

Consultation Paper 309

Update to RG 209: Credit licensing: Responsible lending conduct

Legal Aid NSW submission to Australian
Securities and Investments Commission

May 2019

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Legal Aid
NEW SOUTH WALES 

About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 24 offices and 221 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with LawAccess NSW, community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal services. Our community partnerships include 29 Women's Domestic Violence Court Advocacy Services.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact most on disadvantaged communities, such as credit, debt, housing, employment, social security and access to essential social services.

Legal Aid NSW welcomes the opportunity to make a submission to the Australian Securities and Investments Commission's Consultation Paper 309, *Update to RG 209: Credit licensing: Responsible lending conduct*. Should you require any further information, please contact:

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Introduction

Legal Aid NSW welcomes the opportunity to contribute to the Australian Securities and Investments Commission's (**ASIC**) consultation about updating RG 209: Credit licensing: Responsible lending conduct.

We broadly support ASIC's proposed changes to RG 209 about the responsible lending obligations. In particular, we strongly support:

- clarification about the application of responsible lending obligations to lenders who purport to offer loans to small businesses, but also offer them to consumers;
- more specific guidance about loan fraud and the impact on responsible lending obligations, especially in the context of family violence and elder abuse;
- the inclusion of an example best practice written assessment for licensees to use when determining if a loan is not unsuitable;
- confirming the limited usefulness of benchmarks for licensees in undertaking responsible lending assessments; and
- specific guidance to licensees about how to determine a consumer's requirements and objectives for financial products to better exclude unsuitable products.

More robust guidance in RG 209 will improve outcomes for consumers, who have greater assurance that they have entered into a suitable loan; and for industry, which may be more confident in its lending decisions and compliance actions.

We have responded to the Consultation Paper's questions, occasionally grouping the questions together where our response addresses a number of the questions at once. Legal Aid NSW is not well-placed to answer questions about the effect on business costs in implementing any new measures, and so we have not addressed these questions. Our general response to this issue is that any costs of implementing new measures would be offset by reductions in risk, and the need to resolve fewer disputes.

Proposal B1: Identifying inquiries and verification steps

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?

Yes. It would be useful if ASIC identified the minimum inquiries and verification steps that it considers should be taken as part of a responsible lending assessment. Based on our casework experience, licensees frequently fail to conduct appropriate inquiries and take necessary verification steps in accordance with their obligations under the law.

More detailed and robust ASIC guidance is likely to result in licensees having a clearer understanding of what is required of them under the law. There will also be greater certainty around what inquiries were made, and what verification steps were taken, in the event of a dispute.

The particular inquiries and verification steps that ought to be undertaken as a minimum are expanded upon in our answers to questions B1Q4, B1Q5 and C1Q1.

Recommendation 1 ASIC should identify particular inquiries and verification steps that should be taken by licensees.

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

Legal Aid NSW frequently provides legal advice and assistance to disadvantaged and vulnerable consumers in NSW who have disputes with credit providers, including disputes about the responsible lending practices of a credit provider.

Based on our casework experience, we would welcome guidance about the following industry practices:

- *Clarification on the use of benchmarking:* More guidance about the circumstances where benchmarking is appropriate, including whether benchmarking can be undertaken as a means of assessing a consumer's capacity to pay back a loan where the consumer has underreported their expenditure during the verification process. We would also welcome guidance about circumstances where reported expenses are lower than a nominated benchmark, and the process that licensees follow in these cases to make further enquiries about a consumer's financial situation.

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- *Guidance about written assessments:* We would welcome additional guidance about the level of detail that licensees are required to include in written assessments that a credit contract or consumer lease is 'not-unsuitable'. Our response at D5Q1 contains further information.
 - *Guidance about industry practice for considering bank statements:* While licensees usually request bank statements from consumers as part of their responsible lending assessment, it is often unclear from documents that we receive from lenders how the lender has used the bank statements to arrive at a conclusion that credit is not unsuitable. We would welcome guidance about what steps licensees ought to take when analysing a consumer's bank statements for the purpose of assessing suitability for (?) a loan.

Recommendation 2 ASIC should provide guidance about:

- a. The use of benchmarking;
- b. The level of detail required in a written assessment; and
- c. Industry practice when considering bank statements.

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.

No. There are no products, consumers or circumstances where we consider that it may be reasonable to undertake fewer inquiries and verification steps than those identified as being the minimum required. Regardless of the circumstances of the matter, lenders are obliged not to enter into unsuitable loan contracts, and to comply with their responsible lending obligations in making this assessment.

We have found that the lack of minimum standards has allowed licensees to fail to take sufficient steps in order to comply with their obligations. In our casework experience, it is often clear from examining a credit provider's written assessment that there is not enough information for a credit provider to determine that a loan is 'not unsuitable'.

While ASIC should provide guidance about the minimum inquiries and verification steps required, there are certainly additional indicators of vulnerability that should alert a lender to take further action when determining whether a loan is 'not unsuitable'. These factors would include when:

- the consumer is in receipt of Centrelink benefits;

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- bank statements obtained by the lender show that the consumer regularly has an everyday account balance of \$0, or where accounts show frequent declined or bounced back payments for regular direct debits;
 - the consumer has existing debt under a credit facility, particularly if payments are behind;
 - the consumer has a history of small amount credit contracts and consumer leases;
 - the consumer is behind in payment of household debts such as rates, strata levies and utility bills;
 - the consumer requires a loan to pay off an existing debt under a credit contract; and/or
 - the consumer has a history of hardship requests for previous loans.

We also note our response to the questions in Proposal C2 around the proposed adoption of the ‘if not, why not?’ approach to reasonable verification steps.

Recommendation 3 ASIC should:

- a. Provide guidance about minimum inquiries and verification steps required to be taken by licensees; and
- b. Provide details about indicators of vulnerability where more inquiries and verification steps might need to be undertaken.

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.

It is crucial that a licensee must have a complete picture of a consumer’s financial situation to fully comply with its obligations under the credit law. This will always require the licensee to make some inquiries. The need for this when assessing the suitability of a loan is demonstrated in Janet’s case study below.

Case study: Janet – incomplete inquiry into financial situation

Janet lives in a remote Aboriginal community in Central-West NSW. She decided that she wanted to enter into a consumer lease for a refrigerator. The credit provider's responsible lending assessment showed that Janet was in receipt of a disability support pension, had one dependent and enough income to afford payments of \$50 per month under a consumer lease agreement, after her everyday expenses, including rent and utilities, were taken into account.

However, the lending assessment did not take into account the fact that Janet had two existing personal loans that were in default, and a \$3,400 power bill. As a result, it was unlikely that Janet would be able to afford the repayments under the contract, or would only be able to afford making repayments with substantial financial hardship.

To obtain enough information to properly assess the suitability of a loan, licensees should make inquiries about and take steps to verify the following aspects of a consumer's financial situation for all loans:

- a consumer's source of income, and whether income is received through paid employment or Centrelink benefits;
- the number of dependents or financially dependent people;
- the nature and length of their employment;
- any possible change that might occur with respect to a consumer's financial circumstances throughout the period of the loan;
- a consumer's expenses, including both fixed and variable expenses;
- a consumer's liabilities, in particular any other debts where the consumer has been provided credit;
- a consumer's credit history, particularly if it involves entry into numerous small amount credit contracts;
- a consumer's circumstances, for example their age, geographical factors and English language ability;
- the consumer's future prospects, including any significant change in the consumer's financial circumstances that is reasonably foreseeable;

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- whether the consumer has existing debts that are to be repaid with the provision of credit;
 - whether a consumer has a history of entering into financial hardship arrangements with credit providers; and
 - whether a consumer is frequently late meeting regular financial commitments such as rent or utility bills.

A number of the factors above are noted in the Explanatory Memorandum to the *National Consumer Credit Protection Bill 2009*, in particular at part 3.72.

Recommendation 4 ASIC's guidance should reflect the obligation of licensees to make inquiries and take steps to verify the above aspects of a consumer's financial situation for all loans

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?

ASIC identifying or reiterating particular inquiries and verification steps in its guidance is likely to have a positive impact on consumers. As discussed in our answers to B1Q4 and B1Q5 above, there are a number of inquiries and verification steps that we think should be undertaken by licensees in all circumstances. Some of these factors are noted in the Explanatory Memorandum to the bill.

The current iteration of RG 209 already identifies particular inquiries and verification steps that a licensee is required to take. ASIC reiterating those inquiries and verification steps, or saying that licensees must take certain steps, would mean that licensees are more likely to comply with their responsible lending obligations under the credit law. This in turn would mean that less consumers will find themselves with a loan that they are unable to pay back, or are only able to pay back with substantial hardship.

There should be no change to the ability of eligible consumers to access credit, as ASIC's guidance merely helps licensees comply with their responsible lending obligations, and those obligations remain unchanged. Any increase to the cost of credit should be negligible, as compliance costs will be offset by a reduction in risk, less collection activity and fewer disputes.

Proposal C1: Forms of verification

- 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?

Expansion of the guidance on appropriate and readily available forms of verifying information is essential. The current guidance does not provide enough certainty for licensees, and may not provide a licensee with an accurate reflection of a consumer's true financial situation. It also gives the impression that ASIC considers that obtaining information from sources such as bank statements is only a "reasonable step" where the licensee already has access to that information (that is, a bank dealing with an existing customer).

An expanded list of kinds of verifying information that is considered readily available in most circumstances, as detailed in Appendix 1 of the Consultation Paper, is welcome. The examples in Appendix 1 are appropriate because they provide a licensee with a meaningful and comprehensive insight into a consumer's financial situation. As opposed to the verification process only including income and expenses (to the extent that this information is available for existing customers only), the proposed examples in Appendix 1 will reflect a consumer's entire situation, including their fixed or variable expenses, and any other financial obligations.

The list at Appendix 1 should not be considered as an exhaustive list as there may be expenses affecting vulnerable consumers that emerge over time. For example, for our vulnerable clients, consumer leases for household rental goods are a common expense not currently listed. This type of product is used regularly by a number of our clients, especially within regional and remote Aboriginal communities. We recommend that consumer lease contracts should be included as an example within the fixed or recurring living expenses of ASIC's guidance.

Legal Aid NSW has concerns about lenders using data aggregation services, such as disclosure of consumers' personal information and data security. These concerns should be raised in ASIC's guidance. If obtaining a data aggregation report is to be considered a "reasonable step" to verifying a consumer's financial situation, any guidance provided should also be consistent with the introduction of the Consumer Data Right contained in the *Treasury Laws Amendment (Consumer Data Right) Bill 2019*.

To comply with the objectives of the Consumer Data Right, if a data aggregation report is to be relied on to verify a consumer's financial information, then consumers must have the opportunity to:

- be informed about what data aggregation is, and how it is being used;
- be informed about what the benefits and risks associated with data aggregation are;
- be able to consent in an informed way to the data being used; and
- be able to safely access a copy of the data aggregation report held about them.

- Recommendation 5**
- a. ASIC should expand the list of kinds of verifying information that is considered readily available in most circumstances to include all documents detailed in Appendix 1 of the Consultation paper;
 - b. Consumer leases should be listed as an example of a fixed or recurring living expense; and
 - c. If a data aggregation report is to be considered a "reasonable step" to verifying a consumer's financial situation, then ASIC should provide guidance consistent with the Consumer Data Right.

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?

Yes. Based on our experience it will be beneficial to consumers to clearly state 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 relevant information about a consumer's situation.

When we review documents provided to us by a lender supporting their lending decision, it is common to see that certain documents were obtained by lenders as a "tick a box" exercise. Often, the written assessment does not show that the lender appraised the information contained in the document. Clarification around what steps are actually required to satisfy the information verification process will be useful for licensees to better understand their responsible lending obligations, and will also protect consumers from obtaining credit that they cannot afford to repay without substantial financial hardship.

The case studies below demonstrate situations where a licensee had access to the client's information documents to verify their financial position but chose not to have regard to it. ASIC's plan to expand guidance by clearly stating that it is not sufficient to simply obtain verifying information but not have regard to it will be useful in preventing situations like these. If the client's documents in these cases had been properly assessed, it is reasonable to assume that they would not have been provided with the credit contract at all.

Case study: Bonnie – failure to properly verify financial position

Bonnie is an Aboriginal woman living in a remote community and caring for her three children. With no savings and a poor credit history, Bonnie wanted to enter into a consumer lease for a bedroom suite, dining table set and lounge. As part of the credit provider's responsible lending assessment, Bonnie's Centrelink Income Statement was obtained, but was not used by the credit provider to properly verify Bonnie's financial situation.

Had the credit provider properly assessed Bonnie's Centrelink Income Statement, it would have been aware that Bonnie had requested four lump sum advance payments from Centrelink within the last year. This suggested that Bonnie was already in financial hardship at the time she applied for the lease, but the credit provider's lending assessment did not take this into account. Bonnie entered into the lease, but within a few months she was not able to make the repayments without severe financial hardship.

Case study: Failure to properly verify Krystal's financial position

Krystal is a single mother from western Sydney, caring for a newborn baby. She attended a car dealership near her home and applied for a loan for a new car. A loan was approved by the credit provider for nearly \$20,000 to purchase a new car from the dealership.

As part of the credit provider's responsible lending assessment, Krystal's most recent bank statement was obtained. However, the bank statement does not appear to have been used by the credit provider to verify Krystal's financial situation. Had the credit provider properly appraised Krystal's bank statement, it would have identified that Krystal had a balance of \$1 in her bank account at the time of her application, which should have prompted further inquiries. Krystal sought advice from Legal Aid NSW because she was unable to repay the loan over time without severe financial hardship.

Recommendation 6 ASIC's proposed clarification and expansion of guidance on what are reasonable steps to verify the financial situation of a consumer should be adopted.

Proposal C2: Verifying the financial situation of a consumer

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 costs of credit for consumers)?

The benefits for consumers of the ‘if not, why not’ approach stem from the licensee being accountable and having to justify their decisions to determine applications for credit in a more responsible and informed way. This should encourage improvements to current practices. Following this approach, licensees will be required to specifically explain their decisions, and we are hopeful that consumers will in turn benefit by not entering into credit contracts that are unsuitable to them.

If the ‘if not, why not’ approach is adopted, there are risks that licensees may use this approach to discount information for their suitability assessment; and that they may decide not to take reasonable steps to obtain information verification documents.

This may lead to unsuitable loans being provided to consumers, rather than being refused on the basis of insufficient documentation. This risk can be minimised about robust guidance about the standard of reason required to sufficiently justify not using readily available forms of verifying information.

The cost of implementing the ‘if not, why not’ approach will be offset by the savings to providers in complying with their responsible lending obligations.

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

Further guidance about acceptable verification practices will have a positive effect on competition between licensees. Licensees who are able to implement processes around reasonable verification steps in a quick, efficient and fair manner will set the standard for industry to follow, and will lead to improvement of the standard in the marketplace generally for consumers.

Proposal C3: Use of benchmarks

Regulatory Guide 209 provides clear guidance that licensees must take reasonable steps to inquire and verify a consumer’s actual financial situation. For example, RG 209 at paragraph 105 states that:

Using 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.

Despite this guidance, we have encountered many examples in our casework where licensees have inappropriately relied on benchmarked expenses as a substitute for actual expenses in alleged compliance with their responsible lending obligations.

This issue was highlighted in some detail during the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.¹ Given the widespread lack of compliance, further clarification in RG 209 about reliance on benchmarks would be useful.

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

Yes. Benchmarks can be a useful tool for a lender to test the plausibility of a consumer's expenses, but do not provide any positive confirmation of expenses. Shara's case study below shows that reliance on benchmarked expenses failed to identify other information clearly relevant to an assessment of whether a consumer could afford the credit contract.

Case study: use of benchmarks understates Shara's expenses

Shara lives in western Sydney with her four young children. Her husband receives no income. She needed a larger car and applied to a lender for finance on a second-hand vehicle.

When she applied for a car loan, she was asked to provide bank statements and evidence of her Centrelink income. She was not asked about any living costs or other debts, as the lender applied a benchmark for all her expenses.

Had the lender asked about her expenses and other debts, or actually reviewed the bank statements she had provided, it would have been apparent that she had a number of other 'payday' loans, was behind in her rent and had failed direct debits. It would have been clear that Shara was not able to afford the repayments under the contract, or only with substantial financial hardship.

Benchmarks are only useful to the extent that they provide an indicator that a consumer may have understated their expenses and that further inquiry is warranted. The proposed guidance should explicitly state that where a consumer's disclosed expenses do not meet,

¹ For example, see Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report* (2018) 22-30.

or are very close to the benchmark, that this should be an indicator for further inquiries to be made.

Case study: benchmarks would show Paula and Dave's understated expenses

Paula, and her partner, Dave, live in regional NSW and both receive Centrelink payments as their only source of income.

Dave applied for a small personal loan, but was refused because of his poor credit rating. The lender said they could only approve him if he had a suitable guarantor. Dave, who struggles with drug addiction, exerted significant pressure on his partner Paula to be a guarantor for the loan. Paula, who suffers from depression, eventually agreed and signed up as a co-borrower. The loan was approved, and Dave soon defaulted on his repayments. Paula received no benefit from the loan.

The lender began pursuing Paula to repay the loan, and it was at this stage that she approached Legal Aid NSW for advice.

After reviewing the written assessments provided by the lender, Legal Aid NSW found that the monthly expenses listed were significantly under-recorded. Paula did not have any recollection of providing the amounts to the lender that were assigned to each expense category. It appeared from reviewing the written assessment that random amounts were allocated to each expense in order to make the loan more affordable. For example, no rent expenses were recorded at all, yet there were utilities listed at \$20 per month, food was listed as just \$100 per month, and public transport just \$20 per month. Similarly low amounts were listed for Dave. This very low expenditure should have been a 'red flag' to the lender to make further inquiries.

Had the lender referred to a benchmark to check the plausibility of their stated expenses it would likely have revealed a substantial understatement of their expenses, and further inquiries could have been made to clarify the true position and that the loan was not affordable.

We have concerns that under the proposed guidance, industry may still consider it open to them to continue the practice of simply raising a consumer's living expenses to the Household Expenditure Measure (**HEM**) benchmark if they are below the level without further inquiry. This practice is concerning as it indicates that a lender does not have a sufficient understanding of the person's expenditure, and cannot properly comply with its responsible lending obligations.

Raising expenses to a benchmarked level without further inquiry is also fraught because:

- It fails to identify the likelihood that expenses noted as below the HEM benchmark may be understated and/or indicative of the consumer's limited financial literacy and understanding of their financial position; and
- Consumers whose actual expenses are in fact less than the HEM benchmark are disadvantaged by assuming their expenses are higher than those in practice, reducing their borrowing capacity.

Recommendation 7 Additional guidance should be provided that if a benchmark is applied, and a consumer's disclosed expenses do not meet or are very close the benchmark that this constitutes a 'red flag' which mandates that further inquiries need to be made by the licensee.

We welcome the proposal that benchmarks must be adjusted for variables of a customer's circumstances, and that the expense figures be regularly reviewed to ensure the effectiveness of any benchmark.

We support the proposal that licensees should ensure that their benchmarks are 'not merely reflective of low budget spending', recognising that consumers frequently spend more than the minimum on absolute basics. In our casework experience, we often see clients with credit products that are clearly unaffordable after factoring in basic discretionary spending, such as some children's expenses, cigarettes, alcohol and takeaway food.

We would also support further complementary guidance about how lenders could improve their loan application processes to assist consumers to better disclose their financial situation from the outset and understand their true financial position. For example:

- using targeted questions about expenses that consumers are typically poor at declaring, such as the total value of small regular expenses like coffee and cigarettes, or irregular expenses such as car maintenance;
- interactive statements of financial position that can convert large annual expenses, such as car registration and home and contents insurance, to monthly or quarterly amounts; and
- obtaining documentary evidence to verify essential expenses, such as energy and telecommunications bills.

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

It is not possible to identify a standard buffer which would be suitable for all consumers. An appropriate buffer needs to factor in the purpose, size and term of proposed credit as well as a consumer's overall financial position, including existing credit products, income and projected expenses. For example, we consider that a larger buffer of affordability would be needed for a single parent taking out a mortgage for a residential home, compared to a student applying for a small personal loan while living at home with their parents.

We also strongly support an appropriate savings buffer being factored into affordability calculations.

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)?

This approach would be beneficial to consumers. Clearer guidance in RG 209 confirming that benchmarks can only be used to 'reality check' the plausibility of declared expenses would likely result in more responsible lending. This would be of benefit in not overcommitting consumers. It would also lead to a more fulsome discussion of expenses at the assessment stage, which would assist a consumer to consider for themselves the affordability of proposed credit.

This approach may involve some additional costs to business in undertaking these more thorough inquiries. However, these should be offset by savings of lower risk, less debt collection activity and fewer disputes. It is our view that any costs associated with these changes would be outweighed by the overall benefit to consumers who may otherwise find themselves overcommitted to unaffordable credit.

We can see little risk to consumers in the proposed approach. We note there may be concern from industry that changes in assessing credit could result in a general tightening of access to credit. However, we note Commissioner Hayne's comments about Benchmarks in his Final Report which drew heavily from Treasury's response to the Commission's Interim Report, and which suggested that recent tightening of credit standards had had a limited effect on access to credit.²

² Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (2019) 58.

Proposal C4: Consumer's requirements and objectives

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?

We welcome the proposed guidance to licensees about reasonable inquiries for a consumer's requirements and objectives, cementing the need for thorough inquiries early on in the assessment process.

Consumers are generally less likely to be familiar with all the details and features of available products than the licensee. Placing the onus on the licensee to thoroughly examine requirements and objectives, and to then match suitable products and to demonstrate why a particular product or feature is not unsuitable is welcomed.

The proposed guidance helpfully identifies specific lines of inquiry to assist a licensee to ask the right questions of consumers and then how to use that information to better achieve a consumer's requirements and objectives. We expect that this should in turn enable licensees to better exclude unsuitable products for consumers.

In our casework experience, the examination of a consumer's requirements and objectives, particularly in lower value credit products, tends to be extraordinarily brief and, in our view, does not satisfy responsible lending obligations. This is exemplified in the following case study.

Case study: Mitch unknowingly enters into consumer leases

Mitch is an Aboriginal single father, living in a rural area. He entered into multiple contracts with a local company to purchase household items, including a washing machine, mobile phone, and lounge room setting.

He sought legal advice when he fell into financial hardship with his repayments, having already paid thousands of dollars above the cash price of the items.

We requested the licensee's documents which revealed he was only leasing the items and would never have ownership of the goods. Mitch was stunned to learn this as he believed that he was purchasing the items through sale by instalments and would eventually own them.

Mitch instructs that he was never asked questions about his requirements and objectives, and nothing was recorded in the documents about this. Had the licensee made more detailed inquiries about Mitch's requirements and objectives, it would have been clear that he was seeking eventual ownership of the goods, and that the contracts were not suitable.

We welcome specific guidance on how a licensee ought to record these inquiries, and support the proposal that licensees provide a summary statement of requirements and objectives to a consumer to better ensure there is common understanding.

Recommendation 8 Further guidance should be provided in Regulatory Guide 209 to licensees in making inquiries about a consumer's requirements and objectives.

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)?

This approach would be overwhelmingly beneficial to consumers. Where a licensee has a more comprehensive understanding of a consumer's requirements and objectives, we expect that inappropriate products are more likely to be assessed as unsuitable. Further, these inquiries would also help consumers to make more informed decisions about various products by turning their minds to their real needs early on to better consider which products will suit them.

Overall, we believe this approach would lessen the likelihood of consumers committing to costly products which may not suit their needs, for example:

- consumer leases which are only for a rental of goods, when the consumer actually wants to own the item at the end of the contract;
- products bundled with costly add-ons that are not required or likely to be used (for example awards points features on credit cards which generally attract higher fees and which a consumer may not have a need for);
- unsuitable car loans, which do not reflect the advertised interest rate, and frequently bundle up junk add-on insurance which the consumer is unaware of and is unlikely to be able to claim on;
- interest-only loans entered into without fully understanding the implications, such as increased repayments when the interest-free periods ends and lack of equity in the property despite repayments; and
- high-cost 'payday' loans when the consumer wants low-cost short term loans.

There may be some increased costs to licensees involved in undertaking and recording more thorough inquiries about requirements and objectives, but these should be offset by savings associated with a licensee complying with its obligations under the law.

We can see no risk to consumers in the proposed approach. If there is any restriction on access to credit for consumers we consider it would only be to products which would not have met their requirements and objectives in any case and should properly be assessed as unsuitable.

Proposal D1: Additional guidance on specific issues

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.

Legal Aid NSW is not aware of any licensees who are applying the responsible lending obligations where the law does not require it.

A number of financial service providers seek to avoid falling within the definition of “credit” under the *National Credit Act*, and therefore avoid the Act’s obligations. For example, Buy Now, Pay Later arrangements are effectively providing credit and ought to be regulated by the *National Credit Act*. The products are deceptively easy to obtain, without any need for the provider to verify repayment capacity or observe any other responsible lending obligations. Typically, our clients are financially vulnerable and have signed up to these arrangements at the checkout or online without appreciating the full implications. They later find themselves with large debts they cannot afford to repay and are then saddled with further fees, as shown in Mary’s case study below.

Case study: Mary’s experience with Buy Now Pay Later

Mary is a single woman living in regional NSW with significant mental health issues. She receives the Disability Support Pension and is on the NDIS. Over just a few days when she was very unwell she entered into ‘buy now, pay later’ arrangements with two different providers for multiple transactions. The total debts exceeded \$600. Mary did not know how much she had borrowed, and only became aware of the problem when direct debits started coming out of her account. The only income in her account was her fortnightly social security payment. The debits left her without money for daily living expenses. Legal Aid NSW attempted to obtain relevant contract documents from the providers to assess the loans, but with no legislative requirement to be provided with such documents, only one provider was willing to provide the documents. Legal Aid NSW was able to refer Mary to a financial counsellor who negotiated suitable repayment plans with the lenders.

Recommendation 9 Responsible lending obligations should apply to Buy Now, Pay Later businesses.

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.

Legal Aid NSW supports additional guidance in RG 209, setting out particular examples where responsible lending obligations apply. We are concerned that some finance providers who purport to be lenders to small business are in fact offering credit to consumers, and then refusing to comply the responsible lending obligations and remedies under the National Credit Act.

Legal Aid NSW has advised and represented a number of clients who thought, as a result of representations made by lenders, that they were entering into a consumer contract for finance, but in fact were entering into a small business arrangement. In one case, a broker had also taken steps to obtain an ABN for the clients, without their knowledge. All of our clients were in fact consumers, and were not operating small businesses. In these cases, where the finance provider has induced a customer to enter into a loan on the promise that it is a consumer contract, or in circumstances where it is clear that the consumer is not operating a small business, the *National Credit Act* should apply and the consumer should be entitled to remedies under the Act.

Case study: Consumers induced to enter into a commercial car lease

A number of vulnerable clients in a remote community in NSW wanted to purchase cars. Many of these clients were experiencing financial hardship and were not eligible to obtain a loan through mainstream providers. Word got around the community that if you contacted a car dealer in Sydney you could purchase a car with finance. However, the clients were in fact signing up to a commercial lease to rent a car, rather than purchasing a car as a consumer.

When the clients came to Legal Aid NSW for help, many of them had already had their car repossessed or were experiencing significant financial hardship from making payments under the contract. Several clients had problems with the quality of the cars, and found the cars unreliable to drive in regional areas.

One client told Legal Aid NSW that she was prioritising making payments as she thought it was worth it as the owner of the car. She was shocked and upset when Legal Aid NSW told her that she was leasing the car from a commercial lease provider, and would never be the owner according to the contract.

Another client told Legal Aid NSW that the first time he understood that he was not the owner of the car was when the car was repossessed by the commercial lease company.

Recommendation 10 ASIC should provide clear guidance that credit providers must comply with responsible lending obligations when credit is provided for consumer purposes, regardless of how the credit contract is structured. This should include contracts that purport to be small business loans, but are in fact consumer credit contracts.

Proposal D2: Role of responsible lending obligations in mitigating risks involved in loan fraud

- D2Q1 Would specific guidance about loan fraud and the impact on responsible lending obligations of licensees 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 risks 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?

Specific guidance about loan fraud and the impact on responsible lending obligations is necessary to improve licensee processes for identifying fraud, and reduce the risk of consumers entering into unsuitable credit contracts.

There is a significant need for more guidance to prevent fraudulent loans being written. Legal Aid NSW regularly advises clients about loan fraud in the context of family relationships, particularly elderly clients and/or clients experiencing domestic violence. Sometimes the client will be aware that they are entering into a financial product, as a co-borrower or a guarantor, for the benefit of a loved one, often an adult child. But, they will be unaware of the information provided to the licensee by the adult child and/or a broker. In many cases, this information has been falsified, leading to the outcome that our client appears, on the face of the documents, to be liable for an unsuitable loan. In other cases, the perpetrator of family violence may use the victim's identification documents and name to enter into loans, typically credit cards and personal loans online.

As Corinne's case study below shows, the effect of fraud can have a devastating impact on a person's life.

Case study: Corinne's ex-husband fraudulently applied for credit

Corinne is a single mother of two dependent children. She speaks English as a second language, and she relies on Centrelink payments as her source of income. After many years living with an abusive husband, Corinne left her marriage. Her ex-husband told her: "You will never be rid of me. I have signed you up to many loans, and you will always have debt."

When Corinne came to Legal Aid NSW for help, she was being contacted by debt collectors for five personal loans and credit cards that her former husband had fraudulently signed her up to. Corinne did not receive any money from these loans.

When Corinne requested her credit report, she was shocked to see 15 credit enquiries listed. The enquiries were applications that her ex-husband had made unsuccessfully in her name. While these applications did not progress, the number of enquiries affected Corinne's credit score, and she is finding it very difficult to obtain credit and utility services. The list of enquiries also act as a painful reminder of her violent relationship, and the control that her ex-husband still has over her by fraudulently using her name to apply for credit.

It is very labour-intensive to remove the enquiries as the advice from the credit reporting company is that Corinne must write to each trader listed, explain the circumstances, and request that they instruct the credit reporting company to remove the listing.

It is important that licensees receive guidance about how to improve their verification processes to protect against fraudulent transactions. We welcome ASIC's suggestions about how this might be achieved. ASIC proposes identifying particular circumstances which should raise doubts about the information provided. We recommend that these circumstances include where there are indicators of family and domestic violence. The guidance provided by the Australian Bankers' Association³ and the Australian Financial Complaints Authority⁴ about family violence and loans could be useful when considering what guidance to include in RG 209.

We also recommend that ASIC should provide specific guidance about how fraud risks could be reduced for online application systems. For example, ASIC could provide guidance about a licensee's verification obligations in respect of information provided via online application systems. This could include the licensee taking reasonable steps to satisfy itself that the borrower is in fact the loan applicant.

³ Australian Bankers' Association, 'Financial abuse and family and domestic violence policies' (Industry guideline, November 2016).

⁴ Australian Financial Complaints Authority, 'The AFCA Approach to joint facilities and family violence'.

Any costs to business in implementing additional guidance from ASIC would be offset by savings in minimising fraud.

Recommendation 11 Specific guidance about loan fraud, particularly for the use of online application systems, and the impact on responsible lending obligations is necessary

Proposal D3: Repayment history information

- 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?

Legal Aid NSW welcomes ASIC's proposed guidance to discourage licensees from treating hardship indicators and other negative repayment history information as a trigger for automatic refusal. This information should instead trigger additional inquiries to enable the licensee to understand the circumstances of hardship or repayment difficulties and how this information might inform a licensee's suitability assessment.

Guidance about how to use negative repayment history may encourage responsible financial inclusion, with consumers having access to safe, suitable and fair credit, rather than an automatic refusal if they have been in hardship in the past. This guidance will also allow victims of fraud, such as those who have been left with domestic violence related debt, to apply for and obtain credit. We do not think that any additional business cost of implementing this guidance should be passed along to the consumer.

It is important that licensees comply with their responsible lending obligations when reviewing the negative repayment history information to prevent situations where this information is discounted and the licensee enters into an unsuitable loan with the consumer.

Recommendation 12 Licensees should conduct additional inquiries about a consumer's financial position where there is a negative repayment history

Proposal D4: Maintaining records of inquiries and verifications

- 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?

Legal Aid NSW supports ASIC's proposed guidance on acceptable industry practice for recording the inquiries and verification steps taken by licensees, and the particular recording practices that ASIC has identified as acceptable practice. This approach will act as a further measure to ensure that licensees properly consider verification documents and make relevant inquiries, in line with their responsible lending obligations. Licensees following acceptable practice recording practices will mean that in the case of a future dispute, credit providers, consumers and decision makers will have a clear picture of the inquiries and verification steps that were undertaken.

There is an obvious benefit to a business in properly documenting its processes to evidence compliance with its responsible lending obligations. The cost savings in doing so would offset any cost of implementation.

Recommendation 13 RG 209 should provide guidance about acceptable industry practice for recording inquiries and verification steps.

Proposal D5: 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?

Yes, an example of a written assessment would be useful in several ways.

Firstly, having an example of 'best practice' as to what is expected to be included in a written assessment may mean that licensees are more likely to fulfil their obligations under the credit law at the time that the credit contract is entered into. This in turn would result in fewer loans being provided that do not comply with the credit law. Further, it is likely that a best practice example will make compliance with the credit law easier for licensees.

Secondly, more comprehensive and accurate written assessments based on 'best practice' examples will be useful in the event of a future dispute about whether credit should have been advanced in a particular case.

More accurate written assessments are likely to lead to quicker and more efficient resolution of disputes when they arise, because consumers, representatives, lenders and decision makers will be able to point to a clear and unambiguous record of how a lender determined that the loan was 'not unsuitable'.

In Legal Aid NSW's casework experience, the level of detail included in written assessments provided to us by lenders in the event of a dispute is often poor.

Written assessments that we see are often characterised by inaccurate or incomplete information about a borrower's income and expenditure, particularly with respect to other loans that a borrower has entered into. A borrower's expenditure is frequently underestimated.

Rarely do we see examples of written assessments that include such things as foreseeable changes to financial position, or assumptions dependent on consumer behaviour. Bank statements are often included, purportedly to verify details of a consumer's expenditure. However, in practice it is often unclear the extent to which actual verification of the consumer's financial situation has occurred, if at all, as shown in Ho's case study below.

Case study: inadequate written assessment of Ho's financial position

Ho receives the disability support pension and lives in regional NSW. He signed up for a credit card with a bank and was later given a \$10,000 personal loan by the same bank. He already had a credit card with another bank that he was struggling to keep up with.

When he found himself unable to make the repayments, he sought assistance from Legal Aid NSW.

After reviewing the written assessments provided by the bank, we found that Ho's monthly expenditure was recorded as only \$300.00. There was no mention of his other loan repayments in his expenditure.

While the bank had records of his statements, no regard was given to the fact that Ho frequently ran his account to \$0 just prior to receiving his fortnightly DSP payment.

Recommendation 14 ASIC should provide an example of a written assessment to illustrate the level of information that it thinks should be included by lenders. The example written assessment should be described in ASIC guidance as 'best practice'.

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

Assessments based on the example written assessment in Appendix 2 would likely result in a meaningful and unambiguous analysis of whether a loan is ‘not unsuitable’ for a particular consumer.

Licensees following the example provided would go a long way to ensuring that lenders conduct a responsible lending assessment in line with its obligations under the credit law. Widespread use of this example would also mean that in the case of a dispute – whether that be at the Internal Dispute Resolution level, at the Australian Financial Complaints Authority, or at Court – it would be clear to the consumer, lender and any decision-maker the extent to which a meaningful credit assessment was conducted, and whether that assessment was in compliance with the credit law.

To further ensure accuracy in lenders’ written assessments, the example should include a specific field for existing credit, and details of whether the consumer is behind in repayments.

We strongly support guidance that includes the detailing of foreseeable changes to a consumer’s financial position, and a meaningful assessment of a consumer’s requirements and objectives. In Legal Aid NSW’s casework experience, the question of whether a loan meets a consumer’s requirements and objectives is often overlooked, or treated as unimportant.

The example at Appendix A includes a field for ‘information provided by the consumer that has *not* been relied upon’. It would also be valuable to include a field that details information and documents provided by the consumer and acquired through the licensees verification process that *was* relied upon in making the credit assessment.

Recommendation 15 The example written assessment should include fields for existing credit obligations and whether a consumer is behind in repayments under those credit obligations, as well as a field for details of information and documents that a licensee has relied on in making its assessment

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)?

This approach will likely lead to greater consumer certainty about loans entered into, including a clear understanding of why a loan was deemed 'not unsuitable'. As discussed in our answer to D5Q1 above, this approach will mean that in the event of a dispute, the borrower, lender and any decision maker will have a clear and unambiguous picture of the assessment that was undertaken at the time the loan was entered into.

This approach may lead to more consumers being denied credit if a comprehensive assessment leads to a determination that a loan is unsuitable in the circumstances, but that result is a consequence of compliance with responsible lending obligations and not the process itself.