



ASIC

Australian Securities & Investments Commission

REPORT 358

Review of credit assistance providers' responsible lending conduct relating to debt consolidation

July 2013

About this report

This report sets out our findings following a review of files maintained by credit assistance providers who provided credit assistance to consumers in the form of debt consolidation services between July and December 2010.

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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.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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Executive summary

- 1 In July 2010 a new consumer credit regime commenced, imposing national licensing requirements for consumer credit providers and credit assistance providers such as mortgage brokers. A major part of the new consumer credit regime was the introduction of responsible lending obligations on credit licensees, which require 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 consumer will be able to meet their obligations under a proposed credit contract without substantial hardship; and
 - (e) assess whether a proposed credit contract will be unsuitable.
- 2 A credit licensee must also keep a record of all material that forms the basis of an assessment of whether a credit contract will be unsuitable for a consumer.
- 3 To help industry prepare for the responsible lending obligations, in February 2010 we issued Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209), which sets out our expectations for meeting the responsible lending obligations. Of particular relevance in the context of debt consolidation is the guidance on refinancing: see RG 209.107–RG 209.112.
- 4 We had noted potential problems with refinancing in 2008, in Report 119 *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress* (REP 119): see paragraph 13. As a result, we decided to undertake an early assessment of credit assistance providers' responsible lending conduct in relation to debt consolidation, as this is an important area of refinancing activity.
- 5 This review found that there is scope for further improvement, particularly in the areas of making adequate inquiries and verifications to satisfy the responsible lending obligations and record-keeping obligations.

What we did

- 6 For the purposes of this review, we defined 'debt consolidation' as 'securing new or additional credit for the purpose of using that credit to pay off other pre-existing credit contracts or to reduce the total number of payments being made. The types of credit contract that may be affected include, but are not limited to, home loans, credit cards, personal loans and payday loans'.

- 7 This review included a wide range of loans, from payday-style loans to more substantial loans secured by real property, as well as credit cards and personal loans.
- 8 We selected 17 entities with businesses across all Australian states for consideration in this review, and conducted a detailed review of 82 client files involving debt consolidation. Entities that administered debt agreements under the *Bankruptcy Act 1966* (Bankruptcy Act) and others that assisted consumers to manage their payments to multiple creditors were excluded from the review.

What we found

Finding 1: Impact of debt consolidation on consumers

- 9 The most common debt consolidation solutions presented to consumers were:
- (a) extending loan terms (often resetting to 30 years) to reduce the monthly repayment commitment (50% of all files);
 - (b) switching consumers to interest-only loans; and
 - (c) placing consumers into new credit contracts on different rates (often lower rates, but in some cases on higher rates than pre-consolidation).
- 10 We found credit assistance providers in general did not appear to document in their client file whether potential significant risks and costs of debt consolidation had been discussed with consumers. It is good practice to discuss these risks and costs with consumers and to record this information on the client file. Such considerations are material in assessing whether the loan might be unsuitable for the consumer. Documenting them in the file demonstrates that they have been considered.
- 11 The more significant risks and costs of debt consolidation include:
- (a) higher long-term costs of repayment of a loan resulting from extending the loan term. Resetting a loan to a longer term may have the short-term effect of reducing a consumer's monthly repayments, but may also expose that consumer to substantially higher repayment amounts over the life of the loan;
 - (b) moving consumers to an interest-only loan without an appropriate exit strategy. Switching to interest-only loans can provide a solution to a consumer's short-term repayment difficulties, but the consumer still has to pay off the principal after the interest-only stage ends;
 - (c) leaving pre-existing contracts open, enabling a consumer to redraw on them at a later stage and fall further into debt problems;

- (d) transferring default risk on unsecured loans and loans secured by assets (other than the family home) onto the family home by consolidating all debts into the home loan; and
 - (e) additional costs of debt consolidation, such as broker fees and new loan establishment fees.
- 12 For further discussion of the impact of debt consolidation on consumers, see paragraphs 50–63.

Finding 2: Record-keeping practices

- 13 There was wide variance in the quality of record keeping on files. We found that some entities offering debt consolidation had adopted template documentation; however, this did not ensure that file-keeping practices were consistently applied. Most files reviewed recorded some inquiries into a consumer's requirements and objectives, inquiries into and verification of a consumer's financial situation, or assessment of whether a consumer would be able to meet their obligations under the proposed credit contract without substantial hardship. Only a few credit licensees demonstrated that they recorded appropriate details on all their files.
- 14 The credit licensees that more clearly demonstrated compliance with the legislative requirements included on their files:
- (a) copies of loan applications and supporting documents;
 - (b) a comprehensive record of the active steps the credit assistance provider had taken to form the view that a loan was 'not unsuitable', such as assessing whether the consumer would be unable to comply with their financial obligations under the contract (or could only comply with substantial hardship) and whether the contract would meet the consumer's requirements or objectives; and
 - (c) records of the steps taken to verify the consumer's financial situation (e.g. multiple sources of income verification apparent on file).
- 15 Our ability to undertake file reviews was affected by poor record keeping. In 30% of files reviewed, we were unable to make a comparison between the consumer's pre-consolidation position and their post-consolidation position, because the credit assistance provider failed to record or keep sufficient information to identify the consumer's pre-existing credit contracts. In the context of debt consolidation, a credit licensee is at risk of not being able to demonstrate compliance with its responsible lending obligations where the files do not contain information about the consumer's pre-existing debts: see Example 2 in RG 209.
- 16 For further discussion of record-keeping practices, see paragraphs 64–71.

Finding 3: Potential compliance risks

- 17 We identified other instances where credit assistance providers would find it difficult to demonstrate that they had met their responsible lending obligations. These are set out in Table 1. We encourage credit assistance providers 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 obligations.
- 18 For further discussion of potential compliance risks, see paragraphs 72–90.

Table 1: Instances of potential compliance risks

<p>Finding 3.1: Recording the consumer's requirements and objectives</p>	<p>We reviewed files where credit assistance providers had either not recorded the consumer's requirements and objectives for the loan or had recorded them merely as 'debt consolidation'.</p> <p>A credit assistance provider is at increased risk of not being able to demonstrate that it has made reasonable inquiries about the consumer's requirements and objectives if it fails to maintain details of the consumer's requirements and objectives on file.</p> <p>Noting the purpose of a loan as 'debt consolidation' reflects the outcome of the credit assistance rather than the consumer's objectives. It is more likely that a consumer has specific requirements or objectives—such as repaying other obligations or seeking a lower repayment amount—and licensees should ensure that appropriate inquiries about the consumer's requirements and objectives are made and recorded.</p>
<p>Finding 3.2: Inquiring about and verifying the consumer's financial situation</p>	<p>Some files held insufficient documentation to demonstrate that the credit assistance provider had undertaken adequate inquiries about or had verified the consumer's financial situation.</p> <p>Credit assistance providers can lessen the risk of not being able to demonstrate that they have taken steps to inquire about and verify a consumer's financial situation by consistently including in the files detailed information setting out the consumer's regular income and major expenses, together with verifying documentation such as payslips and bank statements.</p>
<p>Finding 3.3: Retaining information about the consumer's pre-existing contracts</p>	<p>We saw some files that did not contain copies or sufficient details of a consumer's pre-existing credit contracts.</p> <p>Credit assistance providers should obtain copies of a consumer's pre-existing credit contracts or clearly record details for each contract, such as the loan term, interest rate, repayment amounts and any fees or charges for early termination. All of these factors should be taken into consideration in the preliminary assessment of unsuitability.</p>
<p>Finding 3.4: Mismatch between assessments and applications to credit providers</p>	<p>We noted instances where the assessments had been made on lower loan amounts and interest rates than the terms set out in applications for credit or offers of credit to the consumer by the credit provider.</p> <p>Where the terms of the offer of credit change between the time of conducting a preliminary assessment and applying for or offering the credit, the credit assistance provider should ensure an assessment is completed based on the figures in the offer. Good practice would be to also include some explanation on the file as to why the terms have changed.</p>

<p>Finding 3.5: Assessing whether the proposed loan is not unsuitable</p>	<p>In a small number of files, we noted the consumer appeared to be repaying significantly higher amounts of money for longer periods and/or at higher interest rates after the debt consolidation services had been provided.</p> <p>If the result of the credit assistance is that a consumer's cost of credit is <i>higher</i> post consolidation, then there is a significant risk that the loan will be unsuitable. To address this risk, we expect credit assistance providers to acknowledge the higher post-consolidation position and clearly document why such an outcome is not unsuitable.</p> <p>In addition, a credit assistance provider will be at greater risk of non-compliance with its responsible lending obligations if it does not explain to the consumer the risks of debt consolidation and refinancing, and if it does not record those explanations: see Finding 2 at paragraphs 64–71.</p>
<p>Finding 3.6: General file keeping</p>	<p>We saw files that contained only basic documentation demonstrating a consumer's income, major expenses and the application for credit. This showed the transaction that had taken place, but did not provide information that described why the transaction had taken place or that it was not unsuitable.</p> <p>We also found instances where information recorded by the credit assistance provider in preliminary assessments was contradicted by other information on file. Examples include assessments:</p> <ul style="list-style-type: none"> • of consumer expenses where the amount recorded was contradicted by the consumer's paperwork held on the file; and • that did not take account of the number of pre-existing credit contracts where those existing loans were clearly identified in consumer bank statements and other documents held on file.

Further work

- 19 While this report identifies a number of areas where credit licensees were at risk of not meeting their obligations under the *National Consumer Credit Protection Act 2009* (National Credit Act), the purpose of this review was to assess the marketplace, report on practices and highlight areas for improvement.
- 20 We note that our review was undertaken in relation to practices over the first six months of the new responsible lending regime, and that businesses were still adapting their practices in response to the new obligations. Industry has now had sufficient time to establish its practices. We will be more likely to take enforcement action if, in future, we observe the behaviour identified as concerns in this report.
- 21 We have provided feedback to the individual credit assistance providers reviewed about specific concerns. We have also raised the issues identified with industry bodies and will continue to work with them to assist their members in meeting these requirements.
- 22 We have undertaken a number of other reviews of responsible lending obligations 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.

A Background

Key points

Debt consolidation is a service promoted as one that helps consumers, with the language used in advertising suggesting that it can solve debt problems, save money and increase control for borrowers.

While there is no formal definition for 'debt consolidation' under the National Credit Act, generally it is a service that falls within the definition of 'credit assistance' in s8.

Debt consolidation promoted as a consumer benefit

- 23 Debt consolidation is a service promoted as one that helps consumers manage their repayment obligations under multiple credit providers or multiple credit contracts. The underlying premise is that consumers can better manage their payment obligations if they consolidate multiple credit contracts into one contract, enabling them to make one single, regular payment instead of multiple smaller payments to multiple credit providers at various times. Debt consolidation also often occurs when consumers are refinancing from higher to lower interest rate loans.
- 24 The advertising employed in promoting debt consolidation provides some insight into the type of benefit credit assistance providers claim consumers might derive from consolidating debt. Advertising language used by credit assistance providers in promoting debt consolidation services includes:
- (a) 'Debt problems can be solved by simply consolidating existing debts';
 - (b) 'Help you consolidate and save';
 - (c) 'Our personal loans could also help you save money by consolidating loans into one new loan at a lower rate';
 - (d) 'Debt consolidation is one of the best "debt help" solutions'; and
 - (e) 'Debt consolidation will help you regain control of your financial situation'.
- 25 There is no formal definition of 'debt consolidation' in the National Credit Act. It is a service that falls within the definition of 'credit assistance' in s8 of the National Credit Act in that it involves a credit assistance provider suggesting or helping a consumer apply for a new credit contract or increase in the limit of an existing contract. For the purposes of this review, we defined 'debt consolidation' as 'securing new or additional credit for the purpose of using that credit to pay off other pre-existing credit contracts or to reduce the total number of payments being made. The types of credit

contract that may be affected include, but are not limited to, home loans, credit cards, personal loans and payday loans'.

- 26 The businesses identified for inclusion in this review advertised debt consolidation among the range of services they offered. None of the businesses provided debt consolidation to the exclusion of other credit assistance; rather, they offered debt consolidation among other services. A number of entities specialised in assisting consumers to manage multiple payment obligations and advised on debt agreements under the Bankruptcy Act or payment management plans. These types of entities were excluded from this review because they did not arrange new credit as a way of dealing with pre-existing credit obligations, and their activities were generally not subject to the National Credit Act.

Legislation and guidance

- 27 In July 2010 the National Credit Act introduced a number of statutory requirements for credit providers and persons providing credit assistance. These include licensing requirements, general conduct and record-keeping obligations, and specific responsible lending obligations.
- 28 The requirements for reasonable inquiries and assessments were introduced in two stages. From 1 July 2010 these obligations commenced for credit assistance providers (e.g. mortgage brokers) and credit providers other than 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).
- 29 Generally speaking, the responsible lending obligations that commenced on 1 July 2010 applied to a population that comprised credit assistance providers, such as mortgage brokers and smaller non-bank credit providers. Approximately two-thirds of credit licensees have identified themselves as being involved in providing credit assistance through mortgage broking.
- 30 These obligations subsequently commenced for ADIs and registrable corporations on 1 January 2011.
- 31 Before providing credit assistance, the credit assistance provider must make a preliminary assessment as to whether the proposed credit contract will be unsuitable. The contract will be unsuitable for the consumer if, at the time of the preliminary 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.

- 32 To demonstrate that a preliminary assessment has been made, a credit assistance 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.
- 33 There are significant civil and criminal penalties that apply to contraventions of these responsible lending obligations.
- 34 Credit assistance 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.
- 35 We released RG 209 in February 2010, which 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.
- 36 The inquiries and verifications a credit licensee must make to satisfy its responsible lending obligations are scalable—that is, what a licensee needs to do to meet its obligations will vary depending on the circumstances of the consumer: see RG 209.25. Where a credit licensee offers a debt consolidation service to consumers, which includes a review of current debts and how these could best be structured, we would expect the licensee to undertake a greater level of inquiries to gain a more comprehensive understanding of a consumer's financial situation: see Example 2 in RG 209.
- 37 We provide additional guidance on switching or refinancing at RG 209.107–RG 209.112. When undertaking these activities, we expect a credit licensee to give consideration to factors, such as whether the new credit contract:
- (a) would result in overall cost savings to the consumer that are likely to override any loss of benefits; or
 - (b) may result in minimal cost savings, but the new credit contract better meets the consumer's requirements and objectives: see RG 209.107.
- A credit licensee must also take into account all of the circumstances, including the cost of replacement and all associated fees and other charges.
- 38 If this information is not recorded in the client file, we consider that a credit licensee would have difficulty demonstrating that it has complied with its responsible lending obligations. It would also be difficult for a credit licensee to adequately supervise its employees and representatives where they are not recording this information.

- 39 In addition to meeting their responsible lending obligations, credit licensees are required to meet their obligations under s47 of the National Credit Act, including:
- (a) doing all things necessary to ensure that the credit activities authorised by the licensee are engaged in efficiently, honestly and fairly (s47(1)(a)); and
 - (b) complying with the credit legislation, and taking reasonable steps to ensure their representatives also comply (s47(1)(d) and (e)).

We consider accurate record keeping is an essential obligation of credit licensees and their representatives.

- 40 Record-keeping obligations are also contained in the conditions of Australian credit licences. Pro Forma 224 *Australian credit licence conditions* (PF 224) states at item 15 that a 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 Act.
- 41 We have provided guidance in relation to a number of the other requirements 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/rg.

Methodology

- 42 We wanted to assess industry's responsible lending conduct in a number of areas, including debt consolidation. Refinancing was identified as a potentially vulnerable area in REP 119.¹ Refinancing (and debt consolidation) can result in higher repayment amounts over the term of the loan and extra costs on refinancing (including broker fees and establishment fees if there is a new loan). The review also complemented work undertaken on responsible lending in relation to home loans and micro lending.²
- 43 Target entities were identified through a combination of searches of websites and advertising, and specific knowledge of entities offering debt consolidation. We selected credit assistance providers from each Australian state; however, neither territory was represented.

¹ Some of the refinancing identified in REP 119 involved debt consolidation: see, for example, paragraph 94.

² Report 262 *Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans* (REP 262) and Report 264 *Review of micro lenders' responsible lending conduct and disclosure obligations* (REP 264).

- 44 We initially selected 26 entities for review. We contacted each one to determine whether they had provided any debt consolidation within the six-month period from 1 July 2010 to 31 December 2010. This initial contact reduced the entity list to a total of 17. Some targets were excluded either because they had not provided credit assistance involving debt consolidation within the relevant period or they were involved in the administration of payment plans or debt agreements under the Bankruptcy Act (such services were outside the scope of the review).
- 45 The review obtained information from credit assistance providers in two stages. The first stage sought information about the debt consolidation services provided, including the amount consolidated, the interest rate of the new contract, the loan type (e.g. personal or mortgage) and the commission earned. Information in the first stage was obtained through serving notices under s17 of Sch 2 to the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* on those entities that were registered for credit activities, and notices under s49 of the National Credit Act on those that had been granted a credit licence.
- 46 We also sought information about whether the consolidated loans had gone into default since being refinanced. Only one participant in this review was able to provide this information; about 6% of the loans they had written were in default. Most of the credit assistance providers said they were not aware of whether default occurred because it was a matter between the credit provider and consumer.
- 47 A total of 236 instances of credit assistance involving debt consolidation were reported. The instances of credit assistance provided by each targeted entity varied significantly, ranging from nil to 100 consumers being assisted in the relevant period.
- 48 If entities had provided debt consolidation to fewer than 10 consumers during the period, we obtained all of the relevant client files. For entities that had provided more than 10 services, we selected a cross-section of files based on information provided under the first notice. A total of 82 client files were obtained.
- 49 The second stage of the review involved detailed reviews of the 82 client files. Reviews focused on credit assistance providers' responsible lending practices. Consideration extended to comparing the consumer's pre- and post-consolidation position, and whether credit assistance providers were meeting their record-keeping and responsible lending obligations under the National Credit Act. We did not seek to determine whether any particular credit contract was unsuitable for a consumer.

B Findings

Key points

We found credit assistance providers in general did not appear to document in their client file whether potential significant risks and costs of debt consolidation had been discussed with consumers.

There was wide variance in the quality of record keeping on files. Most files reviewed recorded some inquiries into a consumer's requirements and objectives, inquiries into and verification of a consumer's financial situation, or assessment of whether a consumer would be able to meet their obligations under the proposed credit contract without substantial hardship. Only a few credit licensees demonstrated that they recorded appropriate details on all their files.

We also identified some instances where credit assistance providers would find it difficult to demonstrate they had met their responsible lending obligations.

We encourage credit assistance providers 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 obligations.

Finding 1: Impact of debt consolidation on consumers

- 50 The most common debt consolidation solutions presented to consumers were:
- (a) extending loan terms (often resetting to 30 years) to reduce the monthly repayment commitment (50% of all files);
 - (b) switching consumers to interest-only loans; and
 - (c) placing consumers into new credit contracts on different rates (often lower rates, but in some cases on higher rates than pre-consolidation).
- 51 There are potentially significant risks and costs involved in debt consolidating and refinancing, and we found few client files showed that such risks or costs had been discussed.
- 52 The more significant risks and costs of debt consolidation include:
- (a) higher long-term costs of repayment of a loan resulting from extending the loan term;
 - (b) moving consumers to interest-only loans without an appropriate exit strategy;
 - (c) leaving pre-existing contracts open, enabling a consumer to redraw on them at a later stage and fall further into debt problems;

- (d) transferring default risk on unsecured loans and loans secured by assets (other than the family home) onto the family home by consolidating all debts into the home loan; and
- (e) additional costs of debt consolidation, such as broker fees and new loan establishment fees.

Higher costs of repayment from extending the loan

- 53 Resetting the loan to a longer term (e.g. 30 years) may have the short-term effect of reducing a consumer's monthly repayments, but will expose that consumer to substantially higher repayment amounts over the life of the loan. For example, extending a \$250,000 loan from a 25-year term to a 30-year term will increase the total interest to be repaid by more than \$81,000 (approximately 25%).³
- 54 Where files involved consumers whose loans were reset to longer terms (e.g. a 25-year home loan was extended to 30 years), very few of these files contained any information about the additional long-term cost of repaying debt over that period.
- 55 One example of better record keeping was evident in a file where the credit assistance provider arranged to consolidate the consumer's credit contracts into a new loan for a larger sum but at a lower rate, thereby reducing their monthly repayment amounts. The file notes revealed that the credit assistance provider discussed this aspect of the proposed debt consolidation with the client and advised them to continue to make the same monthly repayments as they had been making previously in order to pay off the additional amount borrowed as quickly as possible.

Moving to interest-only loans

- 56 Switching to interest-only loans can provide a solution to a consumer's short-term repayment difficulties; but, as identified on ASIC's MoneySmart website, 'It will take you longer to pay off the loan, because you still have to pay off the principal after the interest-only stage ends. You will also pay more interest overall': see www.moneysmart.gov.au/borrowing-and-credit/home-loans/choosing-a-home-loan#Interest.

³ We used the mortgage calculator at www.moneysmart.gov.au to compare a \$250,000 loan over 25 years at 8% (repaid monthly) to a 30-year loan on the same terms. The total interest increased from \$328,862 to \$410,388, an increase of 24.78%.

Example 1: Interest-only loan

A family was having difficulty in meeting their repayment obligations on several unsecured debts and their principal and interest home loan. They were concerned about defaulting and losing their home. The primary income earner was a long-term casual employee.

The credit assistance provider refinanced the family into an interest-only loan and consolidated the unsecured debts into the mortgage. This strategy reduced the family's monthly repayment commitments by 15%.

The file did not contain any information about whether the interest-only loan was a short-term solution, whether the arrangement needed to be revisited in the future or whether the principal of the loan needed to be reduced over time.

- 57 Where a consumer is advised to take out an interest-only loan, the credit assistance provider should consider how the principal will be repaid in the future, ensure the consumer is aware of the higher costs over the life of the loan and advise the consumer to review their circumstances regularly. This should be documented in the client file.

Closing pre-existing credit contracts

- 58 It is important that credit assistance providers give consideration to whether the consumer's pre-existing credit contracts are left open. In only 19% of files we assessed, the credit assistance provider recorded that it had informed the consumer that they should no longer use existing credit contracts, or had assisted the client to close existing credit contracts.

Transferring default risk from unsecured loans to family home

- 59 Secured loans such as home loans are often the lowest interest rate loans held by consumers, and debt consolidation frequently involves unsecured debts being incorporated into the consumer's home loan. Credit assistance providers need to be mindful of the risk of consolidating unsecured debts into the family home.
- 60 REP 119 quoted one consumer's experience:
- The refinance made my situation worse because it took a bunch of unsecured debts and made them secured against my home. I went from a small mortgage I could afford, to one beyond what the pension can cover.
- 61 The family referred to in Example 1 also consolidated unsecured debts into their new home loan. The mortgage balance increased by 17% after adding the unsecured debts and broker fees, while monthly repayment obligations reduced by 15% on account of switching to interest only. While this reduced short-term pressure on their repayment obligations, any future default places

the home at risk; previously, the family could have prioritised their payments towards the loan secured on their home over other unsecured loans.

Additional costs of debt consolidation

- 62 Only 35% of files demonstrated that credit assistance providers considered consolidating the consumer's debts into one of the consumer's existing facilities, while only 8% actually refinanced within a pre-existing credit contract. Most of those instances where a consumer's debts were consolidated into a pre-existing contract were where the credit assistance provider had placed the consumer into that previous contract.
- 63 Using an existing credit facility could potentially reduce the fees and charges involved in refinancing, and we expect a credit assistance provider to take this information into account.

Finding 2: Record-keeping practices

- 64 Section 47 of the National Credit Act imposes a number of general conduct obligations on credit licensees, including the requirement to:
- (a) comply with the credit legislation;
 - (b) have adequate arrangements and systems in place to ensure compliance with their obligations; and
 - (c) have a written plan that documents those arrangements and systems.
- RG 205 provides guidance to credit licensees on meeting these obligations.
- 65 Record-keeping obligations are also contained in the conditions of Australian credit licences: see PF 224, item 15.
- 66 We found that it was common for entities offering debt consolidation to use template documentation and file-keeping practices. This included template preliminary assessment checklists and fact finders. These template documents were used on some of the relevant files; however, these templates and file-keeping practices were not used consistently by the credit licensees and were not included or completed fully in all circumstances where we would have expected them to be included on the client files.
- 67 There was wide variance in the quality of record keeping on files. In some cases, good file-keeping practices were evident in some files of a particular credit licensee but those file-keeping practices were not consistently applied by that licensee. Most files reviewed recorded some inquiries into a consumer's requirements and objectives, inquiries into and verification of a consumer's financial situation, or assessment of whether a consumer would be able to meet their obligations under the proposed credit contract without

substantial hardship. Only a few credit licensees demonstrated that they recorded appropriate details on all their files.

- 68 The credit licensees that more clearly demonstrated compliance with the legislative requirements included the following on their files:
- (a) copies of loan applications and supporting documents;
 - (b) a comprehensive record of the active steps the credit assistance provider had taken to form the view that a loan was 'not unsuitable', such as assessing whether the consumer would be unable to comply with their financial obligations under the contract (or could only comply with substantial hardship) and whether the contract would meet the consumer's requirements or objectives; and
 - (c) records of the steps taken to verify the consumer's financial situation (e.g. multiple sources of income verification apparent on files).
- 69 In the context of debt consolidation or refinancing more generally, we think that a credit assistance provider will be unable to demonstrate that it is meeting its record-keeping obligations where relevant information about pre-existing contracts being consolidated (including the loan term, interest rates, repayment frequency, and termination or break costs) is not recorded on the file: see Example 2 in RG 209.
- 70 Our ability to undertake file reviews was affected by poor record keeping. In 30% of files reviewed, the credit assistance provider failed to record or keep sufficient information to identify the consumer's pre-existing credit contracts or to identify important characteristics of those pre-existing credit contracts. In the context of debt consolidation, a credit licensee is at risk of not being able to demonstrate compliance with its responsible lending obligations where the files do not contain information about the consumer's pre-consolidated debts.
- 71 This creates a higher risk of the credit licensee not making an accurate assessment of unsuitability. Further, a licensee may have difficulty in demonstrating that it can meet its obligation to adequately supervise its representatives where it cannot review a client file maintained by the representative and see for itself the impact of the debt consolidation.

Finding 3: Potential compliance risks

Finding 3.1: Recording the consumer's requirements and objectives

- 72 The National Credit Act requires credit licensees to make reasonable inquiries about consumers' requirements and objectives and a credit contract must be assessed as unsuitable if it does not meet the consumer's

requirements and objectives: s118(2)(b) and 119(2)(b), National Credit Act. The Explanatory Memorandum to the National Consumer Credit Protection Bill 2009 (Explanatory Memorandum) states at paragraph 3.68 that:

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 match the consumer's purpose.

- 73 RG 209 notes that reasonable inquiries could include inquiries about the timeframe for which credit is required, and whether the consumer seeks particular product features or flexibility and understands the costs of these features and any additional risks.
- 74 Our review found that only 20% of the client files (involving eight of the 17 credit licensees) contained material demonstrating some action or conversation about the longer-term objectives or behaviours of the consumer. The remaining files contained information that suggested the credit licensee focused solely on the immediate transaction (i.e. on the consolidation of debts).
- 75 The information recorded about the consumer's purpose for seeking the service varied widely. In 20% of the assessed files, no clear purpose for the consolidation was displayed. Many of the other files recorded the consumer's purpose as 'debt consolidation'. We consider this to be unhelpful, because it appeared the consumer's objectives were being expressed in such a way as to match the service being provided. Consumers' objectives more frequently centre on issues such as reducing the size or number of regular repayments, or seeking lower interest rates. Debt consolidation is the process through which those objectives might be met, although it might not be the right solution for a particular consumer in all cases.
- 76 Credit licensees more clearly complied with their responsible lending obligations where they kept files that included accurate reasons about why the consumer was seeking to consolidate their debts. In these cases, the credit assistance provider appeared to have greater insight into the consumer's particular circumstances, which enabled it to make a more informed decision about the suitability of debt consolidation as a solution for the consumer.
- 77 There appeared to be a strong correlation between a credit assistance provider making more detailed inquiries about the consumer's objectives and whether the credit licensee explored alternatives to debt consolidation or gave guidance to the consumer about how to marshal their spending. Where in-depth inquiries about the consumer's objectives were not recorded on the file, the credit licensee appeared to provide a more transactional service (i.e. the licensee generally provided a service consolidating loans, and the consumer's existing loans were consolidated rather than dealt with in any

other way). In these cases, the credit licensee risks breaching its responsible lending obligations.

- 78 Many credit licensees used checklists and template documents for assessing consumer objectives, and these appeared to be of some value to the licensee when attempting to determine the true objectives of the consumer. However, the most effective data collection forms allowed for free text and file notes because these enabled the credit assistance provider to describe the consumer's objectives in their own words rather than attempting to fit their purpose within a predefined range of options set out on a form.

Findings 3.2 and 3.3: Inquiring about and verifying the consumer's financial situation, and retaining information about the consumer's pre-existing contracts

- 79 The National Credit Act requires a credit assistance provider to make reasonable inquiries about and take reasonable steps to verify a consumer's financial situation in order to ensure the consumer can meet their obligations under the credit contract without substantial hardship.

- 80 The Explanatory Memorandum states at paragraph 3.70 that:
- reasonable inquiries about the consumer's financial situation could include: determining the amount and source of the consumer's income; determining the extent of fixed expenses (such as rent or contracted expenses such as insurance, other credit contracts and associated information); and other variable expenses of the consumer (and drivers of variable expenses such as number of [dependants] and number of vehicles to run, and any particular or unusual circumstances).

- 81 In addition to general inquiries appropriate for all credit assistance providers to undertake, there are specific inquiries we consider a credit assistance provider must undertake when providing debt consolidation assistance: see RG 209.107–RG 209.112. These inquiries relate specifically to a consumer's pre-existing credit contracts, such as the terms and, importantly, any break costs or fees associated with terminating the contracts. Without this information, a credit assistance provider is not in a position to make an informed assessment about the impact its assistance is having on the consumer and, accordingly, cannot comply with its responsible lending obligations.

- 82 Generally speaking, the level of inquiry made by credit assistance providers about a consumer's financial situation and the verification of the income and expenses were of a reasonable standard when these were undertaken. Typically, verification involved collecting and retaining on the consumer file recent payslips, bank statements and copies of other significant payment obligations. However, some files held insufficient documentation to demonstrate that the credit assistance provider had undertaken adequate inquiries about or had verified the consumer's financial situation.

- 83 Credit assistance providers can lessen the risk of not being able to demonstrate that they have taken steps to inquire about and verify a consumer's financial situation by consistently including in the files detailed information setting out the consumer's regular income and major expenses, together with verifying documentation such as payslips, bank statements and credit reports.

Finding 3.4: Mismatch between assessments and applications to credit providers

- 84 Our review found some files with other record-keeping problems, including partially completed or non-existent preliminary assessments, and affordability calculations based on amounts and interest rates different to those ultimately provided to the consumer.

Example 2: Mismatch between assessments and application to credit provider

One file contained five pages of detailed information about the consumer's existing circumstances, income and expenses. Affordability calculations were performed on an amount of money to be repaid over five years at an interest rate of 16.95% and an assessment was made that such a loan was not unsuitable.

The final loan given to the consumer was for twice the amount of money, at an interest rate of 29.99%. Monthly repayments were more than doubled. The file did not contain affordability calculations based on the higher repayment obligations.

Finding 3.5: Assessing whether the proposed loan is not unsuitable

- 85 In a small number of files, we noted the consumer appeared to be repaying significantly higher amounts of money for longer periods and/or at higher interest rates after the debt consolidation services had been provided.
- 86 If the result of the credit assistance is that a consumer's cost of credit is *higher* post consolidation, then there is an increased risk that the loan will be unsuitable. To address this risk, we expect credit assistance providers to acknowledge the higher post-consolidation position and clearly document why such an outcome is not unsuitable.
- 87 In addition, a credit assistance provider will be at greater risk of non-compliance with its responsible lending obligations if it does not explain to the consumer the risks of debt consolidation and refinancing, and if it does not record those explanations: see Finding 2 at paragraphs 64–71.

Finding 3.6: General file keeping

- 88 In 18% of files, there was not enough information on the file to demonstrate whether reasonable inquiries had been made, and there did not appear to be a preliminary assessment recorded in the file.
- 89 We also found instances where information recorded by the credit assistance provider in preliminary assessments was contradicted by other information on file. Examples include assessments of consumer expenses (e.g. the amount recorded was contradicted by the consumer's paperwork) and the number of pre-existing credit contracts (e.g. the assessments overlooked loans that were clearly identified in consumer bank statements). We also observed instances of affordability calculations being undertaken on lower amounts or interest rates than those subsequently contained in the credit contract offered to the consumer.
- 90 Credit assistance providers should continue to monitor and provide further training to their representatives about undertaking accurate analyses and record keeping.

C Further work

Key points

We have followed up directly with the individual entities that were reviewed about specific concerns.

Notwithstanding any action that ASIC may take, credit licensees who do not satisfy their responsible lending obligations also place themselves at risk of civil action by consumers seeking compensation for any loss or damage they may have suffered as a result.

- 91 The credit assistance providers' files displayed inconsistent record-keeping practices and, in general, did not set out whether potential significant risks of debt consolidation had been discussed with consumers. We have followed up directly with the individual entities that were reviewed about specific concerns.
- 92 Entities should be careful how they market debt consolidation to consumers and should have a proper basis for recommending debt consolidation beyond a general notion that fewer repayments or a lower regular repayment is better. A credit licensee must take active steps to form the view that a loan is 'not unsuitable', such as assessing whether the consumer will be unable to comply with their financial obligations under the contract (or could only comply with substantial hardship) and whether the contract will meet the consumer's requirements or objectives.
- 93 The most informative files showed that, in addition to the debt consolidation assistance, consumers were given guidance about managing their finances (including closing pre-existing credit contracts or examining their spending behaviour).
- 94 Where debt consolidation is provided as a solution to a consumer's immediate difficulties, credit assistance providers should work with consumers to find a longer-term solution to their difficulties or refer them to a financial counsellor. Consideration should be given to whether extending a consumer's repayment term may only delay the consumer's subsequent default or exacerbate their problem.
- 95 With the publication of this review's findings, we will be more likely to take compliance and enforcement action in the future where we become aware of credit assistance providers not meeting our expectations in relation to record keeping and responsible lending conduct.
- 96 Notwithstanding any actions that ASIC may take, we also note that credit assistance providers who do not satisfy their responsible lending obligations also place themselves at risk of civil action by consumers seeking compensation for any loss or damage they may have suffered as a result.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the National Credit Act
ASIC	Australian Securities and Investments Commission
Bankruptcy Act	<i>Bankruptcy Act 1966</i>
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act.
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 of the National Credit Code.
credit assistance	Has the meaning given in s8 of the National Credit Act
credit assistance provider	A person who provides credit assistance to a consumer in relation to a credit contract or a consumer lease and who is not the credit provider (for a credit contract) or the lessor (for a consumer lease)
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
debt consolidation	Securing new or additional credit for the purpose of using that credit to pay off other pre-existing credit contracts or to reduce the total number of payments being made. The types of credit contract that may be affected include, but are not limited to, home loans, credit cards, personal loans and payday loans
Explanatory Memorandum	Explanatory Memorandum to the National Consumer Credit Protection Bill 2009
general conduct obligations	The obligations under s47(1) of the National Credit Act
National Credit Act	<i>National Consumer Credit Protection Act 2009</i> , including regulations made for the purposes of that Act

Term	Meaning in this document
National Credit Code	National Credit Code at Schedule 1 of the National Credit Act
registrable corporations	A registrable corporation under s7 of the <i>Financial Sector (Collection of Data) Act 2001</i>
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

Related information

Headnotes

consumer, credit contract, credit licence, credit licensee, debt consolidation, financial situation, not unsuitable, record-keeping obligations, 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

Bankruptcy Act

Explanatory Memorandum, paragraphs 3.68 and 3.70; National Credit Act, s8, 47, 49, 118(2)(b), 119(2)(b); *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009*, s17 of Sch 2

Financial Sector (Collection of Data) Act 2001

Reports

REP 119 *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress*

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

REP 264 *Review of micro lenders' responsible lending conduct and disclosure obligations*