CONSULTATION PAPER 309

Update to RG 209: Credit licensing: Responsible lending conduct

February 2019

About this paper

This consultation paper seeks feedback on ASIC's proposals for updating our guidance in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

In particular, we are considering our general approach to guidance in this area, what aspects of our current guidance may need updating or clarification, and whether we should provide additional guidance on specific issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued in February 2019 and is based on the National Credit Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on responsible lending. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section E, 'Regulatory and financial impact'.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by Monday 20 May 2019 to:

Fleur Grey
Senior Specialist
Credit, Retail Banking and Payments
Financial Services
Australian Securities and Investments Commission
responsible.lending@asic.gov.au

What will happen next?

Stage 1	14 February 2019	ASIC consultation paper released
Stage 2	20 May 2019	Comments due on the consultation paper
	June–July 2019	Review of submissions and drafting of response
Stage 3	August–September 2019	Response to submissions released
Stage 4	To be advised	Further consultation on draft update to RG 209 as needed followed by release of updated RG 209

A Background to the proposals

Key points

ASIC is reviewing and planning to update our guidance on responsible lending for consumer credit in RG 209.

In particular, we are considering:

- our approach to providing guidance in RG 209;
- what current guidance may need updating or clarifying; and
- whether we should provide additional guidance on specific issues.

1 Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) contains ASIC's guidance on responsible lending for consumer credit. RG 209 was issued in 2010 and last revised in November 2014.

Note: Responsible lending applies to credit granted to individuals or strata companies wholly or predominantly for personal, domestic or household purposes, or to purchase, renovate or improve residential property for investment purposes. The responsible lending provisions do not apply to loans to companies or loans for business purposes: see Ch 3 of the *National Consumer Credit Protection Act 2009* (National Credit Act).

2 Since then there have been relevant judicial decisions, ASIC enforcement actions, ASIC thematic reviews, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), changes in the law and changes in technology—which need to be taken into account and included in an update of RG 209 to ensure all relevant information is set out in one place.

3 We consider it is an appropriate time to review the guidance contained in RG 209—to consider whether it remains effective and identify changes and additions to the guidance that may help holders of an Australian credit licence (licensees) to understand the responsible lending obligations.

Our general approach

4 Currently RG 209 aims to provide principles-based guidance to help licensees identify factors they should consider when determining whether the inquiries they make, and steps they take to verify information, are reasonable. Following the initial consultation in 2009, this approach was taken to allow licensees to tailor their responsible lending processes in a way that is appropriate for their business and consumers.

5 Section B raises questions about whether we should provide additional guidance to licensees, to identify more clearly the inquiries and steps that we think are important for licensees in complying with their responsible lending obligations.

Updating or clarification of current guidance

6 Section C identifies some aspects of the current guidance in RG 209 that we consider may benefit from being updated or clarified, including:

(a) the kinds of information that are available to verify different aspects of a consumer’s financial situation;

(b) the role of expense benchmarks in the process for verifying a consumer’s financial situation; and

(c) what licensees should take into account when inquiring about, and assessing whether a credit product meets, a consumer’s requirements and objectives.

Additional guidance on specific issues

7 Section D identifies a number of issues that are not currently addressed in any detail in RG 209. We have included proposals for guidance on:

(a) areas where the responsible lending obligations do not apply (e.g. small business lending);

(b) the role of the responsible lending obligations in mitigating risks involved in loan fraud;

(c) how negative repayment history information may be used, and the effect this may have on the kinds of inquiries that should be made with the consumer;

(d) good practices for maintaining records that demonstrate compliance with the responsible lending obligations; and

(e) the purpose and content of the written assessment.

Any other additional guidance

8 Throughout this consultation paper, we have asked a series of questions about specific matters. We are also keen to hear from you on any other issues you consider important.

B Our general approach

Key points

We are considering whether to provide additional guidance in RG 209 to identify more clearly the inquiries and steps that we think are important for licensees in complying with their responsible lending obligations.

Reasonable inquiries and verification steps

Proposal

B1 We are considering whether to identify particular inquiries and verification steps in RG 209 that we think would generally be reasonable to provide greater certainty to licensees about complying with their obligations.

Your feedback

B1Q1 Would it be useful for licensees if ASIC were to identify the inquiries and verification steps that we consider should be taken? Why or why not?

B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.

B1Q3 Are there any kinds of credit products, consumers or circumstances for which you consider it may be reasonable to undertake fewer inquiries and verification steps? Please identify the kinds of products, consumers and circumstances and particular features you think are relevant.

B1Q4 In your view, what aspects of the consumer's financial situation would a licensee need to inquire about in all circumstances? If you think some aspects of the consumer's financial situation do not need to be inquired about, please explain why.

B1Q5 In your view, what aspects of the consumer's financial situation would a licensee need to verify in all circumstances? If you think some aspects of the consumer's financial situation do not need to be verified, please explain why.

B1Q6 What would be the effect on consumers of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for consumers?

B1Q7 What would be the effect on business costs of ASIC identifying particular inquiries and verification steps? Please provide details of the effect on compliance costs for the licensee, and any factors that are likely to affect the level of cost or cost savings.

B1Q8 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

Rationale

9 RG 209 notes that the obligation to make reasonable inquiries and take reasonable steps to verify information provided is scalable, and that what a licensee needs to do to meet these obligations in relation to a particular consumer will vary depending on the circumstances. We have provided some guidance on factors that may affect whether the steps taken should be ‘scaled up’ or ‘scaled down’ to meet the reasonable inquiries and reasonable steps threshold.

10 When RG 209 was being developed, ASIC consulted on different approaches that it could take in relation to the responsible lending obligations, including:

(a) to impose minimum requirements on how licensees should comply with these obligations; and

(b) to provide indicative guidance on the processes licensees should use to assess whether a credit contract is ‘not unsuitable’ for a consumer.

Note: See Consultation Paper 115 *Responsible lending* (CP 115) and the Regulatory Impact Statement (RIS) to RG 209.

11 Responses to CP 115 noted that imposing minimum requirements on licensees would have some benefits, including:

(a) predictability for industry;

(b) consistency across industry, by ensuring that all licensees conduct certain checks and verification steps; and

(c) both licensees and consumers would know beforehand what minimum factors would need to be checked and verified, regardless of the type, size and complexity of the loan, and the individual characteristics of the consumer.

12 However, it was decided that setting minimum standards would be relatively inflexible, and not allow industry to tailor their responsible lending processes in a way that is appropriate for their business and consumers. This would involve greater compliance costs and may not be the most efficient approach for businesses. We also noted that setting minimum standards could have an unintended consequence that some licensees will only conduct the inquiries specified by ASIC—it could allow less scrupulous licensees to ignore other relevant issues that fall outside the factors set by ASIC and hide behind technical compliance, resulting in a lower standard of consumer protection.

Note: See discussion of Option 1 in the RIS to RG 209, paragraphs 44–50.

13 We have observed since the start of the responsible lending regime instances where licensees have failed to take sufficient steps in order to comply with their obligations. These observations have been highlighted through ASIC’s enforcement work, as well as our thematic reviews. The reports that have been published following our thematic reviews provide additional guidance to licensees (e.g. our work on interest-only lending).

14 To assist licensees, we are proposing to update RG 209 to reflect the findings of our thematic and enforcement work since 2011, as well as clarifying areas which potentially remain a source of uncertainty.

15 In providing additional guidance, we will continue to make it clear that licensees are not prevented from determining that for a particular consumer it would be reasonable to undertake a lower level of inquiries and verification steps. However, if a licensee decided to do this, they should be able to demonstrate why they consider lesser inquiries and verification steps to be reasonable in the circumstances for the particular consumer involved.

16 We may also consider whether readily identifiable circumstances of the consumer could provide an indication that:

(a) the consumer may be operating at the margins of their disposable income and not able to afford additional financial obligations under a new loan (even if, taken on their own, those obligations would not appear significant); and

(b) additional steps to confirm that the consumer has not underestimated their fixed/recurring expenses would be reasonable.

17 For example, where inquiries about existing debts and credit history reports indicate that the consumer has multiple debts (e.g. multiple existing personal loans, consumer leases or ‘buy now, pay later’ arrangements) and/or delinquencies in payments for essential utilities and services, there may be a higher likelihood that the consumer is operating at the margins of their disposable income and not able to afford additional financial obligations.

C Updating or clarification of current guidance

Key points

We propose to update or clarify some aspects of the current guidance in RG 209, including:

- the kinds of information that are available to verify different aspects of a consumer's financial situation, and our views on whether licensees should use those different sources of information;
- the role of expense benchmarks in the process for verifying a consumer's financial situation; and
- what licensees should take into account when inquiring about, and assessing whether a credit product meets, a consumer's requirements and objectives.

Verification of consumer's financial situation

Proposal

C1 We propose to amend the current guidance in RG 209 on forms of verification to:

(a) clarify our guidance on kinds of information that could be used for verification of the consumer's financial situation, and provide a list of forms of verification that we consider are readily available in common circumstances; and

(b) clearly state that views on what are 'reasonable steps' will change over time, as different forms or sources of verifying information become available. For example, developments in open banking and data aggregation services will assist licensees to efficiently confirm the financial situation of a consumer (including allowing simultaneous inquiry about and verification of some information).

Your feedback

C1Q1 Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available forms of verification?

C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?

C1Q3 Are there particular issues with using data aggregation services that you consider should be raised in our guidance? Please provide details of those issues, and information that you consider should be included in our guidance. For example, would it be useful to include specific guidance on matters the licensee could, or should, raise with the consumer before obtaining the consumer's consent to use this kind of service?

Rationale

Types of information that can be used

18 The current guidance identifies, in Table 4 of RG 209, a number of examples of types of information that could be used to verify a consumer's financial situation. While it is noted that these examples are not intended to be an exhaustive list, we think that may not provide sufficient certainty about the kinds of information licensees should consider using to verify different aspects of the consumer's financial situation. The current guidance may also, incorrectly, give the impression that ASIC considers that using sources of information such as bank statements may only be reasonable steps where the licensee already has access to that information (e.g. a bank or credit card provider dealing with an existing customer).

19 We are considering expanding the list of kinds of verifying information that we consider is readily available in most circumstances. We have included a possible list in Appendix 1 to this paper.

New kinds of verifying information

20 We consider that what are 'reasonable steps' to verify information about the consumer's financial situation will change over time, as different forms or sources of verifying information become available or more easily accessible. For example, developments in relation to open banking, comprehensive credit reporting and data aggregation services will affect the accessibility, and cost of obtaining, transaction information and an overall view of the consumer's financial position from a single source. This is likely to affect whether it would be reasonable for most licensees to obtain positive confirmation of expenses (subject to the consumer's choice of whether to allow access to their banking data).

21 New technology and processes that are developed to take advantage of new data sources will also allow licensees to efficiently meet their obligations—including by allowing licensees to simultaneously inquire into and verify the financial situation of a consumer.

22 We are aware that there may be reasons why reference to information through a data aggregation service is not currently considered to be a reasonable step to take in all circumstances. For example, the consumer (or the consumer's financial institution(s)) may have concerns about disclosure of their personal identifiers or other information to the service provider, or about data security, and the effect of such disclosure on the consumer's rights in relation to unauthorised transactions.

23 However, as developments are made in this area to support consumer access to, and control over, their financial data we consider most licensees will generally be able to use such services to obtain more comprehensive information about the consumer's overall financial situation.

Proposal

C2 We propose to expand our guidance on what are reasonable steps to verify the financial situation of a consumer by:

(a) more clearly stating that it is not sufficient merely to obtain verifying information but not have regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects of the consumer's financial situation; and

(b) including an 'if not, why not?' approach—that is, if a licensee decides not to obtain or refer to forms of verifying information that are readily available, we consider they should be able to explain why it was not reasonable to obtain or refer to those forms of verification in the circumstances of the particular consumer involved.

Your feedback

C2Q1 Do you consider that the proposed clarification of guidance on reasonable verification steps would be useful? Are there any other aspects of our guidance on verification that you consider would be useful?

C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?

C2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

C2Q4 What additional business costs would be involved in this approach?

C2Q5 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

Rationale

24 The current guidance in RG 209 on verification steps:

(a) indicates that what constitutes 'reasonable steps to verify' information is generally scalable, and will depend on the information and resources that the licensee has access to and the facts and circumstances of each case;

(b) recognises that some licensees have access to information that is not readily available to other licensees; and

(c) indicates that information obtained during verification steps may identify inconsistencies in the information held, which should trigger additional inquiries and verification steps.

Note: See RG 209.46–RG 209.52.

25 Guidance on the assessment process also indicates that:

(a) licensees should base the assessment of a consumer's capacity to meet their payment obligations on the information obtained and verified during the inquiry and verification steps; and

(b) the assessment may only take into account information that the licensee has reason to believe is true, or would have had reason to believe was true (if the licensee had made reasonable inquiries and verifications).

Note: See RG 209.93–RG 209.95 and s118(4), 119(4), 131(4), 141(4), 142(4) and 154(4).

26 We have become aware of a number instances in which licensees:

(a) do not obtain or have regard to readily available forms of verification, such as bank statements; or

(b) obtain reasonable forms of verification, but do not have regard to whether that source of information in fact verifies different aspects of the consumer's financial situation (e.g. we have observed situations where a bank statement is relied upon to verify income, while information about the consumer's material expenses is ignored).

27 We consider that our guidance should more clearly express our view that licensees should, to ensure that they only have regard to information that they have reason to believe is true:

(a) seek verifying information for relevant/appropriate aspects of the consumer's financial situation;

(b) have regard to the information contained in the source of information; and

(c) if the information that is obtained contains inconsistencies or otherwise raises questions about the reliability of an aspect of the consumer's financial situation, either seek a further reliable source of information that does verify the information held or discount the information and undertake further discussions with the consumer to address the inconsistencies.

28 We consider that if a form of verification is readily available to the licensee, it will generally be reasonable for the licensee to take steps to obtain and have regard to that information. As noted above, we propose to include in RG 209 an expanded list of the kinds of verifying information that is readily available: see Appendix 1 of this paper.

29 We propose to expand our guidance to indicate that licensees should generally use readily available forms of verifying information, and that if a licensee chooses not to do so they should be able to explain why they did not consider accessing that information to be reasonable in the circumstances (i.e. an 'if not, why not' approach). If the licensee is not able to provide this explanation, we are more likely to consider that the licensee has failed to take reasonable steps to verify the consumer's financial situation.

30 We also propose to support this position with additional guidance about matters that should be recorded by licensees and included in the written assessment of whether a particular contract is unsuitable for the consumer: see Section C.

Use of benchmarks

Proposal

C3 We propose to clarify our guidance in RG 209 on the use of benchmarks as follows:

(a) A benchmark figure does not provide any positive confirmation of what a particular consumer's income and expenses actually are. However, we consider that benchmarks can be a useful tool to help determine whether information provided by the consumer is plausible (i.e. whether it is more or less likely to be true and able to be relied upon).

(b) If a benchmark figure is used to test expense information, licensees should generally take the following kinds of steps:

(i) ensure that the benchmark figure that is being used is a realistic figure, that is adjusted for variables such as different income ranges, dependants and geographic location, and that is not merely reflective of 'low budget' spending;

(ii) if the benchmark figure being referred to is more reflective of 'low budget' spending (such as the Household Expenditure Measure), apply a reasonable buffer amount that reflects the likelihood that many consumers would have a higher level of expenses; and

(iii) periodically review the expense figures being relied upon across the licensee's portfolio—if there is a high proportion of consumers recorded as having expenses that are at or near the benchmark figure, rather than demonstrating the kind of spread in expenses that is predicted by the methodology underlying the benchmark calculation, this may be an indication that the licensee's inquiries are not being effective to elicit accurate information about the consumer's expenses.

Your feedback

C3Q1 Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?

C3Q2 Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable.

C3Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

C3Q4 What additional business costs would be involved in this approach?

Rationale

31 The current guidance in RG 209 indicates the following:

(a) Automated systems and tools, including benchmarks, are not a substitute for making inquiries about the consumer's financial situation. In relation to verification steps, these tools are referred to as being a 'part of the process' for verifying information. Declared income or expenses that are outside the expected range by reference to a benchmark is noted as an example of where further inquiries and verification of information provided will be needed.

Note: See RG 209.49–RG 209.51 and Example 3.

(b) Benchmarks can be useful tools in the process of determining whether a particular consumer is likely to experience substantial hardship in meeting their financial obligations, but is not a replacement for making inquiries about the particular consumer's income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses.

Note: See RG 209.104–RG 209.105 and Example 7.

Findings from ASIC reports

32 In Report 445 *Review of interest-only home loans* (REP 445), we found that some credit providers had a practice of defaulting to a benchmark figure as a substitute for making inquiries into the consumer's expenses: see paragraph 225 of REP 445.

33 REP 445 noted that the Household Expenditure Measure (HEM), which is used by many licensees, represents a low-end estimate of the spending habits of Australian families. It uses a median expenditure of 'absolute basic' goods and services (e.g. most food purchased from a supermarket, children's clothing and child care) combined with the 25^{th} percentile of expenditure on 'discretionary basic' goods and services (e.g. alcohol, eating out, domestic travel and adult clothing).

Note: The HEM benchmark was developed in 2011 by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute) at The University of Melbourne. It represents an estimate of the spending habits of Australian families. The categories used for HEM were updated in June 2018.

34 At the time of REP 445, it was noted that some licensees used a single HEM benchmark figure, which varies depending on the number of adults and children in the family, but does not vary according to income. An income-adjusted HEM benchmark is also available—this benchmark provides a more realistic prediction of consumer spending patterns, as it recognises that higher-income consumers generally have higher living expenses. REP 445 noted that following ASIC's review, the lenders involved in the review had committed to introducing an income-adjusted benchmark.

35 In Report 516 *Review of mortgage broker remuneration* (REP 516), we found that for a significant number of home loans, the disclosed expense amount was the same as the benchmark amount used by the lender.

Note: See REP 516 at paragraph 887 and Figures 28–30.

36 We noted that these results do not reflect the expected distribution of expenses across a large group of consumers (i.e. as predicted by the HEM benchmark). We consider that a lender monitoring the distribution of disclosed expenses would recognise that this indicates that brokers and staff may be submitting home loan applications without genuinely inquiring about consumers' expenses.

Judicial commentary

37 The Federal Court in *Australian Securities and Investments Commission v Channic Pty Ltd* (No 4) [2016] FCA 1174 noted [at 1736] that:

> The section [dealing with verification of financial situation] directs attention to the *particular* financial circumstances of the *particular* consumer. … [The benchmark figure used] … is ultimately a notional figure in *substitution* for making reasonable inquiries. The *adoption* of the notional figure is not *conduct* of "making" reasonable inquiries about the consumer's financial situation or *conduct* of "verifying" the consumer's financial situation. In truth, it is a substitute for doing either of those things.

38 This suggests that if a licensee simply relies on comparison of a consumer's expense information to a benchmark figure (or applies a benchmark figure as a proxy for an expense amount that has been positively confirmed as being accurate), but the consumer has in fact understated their expenses, there is a risk that the licensee would be considered to have failed to take reasonable steps to verify the consumer's expenses.

Prudential guidance: Residential mortgage lending

39 In February 2017, the Australian Prudential and Regulation Authority (APRA) reviewed and republished Prudential Practice Guidance APG 223 *Residential mortgage lending* (APG 223). This guidance indicates (at [44]) that:

> [Authorised deposit taking institutions (ADIs)] typically use the Household Expenditure Measure (HEM) or the Henderson Poverty Index (HPI) in loan calculators to estimate a borrower's living expenses. Although these indices are extensively used, they might not always be an appropriate proxy of a borrower's actual living expenses. Reliance solely on these indices generally would therefore not meet APRA's requirements for sound risk management. APRA therefore expects ADIs to use the greater of a borrower's declared living expenses or an appropriately scaled version of the HEM or HPI indices. That is, if the HEM or HPI is used, a prudent ADI would apply a margin linked to the borrower's income to the relevant index. In addition, an ADI would update these indices in loan calculators on a frequent basis, or at least in line with published updates of these indices (typically quarterly).

40 In April 2018, APRA advised that for individual ADIs to no longer be subject to an investor loan growth benchmark, the ADI must confirm their lending

policies and practices meet specified expectations—including an assurance the ADI's practices meet guidance in APG 223 with a commitment to:

> improving where necessary the collection of information on borrowers' actual expenses, to reduce reliance on benchmark estimates. The use of benchmarks should be closely monitored, and applied in a low proportion of lending (consistent with the typically low calibration of such estimates).

Note: See APRA, Open letter to all ADIs, *Embedding sound residential mortgage lending practices*, 26 April 2018 (PDF, 317 KB).

Income verification

41 Through our surveillance activities, we have identified that some licensees do not always positively verify the income of a consumer—particularly for unsecured credit products. In these cases, licensees have used a risk-based approach, using data and algorithms to determine whether to approve a credit application.

42 While a sophisticated system for credit decisions may reduce the risk that a consumer will be provided with a loan that they cannot afford, the law requires that a credit provider undertake reasonable verification of a consumer's financial situation.

43 Given the importance of income as an element of a consumer's financial situation, we propose to make it clear in our updated guidance that licensees should always positively verify the relevant income sources of a consumer. We do not consider there are any circumstances in which it will be sufficient not to do so.

Household Expenditure Measure (HEM)

44 The HEM has been developed by the Melbourne Institute to provide an alternative measure to the Henderson Poverty Line (HPL). This measure was developed because:

(a) there was a desire among money lenders in Australia for a more current measure based on data on actual expenditures which may be more suitable for the purpose of determining how much an individual can borrow than the poverty line; and

(b) the HPL does not allow differentiation by income of the household even though households on different income levels are likely to have different expenditure patterns.

Note: See Melbourne Institute, The University of Melbourne, *The development of a Household Expenditure Measure*, May 2011.

45 In the Melbourne Institute paper, it is noted that:

> The HEM represents a conservative estimate of what modern Australian families consume, excluding expenditure on housing. To construct the HEM, expenditures are classified into three types: absolute basic expenditures, discretionary basic expenditures, and non-basic expenditures. Only the first two are included in the HEM, with absolute basics being given greater weight than discretionary basics.
>
> …

> The first step is to determine which expenditure items need to be included. If one chooses to be very restrictive in the items that are included in the HEM, then one cannot be also restrictive in only taking a low proportion of expenditure on this narrow set of basics. Alternatively, if one were to include all expenditures (i.e. total expenditure) one would need to take a lower proportion than, say, 50% of total expenditure if the HEM is to be a conservative measure. The HEM combines the two approaches by taking the median expenditure on goods and services that are deemed “absolute basics” and combining this with the 25th percentile of expenditures on what are deemed “discretionary basics”. Because absolute and discretionary basics include a very wide variety (and the bulk) of expenditures by households it ensures the HEM is inclusive. By making the split between absolute and discretionary basics the HEM ensures it is not overly generous by design.

46 Some expenses are not included in the HEM benchmark. For example, it does not take into account the following kinds of expenses (either because they are not included or are classified as ‘non-basic’ expenses):

(a) rent;

(b) mortgage repayments and other home purchase costs;

(c) non-Government school primary and secondary fees;

(d) HECS-HELP payments;

(e) lease payments (other than vehicle leases);

(f) alimony and maintenance payments;

(g) some medical charges (e.g. general practitioner and specialist doctor fees, physiotherapy, nursing home and hospital charges—though it does include hospital, medical and dental insurance);

(h) superannuation, annuities and life insurance;

(i) counselling services;

(j) sickness and personal accident insurance;

(k) legal, accounting and tax agent fees;

(l) union and professional association fees; and

(m) gambling.

Final report of the Financial Services Royal Commission

47 The final report of the Financial Services Royal Commission notes:

> while the HEM can have some utility when assessing serviceability—that is to say, in assessing whether a particular consumer is likely to experience substantial hardship as a result of meeting their obligation to repay a line of credit—the measure should not, and cannot, be used as a substitute for inquiries or verification.
>
> As ASIC rightly indicates in its Regulatory Guide relating to responsible lending conduct:
>
> [u]se of benchmarks is not a replacement for making inquiries about a particular consumer’s current income and expenses, nor a replacement for an assessment based on that consumer’s verified income and expenses.

Note: See Financial Services Royal Commission, Final report, February 2019, pp 57–58.

Proposed clarification

48 We think that the practices of some licensees have improved in recent years to reflect the guidance that use of a benchmark figure is not a substitute for making inquiries about the particular consumer's expenses. We also understand that licensees have generally improved their use of expense benchmarks as a verification tool by using an income-adjusted benchmark.

49 However, we think that it would be beneficial to clarify our guidance to reflect the findings of our reports, and the general approaches to, and limitations on, use of benchmarks that are noted above.

50 In summary, we propose to include the following messages to clarify the current guidance in RG 209 on the use of benchmarks.

Benchmarks can be useful as a tool to test the plausibility of consumer-provided information, but do not give a positive confirmation

51 A benchmark figure does not provide any positive confirmation of what the particular consumer's income and expenses actually are. As noted above, the most commonly used expense benchmark, the HEM, reflects 'low-budget' spending and it is expected that many consumers would in fact have higher living expenses.

52 We consider that benchmarks can be a useful tool to help determine whether information provided is more or less likely to be true and therefore able to be relied on. For example, if a consumer's declared expenses are well above a reliable benchmark figure, the licensee may be less likely to have reason to believe that information provided is not true. Conversely, if those declared expenses are below a benchmark figure, the licensee is likely to have reason to believe that information is not true, and so could not be relied upon unless it has been positively confirmed.

53 Even if a licensee has reference to a benchmark figure to test whether information provided about general living expenses (e.g. food, clothing, communication and entertainment) is plausible, the licensee will still need to make inquiries about whether the consumer has expenses of the kind that are not included in the benchmark calculations and seek verifying information about those expenses.

54 For example, the HEM benchmark does not include a number of expenses that would apply to many consumers (e.g. mortgage payments, non-Government school fees, alimony and maintenance, HECS-HELP payments and some medical fees and charges, which may not be covered in full by Medicare benefits). Licensees that have reference to benchmark figures should ensure they are aware of what expenses are, and are not, included in that calculation, and separately consider the excluded expenses.

Reliance on benchmarks to test information provided may involve a higher risk that the information is not accurate, particularly with some expenses

55 If a licensee is relying on comparison to a benchmark figure to test estimates provided by a consumer, rather than using a positive form of verification such as transaction statements or third-party information sources, there is a higher risk of using information that is in fact not true. As a result, there may be a higher risk of the consumer entering a contract they cannot afford and that is unsuitable.

56 Licensees should take particular care with expense categories that are not included in the HEM benchmark and where the expense is likely to be material and non-discretionary (e.g. existing debts owed by the consumer).

Whether reference to a benchmark figure is a reasonable step for the licensee to have taken will depend on the particular circumstances

57 Licensees should consider the circumstances of the particular consumer and credit product being applied for to determine whether it is sufficient to compare the consumer's estimated general living expenses to a benchmark figure to confirm that it is reasonably reliable, or if they should take additional steps to seek positive confirmation of the information provided.

58 For example, if the repayment obligations under the contract being applied for by the consumer would constitute a higher proportion of the consumer's available income (e.g. there is only a small surplus available once repayments are considered), it may be reasonable to also seek some positive confirmation of the consumer's general living expenses, as there is a higher risk that understatement of those expenses will mean that the consumer cannot in fact afford the contract being applied for and that it will be unsuitable.

59 We note guidance from the Financial Services Ombudsman that licensees should expect consumers to be living comfortably above the level of poverty, and should add a buffer to a published benchmark figure.

Note: The Australian Financial Complaints Authority (AFCA) is in the process of developing its guidance on matters such as responsible lending.

Licensees should take steps to limit the risk that the expense figure used understates the consumer's actual expenses

60 If a licensee has a practice of comparing estimated expenses to a benchmark figure to test reliability (but not seeking positive confirmation), there will remain a risk that the figure that is used understates the consumer's actual expenses. Licensees should generally take the following kinds of steps to reduce this risk:

(a) ensure that the benchmark figure that is being used is a realistic figure, that is adjusted for different income ranges and that is not merely reflective of 'low budget' spending;

(b) if the benchmark figure being referred to is more reflective of ‘low budget’ spending (such as HEM), apply a reasonable buffer amount that reflects the likelihood that many consumers would have a higher level of expenses; and

(c) conduct a ‘health check’ on the effectiveness of the licensee’s inquiries, and the estimates obtained, by periodically reviewing the expense figures being relied upon across the licensee’s portfolio—if there is a high proportion of consumers recorded as having expenses that are at or near the benchmark figure, rather than demonstrating the kind of spread in expenses that is predicted by the methodology underlying the benchmark calculation, this may be an indication that the licensee’s inquiries are not being effective to elicit accurate information about the consumer’s expenses.

61 If the licensee doesn’t take these steps, the licensee may face a higher risk that they would not be able to demonstrate that they had taken reasonable steps to ensure that the consumer’s financial situation has been verified.

Consumer’s requirements and objectives

Proposal

C4 We propose to update the current guidance in RG 209 on reasonable inquiries about the consumer’s requirements and objectives to reflect the findings and guidance in Report 493 *Review of interest-only home loans: Mortgage brokers’ inquiries into consumers’ requirements and objectives* (REP 493).

Your feedback

C4Q1 Do you consider that the proposed clarification of guidance about understanding the consumer’s requirements and objectives would be useful? Why or why not?

C4Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

C4Q3 What additional business costs would be involved in this approach?

Rationale

62 The current guidance in RG 209 on reasonable inquiries about the consumer’s requirements and objectives:

(a) indicates that the licensee needs to obtain sufficient details about why the consumer requires a particular credit product to enable the licensee to understand whether the credit contract or consumer lease that is being offered will meet that purpose;

(b) refers to a number of features of a proposed credit contract or consumer lease that a licensee may need to consider in assessing whether it will meet the consumer's requirements and objectives (including the type, length, rate, terms, special conditions and charges of the proposed contract);

(c) notes judicial comment (in *Australian Securities and Investments Commission v The Cash Store (in liquidation)* [2014] FCA 926) that the consumer's reason for requiring the provision of credit needs to be sufficiently specific and consistent with the amount of credit sought; and

(d) outlines a non-exhaustive list of matters that may be relevant for the licensee to make inquiries about.

Note: See RG 209.34–RG 209.37.

63 The current guidance on assessing whether a credit contract or consumer lease will meet a consumer's requirements and objectives outlines a range of factors that may need to be taken into account, together with some illustrative examples.

Note: See RG 209.119–RG 209.124.

64 REP 493 outlined a number of deficiencies that we found in the processes used by mortgage brokers in relation to assessing whether interest only loans met the requirements and objectives of consumers, and actions that we consider would address these deficiencies. We found that a loan with an interest-only period could be significantly more expensive for a consumer. However, many licensees did not have procedures in place to assess or document how a loan with this additional expense met the consumer's requirements and objectives.

65 We consider that many of the actions recommended in REP 493 are relevant for all licensees. We propose to clarify the current guidance in RG 209 by including additional information based upon those recommendations.

66 We have also observed that many licensees appear to consider it sufficient to identify a single, high-level purpose of use for the credit that is sought (such as buying a house or a car). This practice does not accord with the requirement to make inquiries about two distinct matters:

(a) *The consumer's objectives*—This includes what the consumer wishes to achieve by obtaining the credit contract or consumer lease (e.g. to purchase an asset of a particular value or quality and obtain debt-free ownership within a specified period, or as soon as possible).

(b) *The consumer's requirements*—This includes particular things that the consumer needs or that are obligatory for the consumer (e.g. that the rate and charges that apply to the contract are within a specified amount or at a level that will enable the consumer to complete repayments within a certain timeframe, or that the contract has, or does not have, specified features or conditions).

67 We propose to clarify that licensees should generally:

(a) make inquiries with consumers that enable the licensees to *understand* the consumer's specific requirements and objectives in relation to the provision of credit, and *identify* specific features, benefits and costs associated with the credit contract or consumer lease that will affect whether both the requirements and objectives will be met;

(b) *consider* whether the identified features, benefits and costs of the credit contract or consumer lease will meet both the consumer's requirements and objectives;

(c) be in a position to *demonstrate* how the identified features, benefits and costs of the credit contract or consumer lease meet both the consumer's requirements and objectives (particularly features with specific costs or risks);

(d) if some of the identified features, benefits and costs of the credit contract or consumer lease do not meet the consumer's requirements and objectives, have a further discussion with the consumer to *explain* this and *determine* whether the consumer would consider the credit contract or consumer lease to be unsuitable for their requirements and objectives as a result;

(e) if particular features or benefits depend on the consumer undertaking specific behaviour, ensure that the consumer is *aware* of what they must do to obtain the benefit, as well as the potential costs if the required action is not taken (see REP 493, Action 10); and

(f) have documented processes to *resolve* and *record* the outcome of conflicting consumer requirements and objectives (e.g. specific questions in inquiry tools to identify and record a clear preference) (see REP 493, Action 5).

68 We consider that a licensee is less likely to be in a position to demonstrate an understanding of the consumer's requirements and objectives if they do not have clear documentation of the steps that have been taken. As identified in REP 493, we consider that it would be good practice to give to the consumer a summary statement of the licensee's understanding of the consumer's requirements and objectives, for confirmation of that understanding (see REP 493, Action 7).

Note: See also our proposed additional guidance on content of the written assessment in Proposal C3 and Appendix 1.

D Additional guidance on specific issues

Key points

We propose to include additional guidance in RG 209 on issues that are not currently addressed in any detail, including:

- areas where the responsible lending obligations do not apply (e.g. small business lending);
- the role of the responsible lending obligations in mitigating risks involved in loan fraud;
- how negative repayment history information may be used, and the effect this may have on the kinds of inquiries that should be made with the consumer;
- good practices for maintaining records that demonstrate compliance with the responsible lending obligations; and
- the purpose and content of the written assessment.

Areas where the responsible lending obligations do not apply

Proposal

D1 We propose to include new guidance in RG 209 on the areas where the responsible lending obligations do not apply.

Your feedback

D1Q1 Are there any forms of lending where the responsible lending obligations are being used by licensees in situations where the law does not require the responsible lending obligations in the National Credit Act to apply? Please describe the situations where this takes place.

D1Q2 Are there any forms of small business lending where licensees are unsure about whether the responsible lending obligations in the National Credit Act apply? Please describe the situations which give rise to this uncertainty.

Rationale

69 We have received anecdotal feedback that licensees may be applying the responsible lending obligations where the law does not require them to be applied (e.g. in some small business lending).

70 There is currently guidance on whether the National Credit Act applies to particular activities and products Regulatory Guide 203 *Do I need a credit licence?* (RG 203). We are considering whether there is a need to include some additional guidance in RG 209 which sets out particular examples where the law does not require responsible lending or related obligations to apply.

Fraud risks and impact on responsible lending obligations

Proposal

D2 We propose to include new guidance in RG 209 on:

(a) the role of the responsible lending obligations, and in particular the obligation to take reasonable steps to verify information provided about the consumer's financial situation, in mitigating risks involved in loan fraud; and

(b) risk factors that might indicate that additional verification steps should be taken.

Your feedback

D2Q1 Would specific guidance about loan fraud and the impact on responsible lending obligations of the licensee be useful? Would guidance encourage broader improvements in processes for identifying fraud and reduce the risk of consumers entering unsuitable credit contracts as a result of fraud? Why or why not?

D2Q2 Please provide details of any risk factors that you consider it would be useful to identify, and additional verifying steps you consider to be reasonable in those circumstances.

D2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

D2Q4 What additional business costs would be involved in this approach?

Rationale

71 The requirement for licensees to take reasonable steps to verify information that is provided about a consumer's financial situation recognises that information provided as part of the application process will not, in all cases, be reliable. This may be for a range of reasons, including:

(a) overstatement of income or understatement of expenses by the consumer, either deliberately or due to a mistake or misunderstanding;

(b) mistake or negligence by a person who is assisting the consumer to make an application; or

(c) deliberate fraud by a person who is assisting the consumer to make an application.

72 Loan fraud affects the credit provider and the broader credit market (e.g. the price of credit and reputation of the credit industry). It also affects the particular consumer—raising the chances that the consumer is entering a contract that is unsuitable, and potentially affecting their access to remedies in relation to an unsuitable credit contract and/or exposing them to the risk of liability to the credit provider.

73 In general, we consider that the current guidance (with updates and clarifications discussed in the above proposals) may adequately address the steps that licensees should take to identify an overstatement of income or understatement of expenses by the consumer.

74 In relation to information collected and provided by persons who are providing credit assistance, the current guidance notes that credit providers and lessors can take into account information provided by a credit assistance provider or other third parties, but that they should have processes in place to ensure the reliability of any information collected by third parties (including information contained in a preliminary assessment). Credit providers and lessors should not rely on information if they have reason to doubt the reliability of the information.

Note: See RG 209.53–RG 209.56.

75 We think it would be useful to include more specific guidance on processes that licensees should have in place to identify false or unreliable information provided by a third party. This may include:

(a) identifying particular circumstances we consider should raise doubts about the information provided; and

(b) the kinds of steps that we think it would be reasonable for a licensee to take—both in relation to the application by the particular consumer, and more generally where the licensee receives applications or information from that third party.

76 For example, the following circumstances would be likely to raise doubts about the reliability of information provided:

(a) the licensee is aware of another licensee investigating fraud by the consumer or the third party;

(b) the licensee has suspicions of misconduct by the third party based on reasonable grounds (e.g. discussion with another person such as a customer or employer);

(c) high arrears rates from loans sourced through a particular third party;

(d) complaints about the third party, especially relating to false or altered information or duress in relation to entering credit contract or consumer lease; or

(e) false information previously included in applications provided by the third party.

77 If doubts are raised about the reliability of information provided due to these kinds of circumstances, it would be reasonable for the licensee to:

(a) not take into account that information until additional steps have been taken to confirm its accuracy;

(b) take steps to obtain from another source confirmation of the information provided, for example:

  (i) a separate source of verifying information (e.g. a bank statement that contains information about income to confirm whether a pay slip is true or not); and

  (ii) verifying information provided by a person other than the person who gave the licensee the doubtful information (e.g. request separate provision of verifying information directly from the consumer, or for the consumer to permit the licensee to verify the information through a direct source, such as the consumer's employer, or by using other verification tools, such as data aggregation services).

Note: See *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2018] FCA 155.

78 Licensees that receive applications through third parties who provide credit assistance should generally have processes in place that would enable them to identify recurring circumstances that raise doubts about information, and to take additional steps to ensure that information provided by such third parties is genuine and reliable.

Use of repayment history information

Proposal

D3 We propose to include guidance in RG 209 to clarify how repayment history information may be used, including that:

  (a) the occurrence of repayment difficulties on one product will not necessarily mean that a new credit product will in all cases be unsuitable for that consumer; and

  (b) this information should instead trigger the licensee to make more inquiries to enable them to understand those repayment difficulties, and the likelihood that the circumstances of the consumer leading to those difficulties will mean that the consumer would also be unable to meet financial obligations under the new product being considered.

Your feedback

D3Q1 Would guidance about use of negative repayment history information and hardship indicators reduce the risk that credit providers consider it necessary to refuse applications for further credit products that may in fact be affordable for the consumer? Why or why not?

D3Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

D3Q3 What additional business costs would be involved in this approach?

Rationale

79 Developments in comprehensive credit reporting will involve greater access to both positive and negative repayment history information. During the design of this reporting regime, concerns have been raised that credit providers will be encouraged to use negative information to refuse credit applications without making further inquiries to determine whether the product applied for is affordable for the consumer.

80 The purpose of guidance would be to discourage licensees from treating hardship indicators and other negative repayment history information as a trigger for automatic refusal, but indicate that such information should trigger additional inquiries to enable the licensee to understand the circumstances of hardship or repayment difficulties and how those difficulties have been managed.

81 Additional inquiries could include, for example:

(a) the cause of the difficulty in meeting obligations under the other credit product;

(b) whether this is a short-term problem that is being, or has been, addressed, or whether it is ongoing;

(c) whether the consumer has taken active steps to manage that problem, or negotiate changes to the obligations under their existing product; and

(d) if so, whether the consumer has complied with those changed obligations.

Records of inquiries and verification

Proposal

D4 We propose to include new guidance in RG 209 about maintaining records of the inquiries made and verification steps taken by the licensee, reflecting our findings and recommendations on good recording practices included in REP 493.

Your feedback

D4Q1 Do you consider that guidance on industry best practice for recording the inquiries and verification steps that have been undertaken would be useful for licensees? Why or why not?

D4Q2 Please provide any comments on the particular recording practices identified as ‘best practice’ by ASIC, and whether you consider those practices are generally appropriate for licensees.

D4Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

D4Q4 What additional business costs would be involved in this approach?

Rationale

82 RG 209 does not currently include any detailed guidance about the kinds of information licensees should record for the purpose of enabling them to demonstrate compliance with the responsible lending obligations.

83 RG 209 does note that:

(a) the licensee needs to keep a record of the assessment in a form that allows the licensee to give a copy of the assessment to a consumer promptly in writing, if requested; and

(b) a licence condition supports this obligation, by requiring the licensee to keep a record of all material that forms the basis of the assessment.

Note: See RG 209.138.

84 Throughout our surveillance work, ASIC has identified that there are varying practices in recording the inquiries made and verification steps taken by licensees. ASIC has described in REP 493 some of the different practices and approaches to recording, and identified what we consider to be good practice.

85 We note that a failure to keep a record of inquiries made and verification steps taken may mean that a licensee is unable to adequately demonstrate that they have complied with the responsible lending obligations. We propose to include some guidance, based upon the findings in REP 493 on industry practice, to help licensees develop recording practices that will enable them to demonstrate compliance—in particular we note the following practices:

(a) *Use of tools*—Tools such as applications forms, ‘fact find’ and ‘needs analysis’ documents can be useful to provide a structure for licensees to record inquiry and verification steps, especially if they conduct business through a number of representatives. Where such tools are used, it is good practice to ensure that all questions are answered, including by indicating a ‘nil response’ or ‘not applicable’. If sections are left incomplete, it may be difficult to demonstrate that the licensee and their representatives have a practice of addressing all questions noted in a standard document.

Note: Use of these tools may also help licensees to ensure that they, and their representatives, engage in credit activities in a way that is efficient, honest and fair.

(b) *Record keeping*—As currently noted in RG 209, the inquiry and verification process will often not be a linear process. After the initial collection of information from the consumer during the application process there may be subsequent communications to clarify aspects of the consumer’s requirements and objectives, clarify inconsistencies in the verifying information that has been provided, and to determine the consumer’s willingness and ability to reduce the current expenditure level to afford repayments on a particular product. If these subsequent communications are not properly recorded on the consumer’s file, licensees may not be able to demonstrate that they have complied with their obligations. Keeping file notes or other records in one place may help licensees to explain what steps they have taken, and why those steps are reasonable in the circumstances of the particular consumer.

(c) *Concise narrative summary*—An understanding of the requirements and objectives of a consumer in relation to a particular credit product might be formed by reference to a number of questions throughout an application form or fact find document, dealing with different matters, such as the consumer's purpose, timeframe, features of the product and expected position on completion of the term of the contract. A concise narrative summary included on the consumer's file can help the licensee to 'connect the dots' between the consumer's responses to different questions, and demonstrate that the licensee understood what the consumer's requirements and objectives were and how the credit product that was entered met those requirements and objectives.

Content of a written assessment

Proposal

D5 We propose to provide additional guidance in RG 209 on what information we think should be included in a written assessment.

Your feedback

D5Q1 Would it be useful for ASIC to provide an example of a written assessment to illustrate the level of information that we think should be included? Why or why not?

D5Q2 Please provide any comments on the example set out in Appendix 2.

D5Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

D5Q4 What additional business costs would be involved in this approach?

Rationale

86 RG 209 includes some high-level guidance on what information should be included in a written assessment—generally that the assessment should contain information that will enable:

(a) consumers to understand the basis on which the credit contract or consumer lease has been assessed as 'not unsuitable' for them; and

(b) the licensee to demonstrate compliance with the responsible lending obligations.

Note: See RG 209.141–RG 209.146.

87 In our surveillance work, we have observed significant differences in the level of information included in written assessments by licensees. We consider that additional guidance should be provided to more clearly outline the level of information that we think should be included in written assessments to improve the standard of written assessments that are provided to consumers.

88 The written assessment is required to be provided to consumers, upon a request made by the consumer either before entering a credit contract or consumer lease or within a period of seven years from the day on which credit assistance is provided or the credit contract or consumer lease is entered into.

89 We consider that the purpose of the written assessment is to provide the consumer with information that will enable the consumer to:

(a) understand what information the licensee has taken into account in determining that the credit contract or consumer lease is 'not unsuitable' for the consumer—which should include:

  (i) a statement of the licensee's understanding of the consumer's requirements and objectives for the credit contract or consumer lease;

  (ii) a summary of the information about the consumer's financial position that the licensee has relied upon, and how that information has been verified;

  (iii) if the licensee has decided that they cannot rely on some information provided by or on behalf of the consumer, an indication of why not and what information has been relied upon instead;

  (iv) if the consumer's capacity to make repayments depends upon financial support from another person—a summary of the information about that other person's financial position that the licensee has relied upon, and how that information has been verified;

  (v) if the consumer's capacity to make repayments depends on them taking particular action to reduce their current expenses or potential liabilities (e.g. by cancelling an existing credit card that is being paid out)—a clear statement of the assumptions that are being made about the action the consumer has stated they will take;

(b) if the credit contract or consumer lease has not yet been entered into—amend any incorrect details;

(c) if the credit contract or consumer lease had been entered into—engage in dispute resolution processes with a clear statement of the basis of the licensee's assessment.

Note: An example assessment is attached in Appendix 2 of this paper.

90 We note that current reforms for small amount credit contracts propose to allow ASIC to determine the required form and content of the written assessment.

Note: See the Exposure Draft of the National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017 released by Treasury in November 2017.

E Regulatory and financial impact

91 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

(a) helping licensees to understand what is required to comply with their responsible lending obligations; and

(b) ensuring licensees can continue to tailor their responsible lending processes in a way that is appropriate for their business and consumers.

92 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

93 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

94 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

Appendix 1: Sources for verifying information

This is not intended to be an exhaustive list of types of evidence that a licensee could use to verify information provided by a consumer—it is intended to provide guidance on the kinds of information we consider will generally be readily available, and that it would be reasonable obtain. What amounts to taking 'reasonable steps to verify' information depends on the circumstances.

Table 1: Income

Source of information	What can be confirmed through this source?	Is this information readily available?
For PAYG ('pay as you go') employees: • recent payroll receipts/payslips; • confirmation of employment with the employer (subject to requirements of the *Privacy Act 1988* (Privacy Act)); • recent income tax returns; and • bank statements recording incoming payments.	Amount of net income, frequency of payments and possibly duration of employment Note: For casual or seasonal employment, you are likely to need more source documents covering a wider period to determine if there are variable income patterns (e.g. to obtain an understanding of the average or seasonally adjusted income for the consumer, rather than relying on an overestimated income based on an untypical period of higher hours or pay rates).	Yes. This information is readily available from consumer.
For persons receiving Government benefits—CentreLink statements	Amount of income and frequency of payments	Yes. This information is readily available from consumer.
For self-employed consumers: • financial statements for related business entities; • business account statements; • recent income tax returns; • Business Activity Statements; • a statement from the consumer's accountant setting out details of the consumer's financial position; and • bank statements recording incoming payments.	Will generally show the amount of net income and variable income patterns	Yes. This information is readily available from consumer.

Table 2: Existing debts/liabilities

Source of information	What can be confirmed through this source?	Is this information readily available?
Credit reports Note: The range of information available through credit history reports will be improved through the comprehensive credit reporting reforms, and participation of a wider range of credit providers.	Information on the following: • *Credit listings*—Listings of any credit or loans the consumer has applied for, defaults (overdue payments of 60 days or more where collection activity has started) and any other credit infringements (infringements can be listed for up to five years after they occurred, or seven years for serious infringements) • *Repayment history*—Dates that credit payments were due, whether or not payments were made by the due date, and whether payments were missed • *Other information*—Bankruptcies (for up to seven years after they occurred), court judgments, debt agreements and personal insolvency agreements (for up to five years after they occurred)	For credit providers and lessors—yes. This information is readily available from credit reporting bureaus. Credit assistance providers don't have a right to access credit history reports.
Information/reports from other credit providers (subject to requirements of the Privacy Act)	Information about total amount of debt outstanding, and the amount and frequency of repayments	This information may be available from the consumer, or from financial institutions with the consumer's consent.
CentreLink statements	Liabilities that are paid directly from CentreLink income, using CentrePay	Yes. This information is readily available from consumer.

Table 3: Living expenses—Fixed or recurring expenses (amount does not change significantly for a known period)

Source of information	What can be confirmed through this source?	Is this information readily available?
Contracts, invoices or accounts, or bank statements recording relevant transactions, for example: • housing (rental, council rates); • communication expenses (telephone/internet plans); • child support and spousal maintenance; • insurance; and • regular school fees/child care.	Information about the amount and frequency of required payments	Yes. This information is readily available from the consumer Note: Consumers are generally likely to maintain separate records of these kinds of expenses.

Table 4: Living expenses—Variable (amount and/or frequency subject to change)

Source of information	What can be confirmed through this source?	Is this information readily available?
Contracts, invoices or accounts, or bank statements recording relevant transactions, for example: • utilities (water, electricity, gas); and • regular entertainment or recreation services (pay tv, sports activities, telephone/internet costs outside plan schedule, gambling accounts).	Usual usage and amount, frequency of required payments Note: Some invoices may show historical usage comparisons.	This information may be available from the consumer. Note: Some consumers may not maintain separate records of these kinds of expenses.

Table 5: Overall financial situation

Source of information	What can be confirmed through this source?	Is this information readily available?
Transaction account statements (both for deposit accounts and credit accounts)	Regular and variable income and spending patterns Identify existing debts/liabilities—amount and frequency of required payments Identify types of usual expenditure, amount and frequency of payments (including for variable living expenses)	Yes. These documents are easy and inexpensive to obtain. In most cases, they will provide a convenient source of evidence of the consumer's overall income and outgoings, and may evidence the amount of individual expense items. Statements are readily available to: • the consumer's current financial institution from its own records; and • to other licensees, from the consumer, or from other institutions with the consumer's consent. Note 1: For small amount credit contracts, the licensee is required to obtain and consider account statements that cover at least the immediately preceding 90 days. Note 2: The ease and cost of access to this information will be improved by developments in open banking.
Data aggregation reports	Regular income and spending patterns; investment assets; debts and liabilities These reports may cover and analyse a potentially broader range of accounts	These services are available from providers of these services with the consumer's consent. Whether they are readily available may depend on the extent to which consumers consent to use of the service and cost of the service Note: Many providers of small amount credit contracts have established a practice of using this form of information as an efficient and cost-effective tool to obtain information about the consumer's overall financial situation

Appendix 2: Example assessment

Consumer's details

Name, address, date of birth

Dependants

Number of dependants; type of dependants (e.g. minors, adult children, spouse, elder relatives); age(s) of dependants

Residence

Home owner (with/without mortgage) or tenant

Requirements and objectives

Objective: Purpose of obtaining credit

Concise summary of the consumer's description of the purpose.

Examples may include to:

(a) purchase an asset (e.g. residential property, car, whitegoods) of a specified value (or value range) or quality;

(b) purchase an asset of a specified value or quality *and* cover other costs associated with the purchase or the asset (e.g. valuations, transaction costs, necessary insurance or other products offered together with the asset);

(c) have access to a line of credit for making general day-to-day purchases;

(d) have access to a line of credit for a specific purpose such as a holiday or international travel; to refinance or consolidated existing specified loans; or

(e) lease goods and have flexibility to upgrade models at a future date.

Requirements: Amount and term of credit requested

Summary of the amount or maximum amount of credit requested by the consumer, and the consumer's requested timeframe for completing repayments.

Requirements: Particular features requested or not necessary

Summary of the contract features the consumer has requested, and a description of whether any features are considered a priority or essential for the consumer.

Summary of any contract features the consumer has indicated are not wanted (particularly if additional charges will be incurred as a result).

Financial position

Current income

Amount of [weekly/fortnightly/monthly] net income.

Form of income (e.g. salary, investment returns, superannuation, social security payments).

Source of information used to verify this amount.

Current expenses

Total amount of [weekly/fortnightly/monthly] expenses.

Source(s) of information used to verify this amount.

Include breakdown of total amount to specify the following expenses.

Fixed or recurring expenses

Outline of general type of expenses (e.g. debt commitments, rental, insurance, rates, child support) and the amount.

Variable living expenses (non-discretionary)

Outline types of expenses considered by the consumer to be non-discretionary (i.e. those for which the consumer is not able or willing to reduce to afford the credit contract or consumer lease), and the amount.

Variable living expenses (discretionary)

Outline types of expenses the consumer has identified that they would be willing and able to reduce to afford the credit contract or consumer lease. Specify the current amount of those expenses, and the amount the consumer considers they could reduce those expenses to if required. Outline the basis on which the licensee accepts those reductions to be realistically achievable.

Foreseeable changes to financial position

Outline any reasonably foreseeable changes to income—e.g. the consumer has indicated that they are planning unpaid leave, or the consumer is approaching retirement.

If the purpose of credit is to purchase an asset that involves additional expenses (e.g. additional costs for operating a car and maintaining insurance) especially if required as a term of the contract—outline the nature of expenses taken into account and an estimated amount for those anticipated expenses.

Financial support from a third party

If the consumer relies upon financial support from another person, outline details of this including: the amount of financial support required from the other person; who that person is; whether the other person has acknowledged that they will be making funds available to the consumer and the amount that will be available; details of the other person's financial position (under the same broad categories outlined above).

Source of information used to verify the other person's financial position and capacity to provide the amount identified.

Assumptions dependent on consumer behaviour

If the consumer's capacity to make repayments depends on them taking particular action to reduce their current expenses or potential liabilities (e.g. by cancelling an existing credit card that is being paid out)—a clear statement of the assumptions that are being made about the action the consumer has stated they will take.

Information provided by the consumer that has not been relied upon

Summary of any decision to not rely on information provided by the consumer, and an indication of why that information has not been relied upon and what information has been relied upon instead.

Credit contract or consumer lease meets the consumer's requirements and objectives

A statement of whether the terms of the contract meet each of the specified objectives and requirements.

If some requirements specified by the consumer are not met—outline whether this has been discussed with, and acknowledged by, the consumer.

Consumer's capacity to meet repayments

A statement of whether the consumer has the capacity to meet the financial obligations of the credit contract or consumer lease.

Key terms

Term	Meaning in this document
ADI	Authorised deposit taking institution
AFCA	Australian Financial Complaints Authority
APG 223	Prudential Practice Guidance APG 223 *Residential mortgage lending* (APG 223) reissued by APRA in 2017
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
consumer	A natural person or strata corporation Note: See s5 of the National Credit Act
CP 115 (for example)	An ASIC consultation paper (in this example numbered 115
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 card contract and who is not the credit provider
credit licensee (or licensee)	A person who holds an Australian credit licence under s35 of the National Credit Act
credit product	A credit contract or consumer lease within the meaning of those terms in s5 of the National Credit Act
credit provider	Has the meaning given in s5 of the National Credit Act
final report	The final report of the Financial Services Royal Commission released in February 2019
Financial Services Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
HECS-HELP	Interest-free loans from the government under the Higher Education Loan Programme (HELP) which replaced the Higher Education Contribution Scheme (HECS)
HEM	Household Expenditure Measure, a benchmark developed by the Melbourne Institute as an estimate of the spending habits of Australian families, which is used by many licensees in assessing a consumer's financial situation (see paragraph 33)
HPL	Henderson Poverty Line, an alternative measure to the HEM
Melbourne Institute	Melbourne Institute of Applied Economic and Social Research at The University of Melbourne

Term	Meaning in this document
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
OBPR	Office of Best Practice Regulation
PAYG	‘Pay as you go’, a system for making regular payments towards an expected annual income tax liability
Privacy Act	*Privacy Act 1988*
REP 445 (for example)	An ASIC report (in this example numbered 445)
responsible lending obligations	The obligations under Ch 3 of the National Credit Act
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
RIS	Regulatory Impact Statement
s160F (for example)	A section of the National Credit Act (in this example numbered 160F)

List of proposals and questions

Proposal	Your feedback
B1 We are considering whether to identify particular inquiries and verification steps in RG 209 that we think would generally be reasonable to provide greater certainty to licensees about complying with their obligations.	B1Q1 Would it be useful for licensees if ASIC were to identify the inquiries and verification steps that we consider should be taken? Why or why not? B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices. B1Q3 Are there any kinds of credit products, consumers or circumstances for which you consider it may be reasonable to undertake fewer inquiries and verification steps? Please identify the kinds of products, consumers and circumstances and particular features you think are relevant. B1Q4 In your view, what aspects of the consumer's financial situation would a licensee need to inquire about in all circumstances? If you think some aspects of the consumer's financial situation do not need to be inquired about, please explain why. B1Q5 In your view, what aspects of the consumer's financial situation would a licensee need to verify in all circumstances? If you think some aspects of the consumer's financial situation do not need to be verified, please explain why. B1Q6 What would be the effect on consumers of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for consumers? B1Q7 What would be the effect on business costs of ASIC identifying particular inquiries and verification steps? Please provide details of the effect on compliance costs for the licensee, and any factors that are likely to affect the level of cost or cost savings. B1Q8 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

Proposal	Your feedback
C1 We propose to amend the current guidance in RG 209 on forms of verification to: (a) clarify our guidance on kinds of information that could be used for verification of the consumer's financial situation, and provide a list of forms of verification that we consider is readily available in common circumstances; and (b) clearly state that views on what are 'reasonable steps' will change over time, as different forms or sources of verifying information become available. For example, developments in open banking and data aggregation services will assist licensees to efficiently confirm the financial situation of a consumer (including allowing simultaneous inquiry about and verification of some information).	C1Q1 Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available forms of verification? C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not? C1Q3 Are there particular issues with using data aggregation services that you consider should be raised in our guidance? Please provide details of those issues, and information that you consider should be included in our guidance. For example, would it be useful to include specific guidance on matters the licensee could, or should, raise with the consumer before obtaining the consumer's consent to use this kind of service?
C2 We propose to expand our guidance on what are reasonable steps to verify the financial situation of a consumer by: (a) more clearly stating that it is not sufficient merely to obtain verifying information but not have regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects of the consumer's financial situation; and (b) including an 'if not, why not?' approach—that is, if a licensee decides not to obtain or refer to forms of verifying information that are readily available, they should be able to explain why it was not reasonable to obtain or refer to those forms of verification in the circumstances of the particular consumer involved.	C2Q1 Do you consider that the proposed clarification of guidance on reasonable verification steps would be useful? Are there any other aspects of our guidance on verification that you consider would be useful? C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not? C2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? C2Q4 What additional business costs would be involved in this approach? C2Q5 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

Proposal	Your feedback
C3 We propose to clarify our guidance in RG 209 on the use of benchmarks as follows: (a) A benchmark figure does not provide any positive confirmation of what a particular consumer's income and expenses actually are. However, we consider that benchmarks can be a useful tool to help determine whether information provided by the consumer is plausible (i.e. whether it is more or less likely to be true and able to be relied upon). (b) If a benchmark figure is used to test expense information, licensees should generally take the following kinds of steps: (i) ensure that the benchmark figure that is being used is a realistic figure, that is adjusted for variables such as different income ranges, dependants and geographic location, and that is not merely reflective of 'low budget' spending; (ii) if the benchmark figure being referred to is more reflective of 'low budget' spending (such as the Household Expenditure Measure), apply a reasonable buffer amount that reflects the likelihood that many consumers would have a higher level of expenses; and (iii) periodically review the expense figures being relied upon across the licensee's portfolio—if there is a high proportion of consumers recorded as having expenses that are at or near the benchmark figure, rather than demonstrating the kind of spread in expenses that is predicted by the methodology underlying the benchmark calculation, this may be an indication that the licensee's inquiries are not being effective to elicit accurate information about the consumer's expenses.	C3Q1 Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not? C3Q2 Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable. C3Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? C3Q4 What additional business costs would be involved in this approach?

Proposal	Your feedback
C4 We propose to update the current guidance in RG 209 on reasonable inquiries about the consumer's requirements and objectives to reflect the findings and guidance in Report 493 Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives (REP 493).	C4Q1 Do you consider that the proposed clarification of guidance about understanding the consumer's requirements and objectives would be useful? Why or why not? C4Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? C4Q3 What additional business costs would be involved in this approach?
D1 We propose to include new guidance in RG 209 on the areas where the responsible lending obligations do not apply.	D1Q1 Are there any forms of lending where the responsible lending obligations are being used by licensees in situations where the law does not require the responsible lending obligations in the National Credit Act to apply? Please describe the situations where this takes place. D1Q2 Are there any forms of small business lending where licensees are unsure about whether the responsible lending obligations in the National Credit Act apply? Please describe the situations which give rise to this uncertainty.
D2 We propose to include new guidance in RG 209 on: (a) the role of the responsible lending obligations, and in particular the obligation to take reasonable steps to verify information provided about the consumer's financial situation, in mitigating risks involved in loan fraud; and (b) risk factors that might indicate that additional verification steps should be taken.	D2Q1 Would specific guidance about loan fraud and the impact on responsible lending obligations of the licensee be useful? Would guidance encourage broader improvements in processes for identifying fraud and reduce the risk of consumers entering unsuitable credit contracts as a result of fraud? Why or why not? D2Q2 Please provide details of any risk factors that you consider it would be useful to identify, and additional verifying steps you consider to be reasonable in those circumstances. D2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? D2Q4 What additional business costs would be involved in this approach?

Proposal	Your feedback
D3 We propose to include guidance in RG 209 to clarify how repayment history information may be used, including that: (a) the occurrence of repayment difficulties on one product will not necessarily mean that a new credit product will in all cases be unsuitable for that consumer; and (b) this information should instead trigger the licensee to make more inquiries to enable it to understand those repayment difficulties, and the likelihood that the circumstances of the consumer leading to those difficulties will mean that the consumer would also be unable to meet financial obligations under the new product being considered.	D3Q1 Would guidance about use of negative repayment history information and hardship indicators reduce the risk that credit providers consider it necessary to refuse applications for further credit products that may in fact be affordable for the consumer? Why or why not? D3Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? D3Q3 What additional business costs would be involved in this approach?
D4 We propose to include new guidance in RG 209 about maintaining records of the inquiries made and verification steps taken by the licensee, reflecting our findings and recommendations on good recording practices included in REP 493.	D4Q1 Do you consider that guidance on industry best practice for recording the inquiries and verification steps that have been undertaken would be useful for licensees? Why or why not? D4Q2 Please provide any comments on the particular recording practices identified as 'best practice' by ASIC, and whether you consider those practices are generally appropriate for licensees. D4Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? D4Q4 What additional business costs would be involved in this approach?
D5 We propose to provide additional guidance in RG 209 on what information we think should be included in a written assessment.	D5Q1 Would it be useful for ASIC to provide an example of a written assessment to illustrate the level of information that we think should be included? Why or why not? D5Q2 Please provide any comments on the example set out in Appendix 2. D5Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)? D5Q4 What additional business costs would be involved in this approach?