



Submission to

ASIC Consultation Paper 309

Update to RG209: Credit Licensing – Responsible Lending Conduct

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Attention:

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Care Inc. Financial Counselling Service and the Consumer Law Centre

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Dear Ms Grey

Care Inc. Financial Counselling Service (Care) and the **Consumer Law Centre (CLC)** enthusiastically welcome the review of the Australian Securities and Investments Commission (ASIC) Regulatory Guide 209 and the opportunity for Care and the CLC to provide input and assist in the development of ASIC policy on responsible lending.

We commend ASIC for the timeliness of this review following the recent recommendations of the Financial Services Royal Commission. We believe this review is vital to policy development in suitability, fairness and transparency of lending decisions within the financial services sector.

We firmly believe that ASIC ought to lead the sector by providing guidance to licensees to clearly identify the inquiries and steps that are important, and even necessary, to comply with their responsible lending obligations. Critically, this guidance should extend to raising ASIC expectation level to ensure that:

- there is a greater scrutiny by the licensees in verification of consumers' financial situation;
- benchmarking is used as an aide in the process rather than a substitute for failure to verify consumers' financial situation; and
- financial products provided to consumers are not unsuitable and are fit for purpose.

We welcome ASIC's proposal to introduce guidance on additional matters not covered in RG209, including small business lending, loan fraud, negative repayment history information, maintaining records to demonstrate compliance and the purpose and content of the written assessment.

Below is a brief profile of Care and the CLC, and our comments in response to the specific sections of the Consultation Paper which are most relevant to our service delivery.

About Care Inc. Financial Counselling Service and the Consumer Law Centre

Care has been the primary provider of financial counselling, legal and related services for low to moderate income and vulnerable consumers in the ACT operating continuously since 1983. Care's core services include the provision of information, advice, support and advocacy. The Consumer Law Centre, a program of Care, offers legal advice, casework and advocacy for consumers in the area of credit, debt and fair trading. Care's additional programs include a Community Development and Education Program and the ACT's first No Interest Loans Scheme established in 1997. Care provides policy comment on issues of importance to our client group, especially those most disadvantaged and vulnerable in the ACT.

Our agency responds to over 2,000 new requests for assistance each year. Given the core focus of our work, Care and the CLC have extensive expertise in advising clients in relation to responsible lending conduct matters and progressing complaints for clients with financial institutions and internal and external dispute resolution services including the Australian Financial Complaints Authority (AFCA).

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B1: Reasonable inquiries and verification steps

We agree that reasonable inquiries and verification steps need to be identified in the Regulatory Guide, and with the importance of re-stating the requirements necessary for compliance with the responsible lending obligations under in the *National Consumer Credit Protection Act 2009*. Further, should licensees fail to conduct reasonable inquiries and verification as required under the Act and as prescribed under the regulatory guidance process, we advocate that there be a clear and transparent procedure for investigation and enforcement by ASIC of such breaches. This is to ensure that the financial service sector has a good understanding of the mandatory minimum processes that must be complied with in all cases and clear expectations are set by ASIC as the regulator.

In our view, any watering down of the responsible lending standards, such as a weakened inquiry and verification systems, or overreliance on benchmarks instead of complying with inquiry and verification requirements, poses much greater threat to effective compliance by the sector. It is vital that the same high responsible lending standards are retained for all licensees in relation to all financial service products provided to all consumers.

We support the inquiries about affordability currently set out in RG209, however stress that these must be supplemented by the equally important inquiries about customers' requirements and objectives. This argument is discussed in more detail below at **C4**.

We note that the verification processes should equally be mandatory and match the inquiries, including verification of the completed application forms, income pay slips and other evidence of income, bank account statements to verify expenses, credit report to check liabilities and any further verification that may be required if the information provided is inconsistent or missing.

It is crucial that such verification is genuine and not merely a step to be ticked off on paper. By way of an example, we refer to the below situation where a poorly performed verification process led to severe hardship of a consumer:

A client of the CLC, in his mid-20's, suffering from mental illness and cognitive impairment had applied for a car loan (secured). He stated in his application that he had just left social housing and is about to enter shortly into private rental. The licensee accepted verification of his social housing rent records rather than request evidence of current living arrangements. Even more concerning was the fact that the provider failed to verify his income, which was Nil. The consumer obtained the loan, purchased a car in which he intended to live until being able to secure private rental. He was unable to meet the minimum payments and within months the car was repossessed by the licensee. The car was assessed as not road-worthy. The consumer was rendered homeless and with a significant liability for the shortfall. The CLC faced a significant challenge in convincing the licensee that their failure to verify income and expenses meant that the product offered was not fit for purpose, and in fact was clearly not "not suitable".

Another example of consequences and detriment to clients where reasonable inquiries and verification were not done properly:

A client of the CLC, in his mid-40's and on a disability support pension (DSP) for many years because of his mental illness, was loaned \$700,000 for a \$1 million investment property. The client provided a \$300,000 deposit and the loan was interest only for the first 5 years. The licensee in assessing affordability relied entirely on what the client intended to do in the future relating to the rental of the investment property and failed to enquire where the deposit came from; which had in fact come from friends and relatives. Moreover, the licensee failed to make reasonable enquiries in relation to the client's expenses and assessed them at \$0. Given the time it took for the client to begin renting out the investment property, soon after the loan was granted, the client fell into arrears. The client's DSP was insufficient to cover loan repayments even assuming the client's expenses were actually at \$0. It was very clear that this loan should have been assessed as 'unsuitable' by the licensee.

C1: Verification of consumer's financial situation

We support the ASIC proposal to update and clarify current guidance on the kinds of information to be used for verification purposes, and the examples regarding sources of verifying information provided in Appendix 1 of the consultation paper

However, we hold some concerns about the potential over-reliance by the financial services sector on automation and its ability to easily identify issues such as demonstrated in the example listed above where evidence of past social housing rent was used instead of appropriate inquiries being made about the current living arrangements of the consumer. Similar issues could arise in relation to consumers who have recently lost or changed employment thus reducing their income, or recently separated from their spouse and their financial and family situation and living arrangements drastically changed. For instance, information on a loan application listing "paying out a husband in a family settlement" as the loan's purpose may easily be ignored, with the existing documented history of mortgage payments being relied on as evidence (automated, especially if same credit provider) of the current accommodation expenses.

We also would like to urge ASIC to provide stronger and more definitive guidance and explicitly stop and penalise practice within the sector of requiring consumers to disclose their online banking username and passwords. Our experience suggests that especially the payday lending sector frequently requests such information from consumers to access their bank account statements as part of the verification process. We believe this practice is illegal, as well as it is in breach of the terms and conditions of the credit contract. ASIC's leadership is needed to stop this practice.

Finally, one of the most common problems experienced by our client group, which occurs despite the existence of the inquiries and verification process, is the failure by the licensees to examine the information obtained and verified and to perform or complete the suitability assessment.

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Examples include situations where credit is obtained to repair a car, but expenses are not inclusive of the usual car-running costs, registration or insurance even where, in secured loans, insurance is mandatory; loans for travel for a serious surgery or for disability equipment of substantial value where no other medical/treatment expenses are obtained (which can be substantial); loans for relocation/moving expenses where evidence of the 'old' residential address and employment is used to assess current suitability of the product.

We strongly disagree with the “if not, why not?” proposal at C2(b) of the Consultation Paper. There should not be “if not”. In our submission, it is vital that consumers have the confidence that the financial services sector complies with the responsible lending obligations fully, and consistently applies best practice principles to ensure financial products offered to consumers are always fit for purpose. In our view, financial services providers should always apply the responsible lending principles and ensure consumers will not endure financial hardship because of acquiring such products.

C3: Use of benchmarks

In addition to our comment at B1 and C1 which advocate the necessity of thorough and consistently applied inquiry and verification processes, our experience dictates that the financial services sector has become comfortably and conveniently accustomed to relying on benchmarks to avoid compliance. We believe that a large proportion of licensees hide behind benchmarks to justify failure of their processes, often on a systemic level, to perform the appropriate inquiry and verification regarding consumers' financial situation and their expenses. The benchmarks have now become a one-for-all stop to displace legal obligations of responsible lending.

We are particularly concerned that our client group, including those consumers on low to moderate incomes and in financial hardship, are most affected by the application of current benchmarks. For instance, we note that the Household Expenditure Measure is lower than the Henderson Poverty Index for people who are unemployed.

Any benchmark relating to a 'poverty line' should not, in our submission, be an acceptable method for calculating a person's reasonable household expenses – a benchmark striving to ensure that the product is fit for purpose and will not expose a consumer to significant financial hardship is more appropriate to simply striving that the consumer will not fall below a poverty index. Benchmarks can of course be appropriately utilised as a tool in assisting the required information and verification processes and prove a useful tool to ensure that expenses disclosed by consumers are 'usual' or underinflated. However, the process should primarily focus on independent verification of expenses, and only then, where in doubt, checking against suitable benchmarks. Benchmarks cannot and should not, in our view, replace the need for appropriate information and verification processes.

An example of benchmarking gone wrong/ or arbitrarily used:

A client of Care Inc applied for a loan of approximately \$4,000. The lender had assessed suitability using the Henderson Poverty index (HPI) as well including additional 'required' buffer of \$100 per fortnight. The calculation showed that the client's net position (after applying the HPI and the buffer) was in deficit. The lender proceeded with providing the loan to the client in any case. The client defaulted on the loan from the date the first payment was due. Care's financial counsellor successfully negotiated a waiver of the interest component of the loan.

C4: Consumer's requirements and objectives

We are in strong support of the ASIC's proposal to update the current guidance in RG209 on reasonable inquiries about the consumer's requirements and objectives, reflecting the findings and guidance in *Report 493 Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives*.

Our experience suggests that it is rare for credit providers to enquire or ask questions about the consumers' requirements and objectives. In fact, we believe that the financial sector industry seems to demonstrate a blatant disregard for the requirement of their product to be fit for purpose, and place primary focus on affordability.

For instance, payday lenders systemically use a drop-down list of purposes without any space offered for provision of additional or explanatory information.

Consumer leases are often offered in disregard to the law, whereby consumers are promised they will own the product at the end of the lease. This promise is not reflected in the consumer lease contract, some of our clients have reported being specifically informed that this is for "legal reasons". Consumers who want to own goods at the end of the contract, frequently pay many times the value of the product, but are rarely informed of the retail price of the product they are about to lease.

We do not believe it is appropriate to bundle products and for example offer credit cards as part of a home loan package. Consumers often end up in greater debt as a result of accessing a credit card that they neither requested nor needed.

Another area of concern is in relation to those consumers who experience family violence and enter into a credit contract for their partner, be it for a business mobile phone, or a business car, or a boat, motorbike or holiday retreat solely for the partner. Guidance by ASIC in relation to the necessity of obtaining information about the consumers' requirements and objectives could, in such circumstances, offer a level of protection to this vulnerable group of consumers. It is important that financial institutions and other credit providers have in place policies and processes for dealing sensitively with consumers where domestic violence exists. This includes identifying red flags around whether the loan meets the objectives of the person signing the loan agreement.

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We submit that this process is quite critical and legally essential to ensure that the product is fit for purpose. We advocate that consumers' requirements and objectives in obtaining any financial product must be ascertained so that the financial services sector can discharge its legal obligations with respect to responsible lending. We note that one of the underlying principles in the six norms of conduct outlined in the Financial Services Royal Commission is that finance providers offer services that are fit for purpose. This cannot be done if the purpose – that is, consumers' requirements and objectives – is not ascertained.

Examples of unsuitable lending:

A client of the CLC went to a car dealership with his friend to purchase a car. The friend found a car that was suitable but when the dealership did a credit check on the friend it was found the friend had several defaults. The dealership then suggested to the client that the client could take out the loan for his friend but that the friend would still own the car. On the loan application the dealership had merely written on the form for the question 'reason for loan?' the following: "car for personal use". It was clear that this loan did not meet our client's requirements and objectives.

D1: Areas where responsible lending obligations do not apply

In principle, we have no issue with lenders applying the responsible lending obligations where the law does not require them to do so. This can only have a positive effect in assessing overall risk for the licensee.

However, should such guidance be included in RG 209, we consider a corresponding warning be included in a credit proposal. For example, the 'National Credit Act does not apply, therefore, the responsible lending and hardship provisions of this Act do not apply to this credit contract' or words to this effect.

There is also evidence to support that numerous financial service providers do not understand the association between responsible lending and financial hardship arrangements. There have been cases where a consumer would be much better off if the lender had restructured a loan, without any increase to credit. However, the financial service provider has refused based on responsible lending provisions, and thus not understanding that a loan can be restructured, on the basis of financial hardship, without the need to refinance. Therefore, we also encourage RG209 to clearly state that the responsible lending requirements should not be used as a means of refusing reasonable financial hardship arrangements.

By way of an example, we refer to the following situation where a client required a financial hardship arrangement on his home loan with the request for a loan restructure, however the lender refused stating responsible lending obligations.

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A client of Care Inc. had fallen into arrears on his home loan. This was due to divorce, going from two incomes to one and the client experiencing mental health issues. The client did not have capacity to pay both his arrears and his usual monthly mortgage repayments. The client did however have capacity to pay his usual monthly repayments. The lender was taking steps towards repossession if the arrears were not addressed. The client requested that the lender restructure the loan by adding the arrears to the end of the loan, (capitalising the loan), extending the term of loan and allowing him to continue making his usual mortgage payments.

The bank refused the clients request, stating that they could not restructure the loan based on responsible lending obligations because the client was in financial hardship and they couldn't restructure his loan while he was in hardship.

The client was referred by the lender to Care Inc. The financial counsellor explained to the lender that in fact they could restructure the loan as responsible lending provisions do not apply to financial hardship arrangements where there is no additional credit being provided. The lender eventually agreed to restructure the client's loan, capitalising the arrears and extending the loan term. However, the lender would only do this after the client had paid 6 months of his regular mortgage repayments.

D2: Fraud risks and impact on responsible lending obligations

We support this proposal. We have found that some licensees during the loan application process overstate income and/or understate expenses in order to increase the chances the loan will be approved. In some cases, it may not be considered deliberate; instead more reckless or careless. And is more likely to occur through agents such as brokers and car dealerships.

D3: Use of repayment history information

We consider caution in the use of repayment history that would trigger an automatic refusal of credit. Where there is a poor repayment history, the licensee should make additional enquiries to ascertain the reasons for this.

For example, a consumer may decide to pay their yearly car registration and insurance and choose not to pay an Internet bill. We think this is not unreasonable in the circumstances. It should be noted that even consumers on high incomes sometimes fail to pay bills on time due to the nature of their employment, family circumstances and personal problems. It does not mean they cannot afford a loan. However conversely, we hold concerns that repayment history could be inappropriately used to market credit offers to consumers who may not be able to afford them.

We recommend ASIC consider specific guidance to ensure repayment history is not used inappropriately, leading to increased financial stress.

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D4: Records of inquiries and verification

We support this proposal. We consider that a licensee should maintain records of inquiries and the verification steps taken so that these may be made available to the consumer or AFCA to determine compliance with the law. We do not consider the recording of something the licensee is already required to do by law a more than insignificant cost to the licensee.

D5: Content of a written assessment

We support this proposal. We have found that many credit assessments done by licensees have little or no information as to their methodology in finding the credit contract or lease was 'not unsuitable'. Often there is merely a statement to the effect "after assessing the customer's requirements and objectives, and income and expenses we have found the loan to be not unsuitable". This is most unsatisfactory.

Additional comment regarding regulatory impact

We acknowledge that Care and CLC see only a very small proportion of overall problems encountered by consumers. It is critical that the industry demonstrates compliance with respect to all consumers, not only those who are able to access support from financial counselling and consumer law services. For this reason, prevention on a systemic level and effective regulation is critical.

ASIC's regulatory guidance reflect the expectations set out in Chapter 3 of the *National Consumer Credit Protection Act 2009* and offer best practice standard for the industry, and effective enforcement of this standard. This is especially vital for our clients who are rarely able to access rights through courts and rely on AFCA to access free, independent and consumer friendly dispute resolution.

Our clients are overwhelmingly experiencing financial stress, many due to personal circumstances such as domestic violence, disability and ill health, loss of employment, lack of adequate income or limited financial or overall literacy or cognitive impairment. Many have been the victims of poor lending practices or occasionally fraud by the financial services industry. Most of our clients are on low to moderate incomes, at risk of homelessness, and dealing with multiple stressors including housing insecurity, utility stress, addictions and mental health issues to name a few. To those consumers, it is critical that AFCA decisions are consistent, transparent and published, and in line with best practice set by ASIC. Without publication of such decisions, there is little transparency or assurance that the guidance is enforced consistently and in compliance with the law.

We thank you for the opportunity to make a submission into this important inquiry.