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RE: **Strengthening responsible lending in Australia**

Irresponsible lending harms people. 1.9 million Australians are currently struggling with their credit card debt, with almost a million people trapped in a cycle of persistent debt.[1] Thousands of families have been sold into risky interest-only mortgages.[2] Mortgage brokers consistently sell people into risky home loans that are more likely to fall into arrears.[3]

For too long, credit providers have hidden behind the ambiguity of both the law and regulations to justify providing inappropriate credit to their customers. The conflict that ASIC must resolve is that the less scrutiny a lender undertakes to verify an application, the greater the profit the lender often stands to make. It is imperative that credit providers are held to account.

CHOICE supports ASIC's effort to strengthen consumer protections through the following amendments to the Regulatory Guide 209, clarifying:

- that lenders can not use benchmarks as a proxy for actual inquiries and verification of expenses;
- what forms of evidence that lenders should consider when enquiring into an individual's financial situation; and
- what constitutes reasonable inquiries into an individual's requirements and objectives.

However, there is more that ASIC can do to curtail irresponsible lending. CHOICE recommends the following measures:

- lenders should be required to have any proposed benchmarks reviewed independently. The results of this independent inquiry should be shared publicly and be regularly reviewed by ASIC;
- ASIC should not continue with the proposed 'if not, why not' justification for a lender failing to verify specific information. This will create an unnecessary loophole that industry will seek to profit from;
- lenders should be legally required to provide every borrower with a written assessment for credit, including a comprehensive assessment of requirements and objectives;

[1] ASIC 2018, REP 580, Credit card lending in Australia
[2] ASIC 2015, REP 445, Review of interest-only home loans
[3] ASIC 2017, REP 516, Review of mortgage broker remuneration

- when irresponsible lending cases are brought to AFCA, the onus of proof for verification documents should be shifted from the individual to the lender;
- ASIC should clearly state that if mortgage brokers or credit providers fail to keep adequate records of inquiries and verification, this should be a breach of responsible lending laws;
- ASIC's proposed recommendations in REP493 to ensure mortgage brokers compliance with the law should be codified in RG209. Lenders and brokers alike should be required to adhere to these recommendations.

Benchmarks do not replace a lender's legal obligation to verify expenses

CHOICE supports ASIC's proposal to clarify that 'benchmarks can be useful as a tool to test the plausibility of consumer provided information, but do not give a positive confirmation.'[4] The use of a benchmark cannot replace the legal obligation that a credit provider has to individually identify and verify expenses of a borrower.

The inappropriate use of benchmarks by lenders causes real harm to consumers. Research from ASIC, APRA and the Banking Royal Commission have all shown that credit providers consistently relied on the use of inadequate benchmarks to verify expenses.[5] A particularly fraught and commonly used benchmark is the Household Expenditure Measure (HEM). The HEM represents a conservative 'low-end estimate of spending habits of Australian families'.[6] Significantly, it fails to capture a number of everyday expenses that are essential for many people, including rent, some medical and dental expenses, payments to family members, school fees, pets costs, and car costs.[7]

The use of the HEM by lenders is widespread. In October 2016, an independent audit found that 73% of ANZ loan approvals reviewed had defaulted to the HEM for household expenses.[8] ASIC's review of mortgage brokers remuneration also found that many loan assessments 'were equal to or very close to HEM benchmark'.[9] This shows that brokers and lenders alike have not been adequately verifying their customer's expenses.

A well-designed and fair benchmark can play a role in triggering concerns when an individual's declared expenses fall below a certain threshold. This trigger-point should be an opportunity for the lender to initiate further investigation and inquire with the borrower. Benchmarks should never be used as a proxy for actual inquiries and verification of expenses.

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[4] ASIC 2019, CP309, Update to RG 209: Credit Licensing: Responsible lending conduct, p.20
[5] APRA 2017, Prudential Practice Guidance APG 223, *Residential mortgage lending (APG 223);* Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, p.27; ASIC (2015) REP 445, Review of interest-only home loans
[6] ASIC 2019, CP309, Update to RG 209: Credit Licensing: Responsible lending conduct, p.16
[7] ASIC 2019, CP309, Update to RG 209: Credit Licensing: Responsible lending conduct, p.19
[8] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry transcript, P-7332
[9] ASIC 2017, REP 516, Review of mortgage broker remuneration, p.15

Given the widespread misuse of benchmarks, credit providers should be required to have any proposed benchmarks reviewed independently. These benchmarks and the results of the independent review should be made public for both the corporate regulator and the general public. Increased transparency will ensure that benchmarks are fair and working in the interests of people.

Making verification requirements more transparent

CHOICE welcomes ASIC's proposal to provide more prescriptive guidance on what forms of verification lender should check in order to comply with responsible lending laws. For too long, credit providers have relied on the ambiguity of 'scalability' to justify insufficient and inadequate verification.

The conflict that must be resolved is that the less scrutiny a lender undertakes to verify an application, the greater the profit the lender often stands to make. Commissioner Hayne identified this trade-off as the balance between, 'administrative convenience and obeying the law'.[10] ANZ's Head of Loans admitted to this tension. He acknowledged there is a 'customer benefit trade-off' when considering how detailed and personalised adherence to responsible lending laws should be.[11] Given this acknowledgment by lenders, CHOICE welcomes efforts made in this consultation paper to prescribe clearer standards and requirements for banks in the verification process.

Removing the 'if not, why not basis' loophole

CHOICE does not support ASIC's proposal to include an 'if not, why not' justification for a lender failing to verify expenses. This will create a loophole for lenders, who will seek to argue away deviations from prescribed reasonable steps.

While the intent of the proposal is sound, CHOICE's experience in this sector has shown that financial service providers will take advantage of this reform by not complying with the law. Instead, CHOICE supports strong and clear guidelines around reasonable steps for verification, coupled with effective monitoring and enforcement by the corporate regulator to ensure compliance with the law.

Ensuring that credit providers enquire into consumers requirements and objectives

CHOICE supports greater clarification around the legal requirement for credit providers to undertake an inquiry into an individual's objective and requirements.The obligation to provide a loan that meets an individual's objectives and requirements is an important consumer protection that prevents irresponsible lending.

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[10] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, P-465

[11] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, vol. 2, p.44

Lenders consistently fail to adhere to this important pillar of responsible lending. As outlined by ASIC, '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).'[12] Legal Aid NSW and Financial Rights Legal Centre noted, 'there are many ways that a loan may be affordable and yet not meet a consumer's objectives and requirements."[13] For example, a "consumer may have requested a loan to purchase a fridge valued at $1,000 and be given a credit limit for $8,000."[14] This practice has also been reflected in ASIC's review into interest-only loans sold by mortgage brokers. The review revealed that mortgage brokers consistently failed to undertake inquiries into why riskier interest-only loans suited a borrower's requirements and objectives.[15]

Additionally, to prevent this process from becoming a pro-forma, box-ticking exercise, the lender should be legally required to provide the borrower with a written assessment for credit, including the borrower's requirements and objectives. It should not fall on the borrower to request this information; lenders must take responsibility for this.

Lenders must keep detailed written assessments

Credit providers and brokers should not only be required to provide borrowers with a written assessment, they must also be responsible for maintaining copies of these records. Sound documentation processes is essential in establishing that a broker or lender complied with responsible lending laws. ASIC should clearly state that a failure by credit providers to keep these records will be considered a breach of responsible lending laws. This will also have the benefit of assisting ASIC in auditing compliance with the law.

Increased standards for reporting and data collection needs come with a shift in the onus of proof back on to the lender to ensure that the compliance with responsible lending laws are met. As the Consumer Action Law Centre acknowledged, if a borrower seeks to challenge a loan as irresponsible at the ombudsman, the burden of proof to find verification documents from the time of the loan has fallen to the borrower.[16] This can be often be many years after the loan has been arranged. Instead a failure of credit providers to produce adequate evidence of compliance with responsible lending laws should be evidence that this process did not occur.

Improving the quality of mortgage broker advice

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[12] ASIC 2019, CP309, Update to RG 209: Credit Licensing: Responsible lending conduct, p.23
[13] Legal Aid NSW and Financial Rights Legal Centre, 2017, Credit Law Toolkit, p.86
[14] Legal Aid NSW and Financial Rights Legal Centre, 2017, Credit Law Toolkit, p.86
[15] ASIC 2016, REP 493, Review of interest-only home loans: mortgage brokers' inquiries into consumers' requirements and objectives
[16] Consumer Action Law Centre 2018, Submission to the Royal Commission, Interim Report, p.23

It is concerning that ASIC found that mortgage broking record keeping was “inconsistent and in some cases records were fragmented and incomplete.”[17] A recent review found that in over 20% of cases, mortgage brokers failed to have any documentary evidence about why a riskier interest-only loan would specifically meet the consumer’s requirements and objectives. This is particularly harmful for consumers as mortgage brokers are currently incentivised to sell loans that will provide them with the largest commission. Their interests continue to be aligned with the lenders, not their customers.

CHOICE supports ASIC’s proposed actions in REP493 to ensure mortgage brokers comply with responsible lending laws.[18] These include the requirements to:

- Provide specific guidance on loan products and features;
- Ensure all questions are answered;
- Keep all information in one place;
- Focus on the consumer’s underlying objectives;
- Have documented processes where objectives conflict;
- Include a concise narrative summary;
- Provide a summary statement to the consumer;
- Ensure the consumer understands the products and features;
- Ensure the the consumer knows that they must do.

These are strong, consumer-focused recommendations and should be codified in RG209. Brokers and lenders alike should be required to adhere to them. This will ensure that the consumers interests, not the credit providers, are prioritised.

For further information please contact CHOICE on pveyret@choice.com.au

Yours sincerely,

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[17] ASIC 2016, REP 493, Review of interest-only home loans: mortgage brokers’ inquiries into consumers’ requirements and objectives, p.5
[18] ASIC 2016, REP 493, Review of interest-only home loans: mortgage brokers’ inquiries into consumers’ requirements and objectives, p.9-10

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