



**ASIC**

Australian Securities & Investments Commission

## REPORT 330

# Review of licensed credit assistance providers' monitoring and supervision of credit representatives

March 2013

### **About this report**

This report examines how large credit licensees (identified by the number of their authorised credit representatives), whose primary credit activity is providing credit assistance, are monitoring and supervising their credit representatives' compliance with the responsible lending obligations when providing credit assistance for home loans.

This report presents the findings of our review and outlines our expectations about good practice.

### About ASIC regulatory documents

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**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation
- 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 credit legislation 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, general conduct obligations and responsible lending obligations on credit providers and credit assistance providers.
- 2       We identified the home loan sector as one area for early review of how industry was complying with the new responsible lending obligations, given it is the largest sector of consumer credit by aggregate dollar amount. Report 262 *Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans* (REP 262) sets out our findings from an initial review of individual credit assistance providers' activity between July and December 2010.
- 3       From our discussions with industry stakeholders before the commencement of the National Credit Act, we were aware that a large number of credit assistance providers would be authorised as credit representatives of a credit licensee, rather than obtaining their own credit licence. At the end of the credit licensing transition period (30 June 2011), there were approximately 6,000 credit licensees with approximately 24,000 credit representatives. The 25 credit licensees with the most credit representatives were responsible for approximately 50% of all credit representatives.
- 4       Given this concentration of responsibility for industry compliance, we decided to review how credit licensees with the largest number of credit representatives were ensuring their credit representatives' compliance with the responsible lending obligations when providing credit assistance for home loans. This review reflects ASIC's strategic priority of holding gatekeepers to account to ensure confident and informed financial consumers.

## What we did

- 5       We initially selected 26 credit licensees who had a large number of authorised representatives and whose primary credit activity was credit assistance. As at 1 October 2011, these licensees had appointed 12,545 credit representatives, representing 51% of all credit representatives notified to ASIC.
- 6       We obtained:
  - (a) copies of the selected credit licensees' policies and procedures for monitoring, supervising and training their credit representatives, together with copies of the licensees' responsible lending policies; and

- (b) details of the information maintained by credit licensees about their credit representatives' activities and the extent to which the licensees used this information to manage risk (e.g. whether licensees monitored information on the amount of credit assistance for particular types of loans that might be considered a greater compliance risk, such as home loans promoted as 'low documentation' (low doc)).
- 7 A review of this information indicated that eight of the selected credit licensees provided limited credit assistance and these eight licensees were therefore excluded from further inquiries.
- 8 The remaining 18 credit licensees had a total of 9,869 credit representatives, approximately 40% of all credit representatives notified to ASIC as at 1 October 2011.
- 9 We obtained further details from these 18 credit licensees about their methodology for selecting credit representatives or credit assistance transactions for review, the frequency of reviews, the resources allocated to these reviews and the licensees' record-keeping practices. We also obtained a sample of files reviewed by the licensees together with the documents detailing the findings of each of these reviews.

## What we found

- 10 Credit licensees with a large number of credit representatives providing credit assistance undertook various initiatives before and over the course of our review to comply with their obligations under the National Credit Act. This included implementing new record-keeping and information technology (IT) systems and responsible lending compliance reviews.
- 11 All credit licensees reviewed provided copies of training and compliance documents. Not all licensees were able to supply details about the amount of credit assistance provided by their credit representatives or to supply details about the amount of credit assistance for home loans promoted as low doc, as opposed to home loans more generally.
- 12 On 1 January 2011, the responsible lending obligations commenced for authorised deposit-taking institutions (ADIs) and many other home loan providers. Where information was provided on the volume of credit assistance for home loans promoted as low doc between October 2010 and March 2011, the proportion of credit assistance for home loans promoted as low doc in the three months before the commencement date was nearly twice that in the three months after.
- 13 This suggests that credit providers and/or credit assistance providers may have adjusted their practices and procedures for assessing the suitability of home loans promoted as low doc after 1 January 2011.

## Training and qualifications

- 14 We found that the responsible lending compliance and training documents generally reflected ASIC's guidance in Regulatory Guide 206 *Credit licensing: Competence and training* (RG 206) and Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209). The extent to which the content was tailored to reflect the credit licensee's business varied significantly.

### Recommendation 1: Compliance and training documents

Credit licensees' compliance and training documents should be specifically tailored to reflect the nature, scale and complexity of a licensee's particular business, rather than simply repeating the information contained in ASIC regulatory guides or in documents used by other entities with different business operations.

- 15 We also found significant variance in the manner and extent to which credit licensees monitored their credit representatives' ongoing eligibility to be authorised as credit representatives (e.g. whether a credit representative remained a member of an approved external dispute resolution (EDR) scheme).

### Recommendation 2: Ensuring that credit representatives are eligible to be authorised

Credit licensees should have appropriate practices and procedures in place not only to ensure that their credit representatives are appropriately qualified, initially, to be appointed as a credit representative (e.g. through undertaking background checks and employment screening), but also to ensure that they remain appropriately qualified on an ongoing basis (e.g. through monitoring continuing professional development and membership of an approved EDR scheme).

## Record-keeping and IT systems

### Preliminary assessments

- 16 While all credit licensees reviewed were aware of their obligation to provide consumers with a copy of the preliminary assessment, if requested to do so, four licensees relied solely on the credit representative to provide a copy of the preliminary assessment to the consumer.
- 17 Credit licensees are also required to keep a record of all material that forms the basis of an assessment of whether a credit contract or consumer lease will be unsuitable. Twelve licensees relied solely on the credit representative to maintain access to these records. While credit licensees are not expressly prohibited from relying on their representatives to maintain the records, it

was evident that a significant number of licensees had not fully considered how they would access these records if their representatives were unable or unwilling to provide a copy.

- 18 The best practice we observed was for a credit licensee to have a central computer system that generated a preliminary assessment at the time credit assistance was initially provided and into which all documents forming the basis of that preliminary assessment were scanned.
- 19 Since the commencement of our review, nearly all of those licensees relying on credit representatives to maintain records have made changes to their practices, or are in the process of making changes, to ensure that they have direct access to the supporting documents and assessments.

### Recommendation 3: Providing consumers with preliminary assessments

Credit licensees should have appropriate practices and procedures in place to be able to directly provide consumers with a copy of the preliminary assessment, if requested to do so, within the timeframe prescribed by legislation.

Licensees can reduce the risk of not being able to provide a preliminary assessment in the required timeframe by having direct access to the preliminary assessment and all documents that form the basis of that assessment from the date that credit assistance is provided.

#### Transaction details

- 20 Regulatory Guide 205 *Credit licensing: General conduct obligations* (RG 205) notes at RG 205.22–RG 205.23 that the volume of transactions and the type of credit activities engaged in are relevant considerations in determining what a credit licensee must do to ensure compliance with its obligations. Without access to this information, it would be difficult for a credit licensee to demonstrate that it has complied with its obligations.
- 21 We were concerned by instances where credit licensees were unable to:
- (a) identify any details about the volume of credit assistance provided by their credit representatives, or were only able to identify details of aggregate volumes of credit assistance, without being able to identify the volume of credit assistance provided by individual credit representatives;
  - (b) identify transactions where credit assistance was provided and the credit application was subsequently refused or withdrawn; and
  - (c) differentiate transactions where credit assistance had been provided for specific products or purposes (e.g. home loans promoted as low doc).
- 22 Credit assistance is not limited to credit applications that result in credit being provided. Credit assistance also includes instances where a credit

licensee suggests that a consumer remain in a particular credit contract, suggests that a consumer apply for a particular credit contract but no credit application eventuates, or assists a consumer to apply for a particular credit contract and that application is subsequently refused or withdrawn.

- 23 The best practice we observed was where credit licensees were able to identify credit assistance provided by each of their individual credit representatives by reference to various risk indicators, including loan type or purpose.

#### **Recommendation 4: Record-keeping—Volume and type of credit assistance**

Credit licensees should be able to identify all instances of credit assistance provided by each of their credit representatives, including where credit is not ultimately provided, with best practice being able to also identify the volume of loans from each credit representative by other potential risk indicators (e.g. loan type or loan purpose).

### **Compliance reviews**

- 24 Sixteen of the 18 credit licensees were conducting regular compliance reviews of the credit assistance provided by their credit representatives at the outset of our review, and the remaining two licensees commenced regular reviews over the course of our review. Not undertaking any compliance reviews of their credit representatives places licensees at significant risk of not complying with their responsible lending obligations, as well as their obligation to ensure compliance by their credit representatives.
- 25 In all instances, staff undertaking compliance reviews were not responsible for sales or business development, which reduced the likelihood of their compliance work being compromised or influenced by sales pressures.
- 26 All but two of the credit licensees that conducted regular reviews reviewed all their credit representatives at least annually, with nearly half undertaking multiple reviews each year. Files were generally chosen for review on a random basis, rather than on a risk-based assessment.
- 27 The majority of credit licensees conducted file reviews in a central location. Some licensees also undertook file reviews on site, with two licensees conducting all reviews on site. Of concern were instances where persons being reviewed were notified in advance that particular files would be subject to review, thereby exposing the licensee to a higher risk of files being manipulated.



**Recommendation 5: Compliance reviews—General conduct principles**

Credit licensees should have appropriate practices and procedures in place to undertake compliance reviews of their credit representatives. Prudent practice includes:

- ensuring that staff undertaking compliance reviews are appropriately qualified with sufficient resources to undertake reviews, and do not have conflicting responsibilities (e.g. sales);
- taking a risk-based approach to the selection of credit representatives and transactions for review;
- ensuring that compliance reviews are not compromised by credit representatives being aware in advance of the transactions to be reviewed;
- undertaking compliance reviews on site, where appropriate; and
- considering other methods to review credit representatives' compliance in addition to file reviews (e.g. shadow shopping or direct follow up with consumers).

- 28 We found that the documentation that assisted the persons conducting the reviews covered internal processes and other legislative requirements (e.g. the *Privacy Act 1988*) in addition to the requirements under the National Credit Act. In some instances, the content of an individual credit licensee's file review documents varied over the period, which we believe reflects the continued improvement of licensees' practices and procedures over the period.
- 29 Fourteen of the credit licensees had file review documents that appeared likely to help the reviewing officer determine whether a credit representative was complying with the actual principles of the responsible lending obligations.
- 30 We were concerned by instances where file reviews appeared to take a 'box-ticking' approach that simply checked that the consumer met the product criteria of the credit provider or only checked for the presence of certain documents (e.g. payslips, bank statements, accountants' declarations), without confirming whether the underlying information contained in those documents actually verified the consumer's financial situation and supported the assessment of unsuitability.

**Recommendation 6: Compliance reviews—Responsible lending principles**

When reviewing credit representatives' compliance with the responsible lending obligations, credit licensees should assess the credit assistance provided against their own responsible lending policies, rather than only checking whether an application meets the credit provider's guidelines.

Licensees should not simply review assessments of unsuitability without accessing supporting documents, or only check for the presence of supporting documents (e.g. payslips, bank statements, accountants' declarations). Licensees should review whether the information contained in the supporting documents is sufficient to satisfy the licensee's obligation to make reasonable inquiries and verifications and that it supports the assessment of unsuitability.

- 31 We found that all of the credit licensees undertaking reviews had processes in place to address any adverse review findings through additional training for individual credit representatives. A more comprehensive practice was demonstrated by three licensees, who also included the identified issue in broader training programs for all their credit representatives.
- 32 Many of the credit licensees had processes in place to bring review findings to the attention of senior management, including relevant risk and compliance committees and boards.
- 33 Where a serious compliance issue is identified, resulting in a credit representative's authorisation being terminated, there remains a risk that the individual could continue to operate in the industry (e.g. as a representative of another licensee). The risk of this conduct continuing and having a negative impact on the broader industry can be reduced by licensees notifying an industry body or ASIC of their compliance concerns.

#### **Recommendation 7: Compliance reviews—Incorporation of findings into training, compliance and risk management**

Credit licensees should have processes in place not only to address specific compliance issues with individual credit representatives, but also to identify and address potential systemic compliance issues through regular updates to their training material, compliance plans and risk management systems.

- 34 Licensees' processes and procedures for dealing with the causes of identified non-compliance (e.g. through additional training for their credit representatives) were generally more developed than their processes and procedures for dealing with the effects of non-compliance on consumers.

#### **Recommendation 8: Compliance reviews—Rectifying consumer detriment**

Credit licensees should have processes in place not only to address the causes of specific compliance issues with their credit representatives, but also to identify and rectify any consumer detriment arising from those compliance issues.

## Further work

- 35           The 18 credit licensees reviewed made a number of improvements to their monitoring and supervision processes while we conducted our review. For example, a number of credit licensees have upgraded their IT systems to enable them to better monitor the credit assistance provided by their representatives and scan credit assistance files to a central repository. We are following up directly with licensees about any outstanding concerns.
- 36           We will use the information from this review in the future when assessing whether credit licensees are meeting their obligation to ensure that their credit representatives comply with the credit legislation. When making these assessments we will also consider the nature, scale and complexity of licensees' businesses.
- 37           Although this review focused on licensees' supervision of credit representatives, many of the recommendations are equally applicable to licensees' supervision of representatives more generally, including employees and other persons acting on behalf of the licensee.
- 38           Many of the findings in this review may also be relevant to credit providers that rely on information submitted by credit assistance providers to meet their own responsible lending obligations.
- 39           We therefore encourage all credit licensees to review their processes and procedures in light of this report.

## A Background

### Key points

Credit licensees may authorise persons as credit representatives to engage in credit activities on the licensee's behalf. Licensees are liable for any loss or damage suffered by a client as a result of conduct by its credit representatives. This can include instances where a representative's conduct is not within the authority of the licensee.

Credit licensees must take reasonable steps to ensure that their representatives comply with the credit legislation. We have issued RG 205, which describes what we look for when we assess compliance with this obligation.

As at 1 October 2011, licensees had notified us of the appointment of 24,605 credit representatives, with 39 credit licensees who had each authorised 100 or more credit representatives, accounting for 92% of the total number of credit representatives.

### Appointment and supervision of credit representatives

- 40 The National Credit Act commenced in July 2010, imposing licensing requirements, general conduct obligations and responsible lending obligations on credit providers and credit assistance providers.
- 41 Section 47 of the National Credit Act imposes general conduct obligations on credit licensees. These include taking reasonable steps to ensure that their representatives comply with the credit legislation, and ensuring that representatives are adequately trained and competent to engage in the credit activities authorised by the licensee. RG 205 and RG 206 describe what we look for when assessing compliance with these general conduct obligations.
- 42 Section 5 of the National Credit Act defines a representative of a licensee to include:
- (a) an employee or director of the licensee;
  - (b) an employee or director of a related body corporate of the licensee;
  - (c) a credit representative of the licensee; or
  - (d) any other person acting on behalf of the licensee.
- 43 Division 2 of Pt 2–3 of the National Credit Act allows a credit licensee to give written notice authorising a person as a credit representative to engage in specified credit activities on behalf of the licensee. The credit activities

- specified may be some or all of the credit activities authorised by the licensee's credit licence.
- 44 Credit licensees must not authorise a person as a credit representative in a number of instances, including where:
- (a) a banning or disqualification order is in force against the person;
  - (b) the person is not a member of an approved EDR scheme; or
  - (c) the person has been convicted, within the past 10 years, of serious fraud.
- 45 RG 205.96 notes our expectation that credit licensees will carry out appropriate background checks before appointing new representatives. These checks may include referee reports, searches of ASIC's register of banned persons and police checks. Referee reports may be particularly relevant where a representative has previously been a representative of another credit licensee.
- 46 If a credit licensee becomes aware that a credit representative is no longer eligible to be authorised as a credit representative, the licensee must revoke or vary the authorisation as soon as practicable. The credit licensee must also provide written notice to ASIC within 10 business days of the change or revocation.
- 47 Making an invalid authorisation, or failing to revoke or vary an authorisation as soon as practicable, attracts civil and criminal penalties.
- 48 Credit licensees are liable to clients for any loss or damage suffered by a consumer as the result of conduct by their representatives. This can include instances where a representative's conduct is not within the authority of the licensee. This may also include a credit representative undertaking credit activities with a credit provider outside of the credit licensee's approved panel of credit providers without the authorisation (or knowledge) of the credit licensee (this may also expose the credit provider to potential non-compliance by engaging in a credit activity with an unlicensed person).
- 49 A licensee's liability may also extend to the activities of its credit representatives on behalf of another licensee, where the credit representative has been authorised by multiple licensees for the same conduct.
- 50 Effective compliance measures are important to ensuring that a licensee is complying with its obligations, including identifying and appropriately dealing with instances of non-compliance. Compliance measures also help demonstrate to us that a licensee can comply, and is complying, with its obligations: RG 205.50.

- 51 RG 205.22 acknowledges that what credit licensees need to do to comply with their obligations will vary according to the nature, scale and complexity of their business. RG 205.23 notes that this includes factors such as:
- (a) the diversity and structure of a licensee's operations (including the geographical spread of its operations);
  - (b) the volume and size of a licensee's transactions; and
  - (c) the number of people in the organisation.
- 52 RG 205.97 states that a credit licensee's measures for monitoring and supervising representatives will normally show how a licensee:
- (a) keeps track of who its representatives are, what role they perform and whether they are appropriately authorised;
  - (b) ensures that its representatives act within the scope of what the licensee has authorised them to do;
  - (c) ensures that its representatives understand the licensee's compliance arrangements;
  - (d) monitors its representatives' compliance; and
  - (e) responds to compliance failures.
- 53 Assessment of risk is central to a credit licensee's compliance with its obligations. RG 205.74 also notes our expectations that a licensee's risk management systems will:
- (a) be based on a structured and systemic process that takes into account the licensee's obligations under the National Credit Act;
  - (b) identify and evaluate risks faced by the licensee's business, focusing on risks that adversely affect consumers or market integrity (this includes risks of non-compliance with the credit legislation, as relevant);
  - (c) establish and maintain controls designed to manage or mitigate those risks; and
  - (d) fully implement and monitor these controls to ensure they are effective.

## Our review

- 54 In the first half of 2011 we compiled a list of credit licensees that had more than 100 credit representatives. This resulted in a total of 39 licensees, with up to 4,226 authorised credit representatives. As at 1 October 2011, these licensees had appointed 92% (or 22,615) of the 24,605 credit representatives notified to ASIC.

**Table 1: Types of credit licensees with more than 100 credit representatives**

Primary business description	Number
Aggregator	17
Financial planner	10
ADI	7
Registered finance company	2
Commercial lender	1
Insurance premium funder	1
Micro lender	1

- 55 From this list, we removed those entities who were not primarily involved in providing credit assistance for consumer credit. Generally, the primary business of these entities was that of a credit provider rather than a credit assistance provider.
- 56 Seventeen of the entities with more than 100 credit representatives identified themselves as aggregators. Aggregators, in the context of consumer credit, generally manage the loan application process between credit assistance providers and credit providers. Credit assistance providers must generally have an agreement with an aggregator to be able to submit applications to credit providers on the aggregator's panel. As part of this arrangement, aggregators may also provide training and professional development programs for their members.
- 57 We also identified credit licensees who had slightly less than 100 credit representatives and whose primary credit activity was credit assistance.
- 58 We selected 26 entities for the initial information-gathering stage. These credit licensees had appointed 12,545 credit representatives, representing 51% of all credit representatives notified to ASIC as at 1 October 2011.
- 59 We approached these licensees and sought copies of their policies and procedures for monitoring, supervising and training their credit representatives in relation to their compliance with the responsible lending obligations, together with copies of the licensees' responsible lending policies.
- 60 We also obtained details of the information credit licensees maintained about their credit representatives' activities.
- 61 We specifically requested information on the volume of credit assistance provided for home loans promoted as low doc because we had previously

identified this as an area where credit assistance providers were at greater risk of not meeting their responsible lending obligations: see REP 262.

- 62 By comparing the percentage of credit assistance for home loans promoted as low doc against all credit assistance provided for the three months before and after 1 January 2011 (being the commencement of the responsible lending obligations for ADIs and many other home loan providers) we sought to identify the impact the responsible lending obligations had on this section of the market.
- 63 We also obtained information on the compliance reviews credit licensees had undertaken of their credit representatives' activities, and information on licensees' access to records, including their ability to comply with the requirement to provide a copy of the preliminary assessment, if requested to do so by a consumer, within the statutory timeframe.
- 64 A review of this initial information indicated that eight of the selected credit licensees were not very active in the provision of credit assistance. These eight licensees were therefore excluded from further inquiries for the purposes of this review.
- 65 The 18 credit licensees remaining had a total of 9,869 credit representatives, or approximately 40% of all authorised credit representatives notified to ASIC as at 1 October 2011.
- 66 We held follow-up discussions with each of these 18 credit licensees to obtain further details about how they selected credit representatives or credit assistance transactions for compliance review, the frequency of compliance reviews, the resources allocated to these compliance reviews and the licensees' record-keeping practices.
- 67 We then obtained a sample of files reviewed by the licensees, together with the documents detailing the findings of each of these reviews.
- 68 Because the primary focus of this surveillance was credit licensees' monitoring and supervision of responsible lending compliance, we did not review their monitoring and supervision of compliance with other obligations, such as their arrangements to ensure that clients are not disadvantaged by any conflict of interest.



## B Ensuring that credit representatives are appropriately trained and qualified

### Key points

We expect credit licensees' compliance measures to take into account the specific compliance risks of their respective businesses.

Credit licensees have obligations to take reasonable steps to ensure that their representatives comply with the credit legislation, and to ensure that representatives are adequately trained and competent to engage in the credit activities authorised by their credit licence.

Credit licensees must ensure that they comply with their obligations on an ongoing basis, including ensuring that their credit representatives remain appropriately authorised.

- 69 We found that credit assistance providers' responsible lending compliance and training documents generally reflected our guidance in RG 206 and RG 209.
- 70 We note that the delivery of this content and the underlying concepts is critical to ensuring that authorised credit representatives understand their legislative obligations. However, a review of the actual training delivery was outside the scope of this project.
- 71 The extent to which the content of compliance and training documents was tailored to reflect the credit licensee's business varied. In some instances, the content appeared to simply reflect our guidance. One licensee's policy and procedure documents seemed to draw heavily on information found in two other licensees' policy and procedure documents despite the nature, scale and complexity of the business being substantially different.
- 72 RG 205.52 notes our expectation that a credit licensee's compliance measures will take into account the specific compliance risks of its business. The compliance measures should allow a licensee to communicate to its credit representatives what they need to do to comply, to monitor compliance with all of its licensee obligations and to address any compliance breaches.

### Recommendation 1: Compliance and training documents

Credit licensees' compliance and training documents should be specifically tailored to reflect the nature, scale and complexity of a licensee's particular business, rather than simply repeating the information contained in ASIC regulatory guides or in documents used by other entities with different business operations.

- 73 We also found significant variance in the manner and extent to which credit licensees monitored their credit representatives' ongoing eligibility to be authorised as credit representatives (e.g. whether a credit representative remained a member of an approved EDR scheme).
- 74 RG 205.96 notes our expectation that credit licensees will carry out appropriate background checks before appointing new representatives. These checks may include referee reports, searches of ASIC's register of banned persons and police checks. Referee reports may be particularly relevant where a representative has previously been a representative of another credit licensee.
- 75 RG 205.97 sets out our expectation that credit licensees' measures for monitoring and supervision will show how a licensee keeps track of their representatives, the role they perform and whether they are appropriately authorised. RG 206.90–RG 206.95 sets out additional details about our expectations for continuing professional development for representatives.
- 76 Credit licensees can minimise the likelihood of non-compliance with their general conduct obligations by ensuring they have appropriate practices and procedures in place not only to ensure that their credit representatives are appropriately qualified, initially, to be appointed as a credit representative, but to also ensure that they remain appropriately qualified on an ongoing basis.
- 77 Examples of prudent business practice we observed included where credit licensees:
- (a) took responsibility for paying the fees for their credit representatives' membership of an approved EDR scheme; and
  - (b) had processes in place to ensure that corporate credit representatives were not deregistered.

### **Recommendation 2: Ensuring that credit representatives are eligible to be authorised**

Credit licensees should have appropriate practices and procedures in place not only to ensure that their credit representatives are appropriately qualified, initially, to be appointed as a credit representative (e.g. through undertaking background checks and employment screening), but also to ensure that they remain appropriately qualified on an ongoing basis (e.g. through monitoring continuing professional development and membership of an approved EDR scheme).

## C Record-keeping and IT systems

### Key points

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, and provide a consumer with a copy of the preliminary assessment if requested to do so.

Credit licensees face a greater compliance challenge if they rely on a third party, such as a credit representative, to maintain these documents in a readily accessible form.

Credit assistance is not limited to instances where an application for credit is successful. Credit licensees must therefore ensure that they keep adequate records of all instances of credit assistance provided by them and each of their credit representatives, including instances where a credit representative suggests that a consumer remain in a particular credit contract, suggests that a consumer apply for a particular credit contract but no credit application eventuates, or assists a consumer to apply for a particular credit contract and that application is subsequently withdrawn or refused.

### Preliminary assessments

- 78 A licensed credit assistance provider must, where credit assistance has been provided, give a consumer a written copy of the preliminary assessment of whether a credit contract is unsuitable, if the consumer requests a copy within seven years. A breach of this provision can attract civil or criminal penalties.
- 79 All credit licensees reviewed were aware of their obligation to provide consumers with a copy of the preliminary assessment if requested to do so. However, four licensees relied solely on their credit representatives to provide preliminary assessments directly to consumers.
- 80 A number of licensees required their credit representatives to provide consumers with a copy of the preliminary assessment at the time of providing credit assistance. However, this would not prevent a consumer making a request for a copy of the preliminary assessment at a later date.
- 81 It became evident during the review process that credit licensees who relied on their credit representatives to provide preliminary assessments directly to consumers had not given due consideration to the potential challenges of meeting their obligation if individual credit representatives no longer had a

relationship with the licensee, or if credit representatives were otherwise unwilling or unavailable to provide the assessment.

- 82 It is also a condition for all credit licensees that:
- the licensee must keep a record of all material that forms the basis of an assessment of whether a credit contract or consumer lease will be unsuitable for a consumer in a form that will enable the licensee to give the consumer a written copy of the assessment if a request is made under section 120, 132, 143 or 155 of the [National Credit] Act.
- Pro Forma 224 Australian credit licence conditions (PF 224).*
- 83 There was generally less awareness of this requirement by credit licensees, despite this being a condition of each of their credit licences. Twelve licensees relied solely on their credit representatives to maintain access to the documents forming the basis of the assessment, although three of these licensees were, at the time the information was obtained, in the process of implementing software that would allow the supporting documents to be accessed by the licensee.
- 84 A credit licensee is not legally prohibited from relying on credit representatives to maintain records of the material forming the basis of an assessment. However, licensees need to consider the potential risks, including possible compliance issues, raised by a credit representative being unavailable (such as leaving the industry) or uncooperative.
- 85 Six credit licensees required their credit representatives to use a computer system into which all credit assistance documents were required to be scanned.
- 86 The best practice we observed was for the credit licensee to have a central computer system that generated a preliminary assessment at the time credit assistance was initially provided and into which all documents forming the basis of that preliminary assessment were scanned.
- 87 Since the commencement of our review, nearly all of those licensees relying on credit representatives to maintain records have made changes to their practices, or are in the process of making changes, to ensure that they have direct access to the supporting documents and assessments.

### Recommendation 3: Providing consumers with preliminary assessments

Credit licensees should have appropriate practices and procedures in place to be able to directly provide consumers with a copy of the preliminary assessment, if requested to do so, within the timeframe prescribed by legislation.

Licensees can reduce the risk of not being able to provide a preliminary assessment in the required timeframe by having direct access to the preliminary assessment and all documents that form the basis of that assessment from the date the credit assistance is provided.

## Transaction details

- 88 Fourteen credit licensees were able to provide some detail about the volume of credit assistance provided by their credit representatives. However, in seven instances, they were only able to do this where credit had been provided.
- 89 Credit assistance is not limited to credit applications that result in credit being provided. Credit assistance also includes instances where a person suggests that a consumer remain in a particular credit contract, suggests that a consumer apply for a particular credit contract but no credit application eventuates, or assists a consumer to apply for a particular credit contract and that application is subsequently refused or withdrawn.
- 90 Moreover, a high proportion of applications for credit that are refused or withdrawn may reflect potential non-compliance with the responsible lending obligations.
- 91 RG 205.22–RG 205.23 notes that the volume of transactions and the type of credit activities engaged in are relevant considerations in determining what a credit licensee must do to ensure compliance with its obligations. Without access to this information, it would be difficult for a credit licensee to demonstrate that it has complied with its obligations.
- 92 Of the 14 credit licensees that provided details of credit assistance volumes, nine were able to identify, on an aggregate basis, the instances of credit assistance for home loans promoted as low doc.
- 93 Of the nine credit licensees able to identify credit assistance for home loans promoted as low doc, eight were able to identify the individual credit representatives who had provided the credit assistance. In five instances, this was limited to credit assistance where credit had ultimately been provided.
- 94 Three of the credit licensees who were only able to provide limited information on the volume and type of credit assistance provided by their credit representatives were in the process of upgrading their IT platforms at the time we obtained the information.

### Recommendation 4: Record-keeping—Volume and type of credit assistance

Credit licensees should be able to identify all instances of credit assistance provided by each of their credit representatives, including where credit is not ultimately provided, with best practice being able to also identify the volume of loans from each credit representative by other potential risk indicators (e.g. loan type or loan purpose).

- 95 On 1 January 2011, the responsible lending obligations commenced for ADIs and many other home loan providers. According to the data on the

volume of credit assistance provided for home loans promoted as low doc, the volume of credit assistance for these loans (compared to all credit assistance) in the three months after 1 January 2011 was nearly half that in the three months before.

- 96 The fall after 1 January 2011 in the proportion of credit assistance for home loans promoted as low doc suggests that credit providers and/or credit assistance providers may have adjusted their practices and procedures for assessing the suitability of home loans promoted as low doc after 1 January 2011.

## D Compliance reviews

### Key points

Credit licensees must have appropriate processes and procedures in place to review their representatives' compliance with the credit legislation, including the responsible lending obligations. Relevant factors include allocating appropriate staff to undertake reviews, assessing the relative compliance risks for specific credit representatives or transactions, and taking steps to ensure that the compliance review process is not compromised.

Simply relying on a credit provider's product guidelines or only checking for the presence of supporting documents (e.g. payslips, bank statements, accountants' declarations), without reference to the information actually contained in these documents, will generally not satisfy a credit licensee's responsible lending obligations, and will therefore not form an appropriate basis for a compliance review.

Credit licensees should have robust mechanisms for remedying any compliance breaches identified, including processes to address:

- specific compliance issues with individual representatives;
- systemic compliance issues affecting multiple representatives; and
- consumer detriment arising from a breach.

97 RG 205.94(a) notes our expectation that credit licensees will have measures to allow them to determine whether their representatives are complying with the credit legislation.

98 At the outset of our review, all but two of the credit licensees had implemented a process to review the credit assistance files of their credit representatives. The remaining two licensees commenced regular reviews during the course of our review. It is not clear how a licensee would effectively monitor whether its representatives are complying with the legislative obligations without reviewing instances of actual credit assistance provided by each representative.

### Compliance review resources

99 Licensees that conducted regular compliance reviews had at least one individual whose primary role was to conduct file reviews. Where these individuals had other responsibilities, these generally related to training and accreditation and were seen as compatible with the primary role.

- 100 In all instances, staff with primary responsibility for undertaking compliance reviews were not responsible for sales or business development, which minimised the likelihood of their compliance work being compromised or influenced by sales pressures. We believe that this represents prudent practice.
- 101 Individuals conducting the compliance reviews generally had credit industry experience. At a minimum, staff involved in reviewing credit assistance files should have a sound understanding of consumer lending practice, rather than only checking for the existence of documents against a checklist.
- 102 Credit licensees had varying levels of dedicated compliance resources, reflecting the different numbers of credit representatives, compliance systems and business models, including some entities that also held an Australian financial services (AFS) licence.
- 103 One licensee had adopted a three-tiered compliance structure, which included compliance responsibilities across both compliance and sales teams at state and national levels. This provided a more robust approach and increased the likelihood of non-compliance being identified and addressed in a timely manner.
- 104 RG 205.105 states that having adequate technological and human resources is crucial to a credit licensee's ability to demonstrate that it has the capacity to carry on its credit business in full compliance with the law and to supervise its representatives. Failure to have enough resources may create an unacceptable risk that a licensee may not comply with all of its obligations.
- 105 RG 205.109 explains that we expect that credit licensees will identify key indicators that their human resources are inadequate. These key indicators are likely to include:
- (a) a low ratio of compliance staff to credit representatives; and
  - (b) client accounts and interests not being monitored when staff are absent.
- 106 We acknowledge that the ratio of compliance staff to representatives will depend on a number of factors, including the credit licensee's business activity and the sophistication of the IT systems that support the compliance programs.

## Frequency of reviews

- 107 All but two of the credit licensees that conducted reviews of their credit representatives did so at least annually, with nearly half undertaking multiple reviews each year. There was flexibility built into each of the licensees' programs to enable an increased number of reviews for new credit representatives or where compliance issues had been identified.



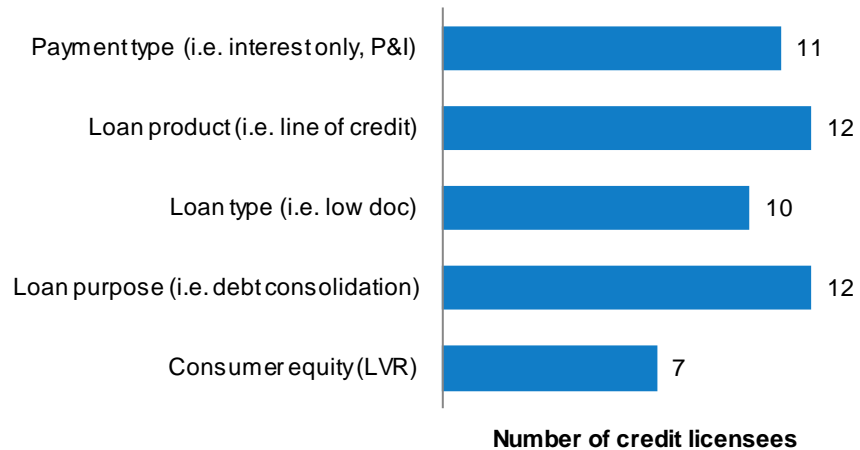
- 108 The more frequently credit licensees undertake reviews, the better placed they are to identify and address any potential non-compliance by credit representatives and reduce the possibility of systemic risk.
- 109 Credit licensees are at a greater risk of not having adequate measures to monitor and supervise their credit representatives if they rely on only one dedicated compliance resource to undertake infrequent reviews. Additional resources not only provide licensees with greater flexibility and certainty about the conduct of their compliance reviews, but also potentially provide additional risk mitigation where each credit representative's conduct can be reviewed by different persons.
- 110 Two credit licensees determined the frequency of their compliance reviews based on the length of their relationship with the credit representative. Credit representatives who had a shorter relationship with the licensee were subject to more frequent file reviews.
- 111 Although credit licensees that have a long-term relationship with their credit representatives may assess the risk of non-compliance through the past performance of these credit representatives, this does not exclude licensees from taking reasonable steps to ensure representatives' ongoing compliance. We note that persons with a longer relationship with a licensee, and greater knowledge of the licensee's compliance systems and procedures, may be better placed to avoid detection of non-compliant activity. This risk should also be addressed in a licensee's processes and procedures.

## Selection of files for review

- 112 Credit licensees that undertook file reviews generally chose the files to be reviewed at random. At the time we commenced our review, it was not apparent that any licensees had processes in place to identify specific transactions for review that might pose a greater compliance risk. Risk indicators could include product type, loan purpose (including instances where loan proceeds may be used to purchase products or property promoted by the credit assistance provider), consumer profile, consumer complaints recorded by the licensee's internal dispute resolution procedures, or the volume of credit assistance provided by individual representatives. Over the course of our review, a number of licensees advised that they had implemented risk weighting to the file selection process, including indicators such as loan type, arrears data and market intelligence.
- 113 Not identifying and managing potential 'high-risk' transactions and/or practices may place licensees at greater risk of not being able to demonstrate that they have met their general conduct obligations, including their obligation to have adequate risk management systems and to take reasonable steps to ensure compliance by their credit representatives.

114 We identified some key characteristics of credit products that could affect the loan risk profile, and measured each credit licensee's ability to identify these.

**Figure 1: Credit licensees able to identify key loan characteristics**



Note: P&I = principal and interest; LVR = loan-to-valuation ratio.

115 Seven credit licensees were able to identify all loan characteristics, while four were unable to identify any. In some instances the licensee relied solely on the credit representative to identify specific loan characteristics, without having the ability to readily verify the information provided. This practice places the licensee at risk of having compliance reviews compromised.

## Conduct of compliance reviews

116 RG 209.35 notes that:

if you have employees who are situated in a number of different locations, you will need to have specific measures in place to ensure that employees are adequately supervised. Adequate supervision could include a combination of having compliance staff in regional offices (or visiting regional offices), conducting regular auditing or 'spot checks' on staff in all locations, or using a centralised system for accessing credit applications.

This guidance is relevant to licensees' supervision of all representatives, including credit representatives.

117 Twelve of the credit licensees conducted compliance reviews centrally, largely because of the geographic distribution of their credit representatives across more than one state.

118 Two licensees undertook a combination of central and on-site reviews, predominantly driven by the location of the credit representative. If the credit representative was in the same location as the compliance officer, the

compliance officer had the option to conduct a review at the credit representative's place of business.

- 119 There is a risk that compliance reviews may be compromised where the files to be reviewed can be manipulated before the review process (e.g. if the credit representative knows well in advance the transactions that will be reviewed). Credit licensees should therefore ensure that they have appropriate measures in place to address the risk of the compliance review being compromised.
- 120 A robust process for identifying and reviewing credit assistance files is an important aspect of ensuring that credit representatives comply with their responsible lending obligations. However, reviewing documents by itself might not provide a complete picture of the reasonableness of the inquiries and verifications made by credit representatives. Credit licensees should therefore also consider the implementation of additional review processes—such as shadow shopping or mystery shopping exercises and direct follow up with a sample of consumers—which may provide a more complete picture of the credit assistance provided by their credit representatives.

#### Recommendation 5: Compliance reviews—General conduct principles

Credit licensees should have appropriate practices and procedures in place to undertake compliance reviews of their credit representatives. Prudent practice includes:

- ensuring that staff undertaking compliance reviews are appropriately qualified with sufficient resources to undertake reviews, and do not have conflicting responsibilities (e.g. sales);
- taking a risk-based approach to the selection of credit representatives and transactions for review;
- ensuring that compliance reviews are not compromised by credit representatives being aware in advance of the transactions to be reviewed;
- undertaking compliance reviews on site, where appropriate; and
- considering other methods to review credit representatives' compliance in addition to file reviews (e.g. shadow shopping or direct follow up with consumers).

## Compliance review tools

- 121 Compliance review documents from all of the credit licensees undertaking file reviews covered their internal processes and other legislative requirements (e.g. the *Privacy Act 1988*) in addition to the National Credit Act.

- 122 All but two of the credit licensees had file review documents that appeared likely to help the reviewing officer determine whether a credit representative was complying with the actual principles of the responsible lending obligations.
- 123 We were concerned by instances where credit licensees' file reviews appeared to take a 'box-ticking' approach.
- 124 Simply reviewing an assessment of unsuitability without having access to the primary documents on which it was based is not sufficient to assess compliance with the responsible lending obligations. In addition, while one can readily record the presence, or absence, of documents (e.g. payslips, banks statements, accountants' declarations), the underlying information contained in those documents must also actually verify the consumer's financial situation and support the assessment of unsuitability.
- 125 In one instance, it appeared that the credit licensee's file reviews sought to establish whether its credit representatives were complying with the responsible lending obligations only by checking that the consumer met the basic product criteria of the credit provider. We have been advised that the licensee has since updated its review practice to address this concern.
- 126 Relying on a credit provider's product criteria will also not be sufficient to meet the responsible lending obligations. Credit assistance providers must assess and verify a consumer's particular circumstances, including their requirements and objectives, to establish whether a proposed credit contract will be 'not unsuitable', rather than simply checking to see that a consumer fits the guidelines of a particular loan.

#### **Recommendation 6: Compliance reviews—Responsible lending principles**

When reviewing credit representatives' compliance with the responsible lending obligations, credit licensees should assess the credit assistance provided against their own responsible lending policies, rather than only checking whether an application meets the credit provider's guidelines.

Licensees should not simply review assessments of unsuitability without accessing supporting documents, or only check for the presence of supporting documents (e.g. payslips, bank statements, accountants' declarations). Licensees should review whether the information contained in the supporting documents is sufficient to satisfy the licensee's obligation to make reasonable inquiries and verifications and that it supports the assessment of unsuitability.

## Recording and acting on compliance review findings

- 127 RG 205.35 sets out our expectation that credit licensees will need to keep records of their monitoring activities, including records of reports on compliance and non-compliance.
- 128 We found that a range of systems were used to record the outcomes of licensees' compliance reviews, ranging from manual spreadsheets to specifically developed software. A prudent approach to risk management ensures that adverse trends can be readily identified and acted on accordingly.
- 129 RG 205.69 notes that the role of senior management in overseeing compliance measures includes receiving regular reports on those compliance measures. Many of the credit licensees had processes in place to bring review findings to the attention of senior management, including relevant risk and compliance committees and boards. RG 205.97(e) notes our expectation that credit licensees' measures for monitoring and supervising representatives will show how licensees' respond to compliance failures.
- 130 All of the credit licensees undertaking reviews had put in place processes to address any adverse review findings with individual credit representatives. The licensees all sought to address any minor issues through individual training with the credit representative, and 11 of the licensees also undertook further reviews of the credit representative's files.
- 131 Where a serious compliance issue is identified, resulting in a credit representative's authorisation being terminated, there remains a risk that the individual could continue to operate in the industry (e.g. as a representative of another licensee). The risk of this conduct continuing and having a negative impact on the broader industry can be reduced by licensees notifying an industry body or ASIC of their compliance concerns.
- 132 Three of the credit licensees included identified compliance issues in broader training programs for all of their credit representatives.
- 133 We believe that it is prudent practice for credit licensees to determine the extent of any potential non-compliance, and establish specific training for the licensee's other representatives in relation to identified systemic issues.
- 134 RG 205.28 notes our expectation that credit licensees will:
- (a) document their compliance measures in some form;
  - (b) fully implement them and monitor and report on their use; and
  - (c) regularly review the effectiveness of compliance measures and ensure they are up-to-date.

- 135 Credit licensees should therefore ensure that, if any systemic issues are identified in the course of their compliance reviews, their compliance plans and risk management systems are updated to address these issues.

**Recommendation 7: Compliance reviews—Incorporation of findings into training, compliance and risk management**

Credit licensees should have processes in place not only to address specific compliance issues with individual credit representatives, but also to identify and address potential systemic compliance issues through regular updates to their training material, compliance plans and risk management systems.

- 136 RG 205.94(b) outlines our further expectation that credit licensees' compliance measures will include robust mechanisms for remedying any breaches.

- 137 Remedying breaches may include a range of potential actions for the credit representatives who are found to be non-compliant, and the licensees' representatives more generally. In addition, remedying breaches may include identifying and rectifying consumer detriment arising from the breaches.

- 138 Licensees' processes and procedures for dealing with the causes of identified non-compliance (e.g. through additional training for their credit representatives) were generally more developed than their processes and procedures for dealing with the effects of non-compliance on consumers.

**Recommendation 8: Compliance reviews—Rectifying consumer detriment**

Credit licensees should have processes in place not only to address the causes of specific compliance issues with their credit representatives, but also to identify and rectify consumer detriment arising from those compliance issues.

## Appendix: Table of recommendations on managing compliance risks

**Table 2: Recommendations to assist credit assistance providers in meeting their obligation to ensure that credit representatives comply with the responsible lending obligations**

<p><b>Recommendation 1: Compliance and training documents</b></p> <p>See paragraphs 69–72</p>	<p>Credit licensees' compliance and training documents should be specifically tailored to reflect the nature, scale and complexity of a licensee's particular business, rather than simply repeating the information contained in ASIC regulatory guides or in documents used by other entities with different business operations.</p>
<p><b>Recommendation 2: Ensuring that credit representatives remain eligible to be authorised</b></p> <p>See paragraphs 73–77</p>	<p>Credit licensees should have appropriate practices and procedures in place not only to ensure that their credit representatives are appropriately qualified, initially, to be appointed as a credit representative, but also to ensure that they remain appropriately qualified on an ongoing basis (e.g. through monitoring continuing professional development and membership of an approved EDR scheme).</p>
<p><b>Recommendation 3: Providing consumers with preliminary assessments</b></p> <p>See paragraphs 78–87</p>	<p>Credit licensees should have appropriate practices and procedures in place to be able to directly provide consumers with a copy of the preliminary assessment, if requested to do so, within the timeframe prescribed by legislation.</p> <p>Licensees can reduce the risk of not being able to provide a preliminary assessment in the required timeframe by having direct access to the preliminary assessment and all documents that form the basis of that assessment from the date that credit assistance is provided.</p>
<p><b>Recommendation 4: Record-keeping—Volume and type of credit assistance</b></p> <p>See paragraphs 88–94</p>	<p>Credit licensees should be able to identify all instances of credit assistance provided by each of their credit representatives, including where credit is not ultimately provided, with best practice being able to also identify the volume of loans from each credit representative by other potential risk indicators (e.g. loan type or loan purpose).</p>
<p><b>Recommendation 5: Compliance reviews—General conduct principles</b></p> <p>See paragraphs 99–120</p>	<p>Credit licensees should have appropriate practices and procedures in place to undertake compliance reviews of their credit representatives. Prudent practice includes:</p> <ul style="list-style-type: none"> <li>• ensuring that staff undertaking compliance reviews are appropriately qualified with sufficient resources to undertake reviews, and do not have conflicting responsibilities (e.g. sales);</li> <li>• taking a risk-based approach to the selection of credit representatives and transactions for review;</li> <li>• ensuring that compliance reviews are not compromised by credit representatives being aware in advance of the transactions to be reviewed;</li> <li>• undertaking compliance reviews on site, where appropriate; and</li> <li>• considering other methods to review credit representatives' compliance in addition to file reviews (e.g. shadow shopping or direct follow-up with consumers).</li> </ul>

<p><b>Recommendation 6: Compliance reviews— Responsible lending principles</b></p> <p>See paragraphs 121–126</p>	<p>When reviewing credit representatives' compliance with the responsible lending obligations, credit licensees should assess the credit assistance provided against their own responsible lending policies, rather than only checking whether an application meets the credit provider's guidelines.</p> <p>Licensees should not simply review assessments of unsuitability without accessing supporting documents, or only check for the presence of supporting documents (e.g. payslips, bank statements, accountants' declarations). Licensees should review whether the information contained in the supporting documents is sufficient to satisfy the licensee's obligation to make reasonable inquiries and verifications and that it supports the assessment of unsuitability.</p>
<p><b>Recommendation 7: Compliance reviews— Incorporation of findings into training, compliance and risk management</b></p> <p>See paragraphs 127–135</p>	<p>Credit licensees should have processes in place not only to address specific compliance issues with individual credit representatives, but also to identify and address potential systemic compliance issues through regular updates to their training material, compliance plans and risk management systems.</p>
<p><b>Recommendation 8: Compliance reviews— Addressing any detriment to consumers</b></p> <p>See paragraphs 136–138</p>	<p>Credit licensees should have processes in place not only to address the causes of specific compliance issues with their credit representatives, but also to identify and rectify consumer detriment arising from those compliance issues.</p>



## Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution
ASIC	Australian Securities and Investments Commission
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act.
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 at Sch 1 of the National Credit Act
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
credit representative	A person who has been authorised by a credit licensee to engage in credit activities on the licensee's behalf under s64 and 65 of the National Credit Act
EDR scheme	An external dispute resolution scheme approved by ASIC under the <i>Corporations Act 2001</i> (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
National Credit Act	<i>National Consumer Credit Protection Act 2009</i> , including regulations made for the purposes of that Act
REP 262 (for example)	An ASIC report (in this example numbered 262)
RG 206 (for example)	An ASIC regulatory guide (in this example numbered 206)

## Related information

### Headnotes

compliance reviews, general conduct obligations, home loans promoted as low doc, practices and procedures, record keeping, responsible lending, reviewing credit assistance files, supervision of credit representatives, training and compliance

### Pro formas

PF 224 *Australian credit licence conditions*

### Regulatory guides

RG 205 *Credit licensing: General conduct obligations*

RG 206 *Credit licensing: Competence and training*

RG 209 *Credit licensing: Responsible lending conduct*

### Legislation

National Credit Act, Div 2 of Pt 2–3, s5, 47

*Privacy Act 1988*

### Reports

REP 262 *Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans*