provides is inconsistent with other information that the credit provider holds about the consumer (e.g. in a credit report or account information for existing customers); and/or

(b) the information that a consumer provides is outside the standard range for the consumer (e.g. the income stated is far greater than would be expected for the type of work the consumer undertakes, as indicated by benchmarks).

69 These obligations are scalable—that is, how a credit provider complies with the obligations depends on the circumstances: see RG 209.17. However, this does not mean that a credit licensee would be altogether exempt from these obligations.

70 Inquiries into and recording of the consumer's level and source of income were generally undertaken using forms such as a loan application, a financial assessment and/or an income and expenditure statement.

71 Most of the files reviewed contained a statement about the consumer's income and/or expenditure.

72 Our review found that micro lenders used payslips, a statement from Centrelink or a consumer's bank account statement to assist with assessing a consumer's financial situation. In some instances micro lenders requested a copy of the consumer's credit report.

73 Using multiple sources to confirm a consumer's income and expenditure increases the likelihood of a credit licensee complying with their responsible lending obligations and appears to be industry best practice. Better files contained documents that indicated the lender had verified the consumer's income by relying on recent payslips and employer confirmation, together with a recent bank statement. On occasion, some of the micro lenders reviewed demonstrated industry best practice.

74 We saw files where verification of a consumer's fixed and variable expenses was largely absent from the consumer files. This may create an area of risk for the licensee, particularly where information provided by a consumer was not accurate (e.g. the number of dependants).

Example

If a micro lender has made no inquiries about variable expenses, such as confirming details of a consumer's dependants, and maintained no Centrelink benefit statements on file, which ordinarily include the number of the benefit recipient's dependants, it will be difficult for the lender to accurately assess a consumer's financial situation.

75 Our review found that while the majority of micro lenders undertook inquiries into and verification of consumer expenses, in some cases this practice was not consistently applied to all files reviewed. For example, while some files contained a copy of a bank statement, there was at times no information on file showing how the information in the statement was used by the micro lender.

76 Having limited information on file showing inquiries into and recording of a consumer's expenses increases the risk of micro lenders not being able to demonstrate that they have taken reasonable steps to inquire into and to verify a consumer's financial situation.

77 Our review found some circumstances where entries on the consumer's bank statement conflicted with income and expense information contained elsewhere in the file. In these situations, there were no file notes demonstrating further inquiries being undertaken by the micro lender, or providing any explanation about the discrepancies.

78 When information provided by a consumer was inconsistent with other information held on file, further verification and recording the consumer's actual living expenses reduces the risk of the micro lender not being able to demonstrate that they had taken reasonable steps to verify a consumer's financial situation.

Assessment of unsuitability

79 Our review found that while micro lenders were making assessments as to the unsuitability of a loan for a consumer, the files reviewed did not consistently contain information showing how the micro lenders were calculating that a consumer would be able to meet repayments on the proposed consumer credit contract without suffering substantial hardship.

80 Approaches used by micro lenders included using the budget planner calculator on the ASIC consumer website and making basic calculations based on the consumer's income and expenditure as stated on the application form.

81 There were occasions where the files reviewed contained a figure with little or no information substantiating how it was calculated or how it was used by

the micro lender to demonstrate that the proposed credit contract was not unsuitable for the consumer.

82 Our review identified files where:

(a) limited inquiries were made about the consumer's financial situation, requirements and/or objectives;

(b) the expenses in the application appeared to be understated when assessed against the basic living costs for most households;

(c) the expenses stated in the application added to the cost of the credit applied for exceeded the stated income;

(d) there had been a default on the first or second loan repayment for a previous loan;

(e) some of the money provided was to refinance another small loan;

(f) the bank statement showed the consumer's account was overdrawn by the end of each pay cycle; or

(g) the income appeared to be overstated and/or did not appear to match information obtained during the verification process.

83 Not recording how a consumer's ability to repay the proposed consumer credit contract was assessed (including an absence of information in the file describing how issues such as these were taken into account when assessing whether the loan was not unsuitable for the consumer) increases the risk of micro lenders not being able to demonstrate that they have assessed whether the consumer would be able to repay the proposed credit contract without substantial financial hardship.

Contract terms

84 Our review identified that some micro lenders have begun including terms in their credit contract addressing the suitability of the contract. These terms ranged from requiring the consumer to declare that they are of the opinion that they are able to afford the loan repayments at the rate set out in the agreement, to declaring that they can afford the loan as per the agreement.

85 This practice in no way diminishes the credit provider's responsibility to undertake an assessment of unsuitability and provide loans that are not unsuitable. A term in the credit contract that requires a consumer to effectively declare the loan is suitable does not negate the need for a micro lender to take steps to meet its responsible lending obligations and ensure the consumer is not entering into credit contracts that are unsuitable.

Disclosure obligations

86 The National Credit Code incorporates the disclosure provisions of the UCCC, designed to establish truth in lending, with some enhancements to these obligations. A credit provider is required to make pre-contractual disclosures in the form of a statement setting out those matters included in the contract document, and to provide an information statement about the consumer's statutory rights and obligations. The matters that must be included in a contract document are prescribed and ensure that consumers are given the cost of products.

87 Our review found that the majority of micro lenders met their pre-contractual disclosure obligations under the National Credit Code in most instances.

Information statements

88 We reviewed files that did not appear to include any indication that an information statement was given to consumers, or the information statement given did not comply with the requirements in the National Credit Code, in that it did not contain the necessary details. This is not a new requirement for micro lenders.

Direct debit default notices

89 The National Credit Code introduced new provisions requiring a direct debit default notice to be issued within 10 business days of a consumer making loan repayments via direct debit falling into default.

90 Our review found that most of the micro lenders reviewed had files where consumers made loan repayments via direct debit and had defaulted during the course of their loan.

91 Many micro lenders have commenced issuing direct debit default notices. We saw some examples of files that did not contain evidence of the issuing of a direct debit notice or the notice issued did not comply with all the legislative requirements.

C Further work

Key points

We are following up directly with the micro lenders reviewed, and with industry bodies, on the issues identified in our review.

92 We are following up directly with the individual entities that were reviewed about specific concerns. We will also be raising issues identified with industry bodies and will continue to work with them to assist their members in meeting these requirements.

93 We encourage micro lenders to regularly review their processes and procedures to ensure that they are able to demonstrate that they are meeting their responsible lending and disclosure obligations.

94 We have been undertaking a number of other reviews of responsible lending conduct in various areas of the credit industry. We intend to consider the findings from these reviews and liaise with relevant stakeholders to determine what further guidance may be required in RG 209.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act.
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 of the National Credit Code.
credit assistance provider	A person who provides credit assistance, as defined by s8 of the National Credit Act
credit contract	Has the meaning in s4 of the National Credit Code
credit legislation	Has the meaning given in s5 of the National Credit Act
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds an Australian credit licence under s35 of the National Credit Act
credit provider	Has the meaning given in s5 of the National Credit Act
EDR	External dispute resolution
EDR scheme	An external dispute resolution scheme approved by ASIC under the Corporations Act (see s912A(2)(b) and 1017G(2)(b)) and/or the National Credit Act (see s11(1)(a)) in accordance with our requirements in RG 139
Explanatory Memorandum	Explanatory Memorandum to the National Credit Act
general conduct obligations	The obligations under s47(1) of the National Credit Act
IDR	Internal dispute resolution
IDR procedures	Internal dispute resolution procedures that meet the requirements and approved standards of ASIC under RG 165
lender	A credit provider

Term	Meaning in this document
micro lender	Lender providing loans not involving real property, such as short-term loans of small amounts and payday loans: see paragraphs 22–24.
National Credit Act	*National Consumer Credit Protection Act 2009,* including regulations made for the purposes of that Act
National Credit Code	National Credit Code at Sch 1 of the National Credit Act
payday loans	Loans with a repayment date of the consumer's next pay
registrable corporations	A registrable corporation under s7 of the *Financial Sector (Collection of Data) Act 2001*
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
s47 (for example)	A section of the National Credit Act (in this example numbered 47), unless otherwise specified
Transitional Act	*National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009*
UCCC	Uniform Consumer Credit Code

Related information

Headnotes

consumer, credit contract, credit licence, credit licensee, direct debit default notice, disclosure obligations, financial situation, micro lender, not unsuitable, responsible lending obligations, requirements and objectives, substantial hardship

Pro formas

PF 224 *Australian credit licence conditions*

Regulatory guides

RG 203 *Do I need a credit licence?*

RG 205 *Credit licensing: General conduct obligations*

RG 209 *Credit licensing: Responsible lending conduct*

Legislation

Explanatory Memorandum, paragraphs 3.138, 3.139; National Credit Act; National Credit Code; Transitional Act

Financial Sector (Collection of Data) Act 2001

Other publications

Treasury, *Financial services and credit reform: Improving, simplifying and standardising financial services and credit regulation* (June 2008)

Dean Wilson, *Payday lending in Victoria* (2002)

Zac Gillam and the Consumer Action Law Centre, *Payday loans: Helping hand or quicksand? Examining the growth of high-cost short-term lending in Australia, 2002–2010* (September 2010)