Maurice Blackburn Lawyers
Since 1919

Maurice Blackburn Pty Limited
ABN 21 105 657 949

Level 21
380 Latrobe Street
Melbourne VIC 3000

DX 466 Melbourne
T (03) 9605 2700
F (03) 9258 9600

27 May 2019

Fleur Grey
Senior Specialist Credit,
Retail Banking and Payments Financial Services
Australian Securities and Investments Commission

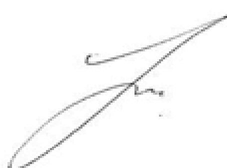
By email: responsible.lending@asic.gov.au

Dear Ms Grey,

We welcome the opportunity to provide feedback in relation to ASIC Consultation Paper 309, Update to RG 209: Credit licensing: Responsible lending conduct.

Please do not hesitate to contact me and my colleagues on 07 3014 5051 or at JMennen@mauriceblackburn.com.au if we can further assist with ASIC's important work.

Yours faithfully,



Josh Mennen
Principal Lawyer
MAURICE BLACKBURN

Submission in response to ASIC Consultation Paper 309, Update to RG 209: Credit licensing: Responsible Lending Conduct

May 2019

TABLE OF CONTENTS

Page

INTRODUCTION... 2
OUR SUBMISSION... 2
RESPONSES TO SECTION D. ISSUES WHICH ARE NOT CURRENTLY ADDRESSED IN DETAIL IN RG 209.. 5
Responses to specific proposals in CP 309 5
Other issues for consideration... 7

Introduction

Maurice Blackburn Pty Ltd is a plaintiff law firm with 32 permanent offices and 31 visiting offices throughout all mainland States and Territories. The firm specialises in personal injuries, medical negligence, employment and industrial law, dust diseases, superannuation (particularly total and permanent disability claims), negligent financial and other advice, and consumer and commercial class actions.

Maurice Blackburn employs over 1000 staff, including approximately 330 lawyers who provide advice and assistance to thousands of clients each year. The advice services are often provided free of charge as it is firm policy in many areas to give the first consultation for free. The firm also has a substantial social justice practice.

Our Submission

Disconnect between current prudential regulation and consumer protection processes

As we continue to digest the findings and outputs of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission), consumer advocates are looking for a more rigorous approach to regulation.

Agencies such as ours deal on a daily basis with the financial and psychological and interpersonal impacts of poor behaviour on the part of lenders.

The causes of problems relating to credit over-commitment facing consumers are multidimensional, and therefore require a multidimensional solution. That must include addressing, among other things, the culture of self-interest and skewed financial incentives that tempt bankers/brokers to get large loans approved even where they are unaffordable.

Under the current culture, great harm has been done to a large number of Australians – and this has been made evident by a number of high profile investigations (including the Royal Commission) and associated media coverage.

Maurice Blackburn believes that there is a disconnect between current prudential regulation processes, and consumer protection processes. We believe that there is now abundant evidence to suggest that consumer protections against unfair lending practices are lacking.

There are numerous indications that the trust placed on financial service providers is misplaced. For example:

- A survey of more than 900 home loans conducted by investment bank UBS[1] found that around $500 billion worth of outstanding home loans are based on incorrect statements about incomes, assets, existing debts and/or expenses.

  This means 18% of all outstanding Australian credit is based on inaccurate data, often caused by poor advice or misrepresentations by a mortgage broker eager to generate a sale commission. A staggering 30% of loans surveyed had been issued based on understated living costs and around 15% on understated other debts or overstated income.

- The same study found that loan amounts are likely to be greater where a credit assistance provider is involved.

[1] *Australian Banking Sector Update. UBS Evidence Lab - $500 billion in 'Liar Loans'? (September 2017).*

- ASIC's 2015 investigation into interest-only loans, which resulted in Report 445[2] noted that:

  We were disappointed to observe that the practices of many lenders appeared to fall short of our expectations, which are detailed in RG 209 and previous responsible lending reports.(para 30, p.10)

  The formal findings of the investigation went on to document the industry's failure in:
  - keeping sufficient evidence of inquiries into consumer's requirements and objectives,
  - ensuring that the consumer had sufficient income,
  - demonstrating that they had made sufficient inquiries into a consumer's expenses and relied heavily on expense benchmarks to estimate living expenses, and
  - calculating affordability, through using repayments that are artificially low.[3]

- The final report of the Royal Commission noted the following:[4]

  Industry codes of practice occupy an unusual place in the prescription of generally applicable norms of behaviour. They are offered as a form of 'self-regulation' by which industry participants 'set standards on how to comply with, and exceed, various aspects of the law'. They are offered, therefore, as setting generally applicable and enforceable norms of conduct. Industry codes pose some challenge to the understanding that the fixing of generally applicable and enforceable norms of conduct is a public function to be exercised, directly or indirectly, by the legislature.

  The Royal Commission went on the formally recommend that industry codes should include 'enforceable code provisions' with associated civil penalties through which ASIC could hold the industry accountable.[5]

These influential inquires have painted a clear picture that industry players have been unable, under their own administration, to balance their profit motivation with their duties to act in the best interests of their customers.

Current litigation

Maurice Blackburn notes ASIC's proceedings against Westpac Banking Corporation (Federal Court of Australia proceedings NSD293/2017), alleging that Westpac contravened responsible lending provisions in assessing home loans for customers in the period between 12 December 2011 and March 2015. It is our understanding that these proceedings were heard before Perram J between 6 and 14 May 2019, and that judgment was reserved[6].

We understanding that ASIC's allegations included:
- That Westpac broke responsible lending laws 261,987 times between 2011 and 2015;
- That Westpac should have used customers' self-reported expenses when assessing their ability to repay the loan; and

[2] https://download.asic.gov.au/media/3329474/rep445-published-20-august-2015.pdf
[3] Ref Table 1, p.12
[4] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, p.105
[5] Ref Recommendations 1.15 ad 4.9.
[6] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-255mr-westpac-admits-to-breaching-responsible-lending-obligations-when-providing-home-loans-and-a-35-million-civil-penalty/

- Westpac should not have solely relied on the household expenditure measure (HEM) benchmark, because it is a conservative measure of family expenses[7].

Maurice Blackburn is currently representing consumers who entered into unsuitable loans secured by residential property with Westpac, in a class action alleging that Westpac failed to comply with responsible lending obligations in respect of loans issued on or after 1 January 2011 and that Westpac entered into the loans when those loans were unsuitable for the borrower.[8]

Maurice Blackburn's ability to provide a full and considered commentary in respect of CP 309 and RG 209 is curtailed by the issues currently under judicial consideration.

In those circumstances, we have limited our response to a number of general comments. We welcome future opportunities to fully participate in a consultation relating to RG 209 when these issues are resolved by the Courts.

[7] https://www.afr.com/business/banking-and-finance/inside-the-westpac-case-that-could-alter-banking-20190510-p51lz4

[8] Tate & Anor v Westpac Banking Corporation Federal Court of Australia proceedings VID145/2019

Responses to Section D. Issues which are not currently addressed in detail in RG 209

Responses to specific proposals in CP 309

D2Q1 & D2Q2

We propose to include new guidance on the role of the responsible lending obligations, and in particular the obligation to take reasonable steps to verify information provided about the consumer's financial situation, in mitigating risks involved in loan fraud; and risk factors that might indicate that additional verification steps should be taken.

Maurice Blackburn agrees with the proposition that more guidance should be provided to lenders in relation to their responsibilities in relation to loan fraud and other undesirable lending practices.

Maurice Blackburn notes two particular areas for concern:

i. Broker involvement in load fraud

Maurice Blackburn would support action by ASIC, in its review of RG209, that strengthens licensees' accountability for accepting false information supplied by a broker.

The UBS study mentioned earlier reports some troubling findings in relation to the involvement of brokers.

Firstly, it found that the rate of "completely factually accurate" mortgages written by brokers was at about 61%. They wrote:

> *We found a statistically significantly higher level of factual inaccuracy via the broker channel than via the bank's proprietary networks however, the level of factually inaccuracy has risen across both channels.*[9]

Secondly, their findings suggest that brokers have regularly participated in unlawful or otherwise inappropriate lending practices in order to ensure loan approvals. They wrote:

> *While the significant level of mortgage misrepresentation is a concern, we are more concerned that a substantial number of applicants continue to state that their mortgage consultant suggested they misrepresent their documentation.*[10]

We agree with the sentiment expressed in paragraph 75 of CP309 that it would be useful to include "*more specific guidance on processes that licensees should have in place to identify false or unreliable information provided by a third party*"[11], but note that the guidance should indicate it is not a comprehensive checklist, including in respect of circumstances which are likely to raise doubts about the reliability of information.

ii. Introducers

---

[9] *Australian Banking Sector Update. UBS Evidence Lab - $500 billion in 'Liar Loans'? (September 2017), p.5*
[10] Ibid, p.6
[11] P.27

The final report of the Royal Commission makes special mention of 'Introducers'. The report notes the following:[12]

> *Under the law, introducers must comply with certain requirements, including that they do no more than refer the potential borrower to the lender and facilitate the borrower making contact with the lender.*
>
> *Introducers have an obligation to disclose to a potential borrower any benefits, including commissions, that the introducer may receive for the referral.*
>
> *The effect of the current regime is that introducers are not permitted to be involved in the credit application or assessment process.*
>
> *Introducers must only act within the confines of their prescribed role. Entities must have systems in place to ensure that introducers do not exceed this role. And entities should not regard the role of the introducer as modifying their own responsible lending obligations. If introducers and entities behave in this way, introducer programs are not incompatible with responsible lending obligations.*

Maurice Blackburn encourages ASIC to ensure that a revised version of RG209 reflects the Royal Commissions findings above.

D4Q1

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

Maurice Blackburn agrees with the proposed additions to guidance on record keeping, as described in paragraph 85 of CP309.[13]

We do, however, suggest that ASIC consider advising lenders to retain records of inquiries and verification steps for fourteen years, not seven.

In our experience, losses associated with a financial product may not crystallise within seven years. The destruction of records immediately after seven years may make it difficult to substantiate claims that proper inquiry and verification had taken place.

D5Q1 & D5Q2

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

As per our response to D4Q1 above, we believe that ASIC should be providing guidance that records should be kept for a period of fourteen years.

Paragraph 88 of CP309 suggests that records of the written assessment should be retained for seven years, in case the consumer requires a copy.

[12] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, p.83. Their emphasis.
[13] P.30

As mentioned above, in our experience, losses associated with a financial product may not crystallise within seven years. The destruction of records, including written assessments, immediately after seven years may make it difficult to substantiate claims that decision making processes had been followed.

Maurice Blackburn agrees that it would be useful for ASIC to provide an example of a written assessment to illustrate the level of information that they think should be included. We believe that the example provided as Appendix 2 to CP309 is a good template. We suggest adding details of the investment and the value assessment.

Other issues for consideration

Open banking

Maurice Blackburn recognises that we are at the precipice of an era where ready access to data will be the difference between the success or failure of certain industries, innovations and practices.

There is an inevitability to the introduction of systems and processes which free up the flow of data. It is appropriate, then, in perceiving that inevitability as a positive, that our focus turns to ensuring that sufficient checks and balances are in place.

We note specifically the potential benefits of the open banking regime in assisting banks to make better assessing whether applicants are well placed to be able to service loans, being a legislatively mandated process of inquiry and verification[14].

The problems of appropriate inquiry and verification will not be cured by the mere availability of enhanced data systems. For example, if the lender's system allows for 'low doc' loans, or the loan officer may be less likely to receive a bonus or commission if a loan is rejected, then the loan officer may not utilise the available open banking data that may show the applicant's unreliable income or existing debts.

Notwithstanding that codicil, the availability of timely, thorough and accurate data would be beneficial to both the lender and the consumer if used consistently and responsibly.

The benefits of access to data therefore need to be balanced with adequate consumer protections, which ensure:

- That consumers' right to privacy is protected against unauthorised access to their data,
- That consumers have the capacity to choose what data is released and to whom, and
- That regulatory processes are appropriately resourced to do their job.

A number of safeguards will need to be imposed:

- A need for consistency across industry, by ensuring that all licensees conduct certain checks and verification steps,
- Consumers must have control over what data is available, and who gets to see it,
- Strong penalties would have to be enforced for breaches of the consumers' will, and
- Education processes must be adequate such that consumers understand the ramifications of being part of the regime,

[14] *National Consumer Credit Protection Act* 2009 (No. 134, 2009) – s.130

Maurice Blackburn is concerned that the instigation of the above safeguards requires a degree of awareness, literacy and understanding of the system. This is a reasonable assumption under an opt-in regime – as the financial service recipient has made an informed decision about their participation. Under an opt-out system, a disengaged consumer could inadvertently fail to set up appropriate safeguards, and not know until after information has been shared.

Maurice Blackburn believes that one of the central pillars of a successful Open Banking regime would be the need for informed and deliberate consent.

If the system has default settings which place the consumer's consent at the centre of decision making, many concerns related to inappropriate access will be negated.

In short, Open Banking should make the processes of inquiry and verification easier and more efficient, but it is not a panacea for inadequate checks and balances.

Data Aggregation Services

Maurice Blackburn has similar concerns about Data Aggregation Services, as are spelled out in paragraphs 22 & 23 of CP309, including:

- That the consumer may have concerns about disclosure of their personal identifiers or other information to the data aggregation service, and
- The effect of such disclosure on the consumer's rights in relation to unauthorised transactions.

Once again, Maurice Blackburn believes that the need for **informed and deliberate consent** should be central to any advice offered about the use of data aggregation services.

Additionally, the Royal Commission expressed significant concerns in relation to the commission structures that remunerate data aggregators[15], and the potential for vested interests to dominate decision making. We share those concerns.

Specific guidance in relation to consumers with particular vulnerability

Maurice Blackburn notes that current guidance is lacking in terms of the provision of specific guidance in relation to cases of special vulnerability and disadvantage.

We encourage ASIC to consider the development of specific guidance in relation to consumers who have a particular vulnerability, or there is an inequality of bargaining power as between the consumer and the licensee, which affects the consumer's ability to make a judgment as to their own best interests. Examples of such vulnerabilities include:

- Consumers from non-English speaking / cultural and linguistically diverse backgrounds
- Inexperience with financial matters
- Illiteracy or lack of education
- Poverty or need of any kind of the consumer
- The consumer's age
- Consumers with mental health issues, or other physical illness
- Age or emotional dependency
- Other groups that may experience disadvantage in the current systems.

[15] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf, p.83

These important principles are perhaps most notably enshrined in the High Court decision of *Commercial Bank of Australia v Amadio*[16] which found an elderly couple who acted as guarantor for their son's mortgage were at a special disadvantage which seriously affected their ability to make a judgement as to their own best interests.

We also note the case of *Elkofairi v Permanent Trustee Co Ltd*[17] where the court, in considering the terms of the contract and the circumstances in which the contact was made, took into account Mrs Elkofairi's lack of education, poor health and difficult domestic situation, even though the lender had no knowledge of these circumstances, suggesting a failure on the part of the lender to make appropriate enquiries.

The Royal Commission shone a spotlight on the need to ensure that financial service providers have appropriate culture, systems and processes in place to:

- Recognise and respond to the needs of these cohorts, and
- Protect against the exploitation of vulnerable people.

Maurice Blackburn have acted for individuals with special disadvantages such as psychological illness and limited English language skills. We have been surprised and disappointed at the lack of rigour in lending practices around identifying and addressing such vulnerabilities. In one case, a man with a long history of schizophrenia was given a $10,000 to start a business in circumstances where he had been unemployed for years due to total and permanent disability and was a former bankrupt. He went on to quickly squander the funds.

Specific guidance relating to inquiry and verification processes for guarantors

We note that CP309 is silent on additional expectations ASIC might have in relation to enhanced inquiry and verification processes required for loans involving a guarantor. We believe this may warrant extra consideration taking into account the learnings from the *Amadio* case referenced above.

Specific guidance relating to refinancing arrangements

Similarly, we note that there is very little mention in CP309 of refinancing arrangements. We recognise that current advice to lenders, and case studies/examples of expected behaviours in relation to refinancing is strong in RG209 – but we wonder whether the themes of change outlined in CP309 should extend more to refinancing arrangements.

Rent-to-buy Schemes

Maurice Blackburn is aware of an apparently increasing incidence of media coverage of consumers falling victim to rent-to-buy schemes.[18] Previous ASIC investigations, and a recent Federal Senate Economics References Committee have highlighted the danger for consumers in such arrangements.[19]

---

[16] (1983) 151 CLR 447; [1983] HCA 14
[17] (2003) 11 BPR 20,841
[18] See for example https://www.abc.net.au/news/2018-01-23/radio-rentals-to-refund-20m-to-customers/9352740
[19] See e.g. ASIC REP 447, ASIC prosecutions of The Rental Guys, Rent to Own, and Thorn Australia, and Senate Report: Credit and financial services targeted at Australians at risk of financial hardship dated 22 February 2019, corrigendum dated, available:
https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Creditfinancialservices/Report

These unconscionable lending practices demonstrate the need for lenders and brokers to play a more active role in considering the drivers behind the loan application. That should include an onus to confirm whether the consumer is acting on formal advice or otherwise being influenced by a third party in applying for the loan, and if so to make inquiries about that with a view to identify any 'red flags'. This should include confirming the source of the any deposit. In that regard, we have seen examples of vulnerable consumers who have entered unfair contracts with vendors to obtain the deposit to secure a home loan, which has been completely unnoticed by the lender. Then after they are unable to meet the vendor loan and or the mortgage they lose their home and face bankruptcy.

Maurice Blackburn supports the principles outlined in paragraph 67 of CP309[20]. We believe that there are two additional areas that could be incorporated into the proposed clarifications:

i. Reference the value of the asset. Perhaps an additional point could be added to paragraph 67, worded along the lines of: "*make an assessment of the value of the asset, and make comment on its suitability to the financial product and to achieving the consumer's objectives and requirements*".

ii. Reference the viability of the investment. This would require the lender to focus on how well the investment satisfies the objectives and requirements of the consumer, as well as the lending product they are seeking in order to achieve the investment, having regard to the issues discussed throughout this submission concerning vulnerable consumers.

We believe that in situations such as short-term loans, refinancing, investment loans and rent-to-buy products, the above considerations could help the lender and consumer reconsider the risks associated with the product.

Case Study*

Abeba is a 26 year old mother of three young children. She is an East African woman who came to Australia from a refugee camp approximately 10 years ago.

In 2014 when she was 21, she was renting a house in Melbourne and was a single mother to her 6-month old child. She worked in a family day care earning around $600 a fortnight, which was supplemented with Centrelink.

Abeba decided to move closer to her mother in the western suburbs of Melbourne to obtain assistance raising her children while she was working. She began searching for properties online to rent. This is where she came across an advertisement which said 'rent-to-own'.

"The website said something like 'Rent to buy your own home, pay less deposit on your own home - Centrelink payments are no problem, bankruptcy, no problem.' I didn't really know what that means. I thought it just means it was normal rent. I thought maybe 'rent-to-own' was the real estate agent's name. The first time I paid rent was when I came to Australia and I didn't know much about it. I didn't think that 'rent-to-own' meant I would be buying a house."

Abeba called the number on the website and had several conversations with the owner of the company. She chose a four bedroom house that was being advertised for $550 a fortnight. Throughout all these interactions, Abeba told the representative about her

[20] Page 24

income and that she was on Centrelink. Abeba agreed to move into the property and paid her first month's rent.

Abeda eventually entered into an "agreement" via a broker for a rent-to-buy loan with high interest rates. She received no legal or conveyancing advice. The purchase price of the property appeared inflated for a four bedroom house in the western suburbs. There were also questions about whether any agreement was validly written up or signed. She never met the vendor and was told by the broker that she had the authority to sell the property on the vendor's behalf. Over the next few months she was repeatedly contacted and approached for additional repayments to service the loan. A caveat was placed on her property by a company owned by the broker.

About 2 years later Abebe was taken by an associate of the broker to meet a banker at one of the big four banks. At this stage she was no longer working as a child care worker, was a single mother and her only source of income was Centrelink. Documents made clear that there had been a gross, potentially fraudulent, misrepresentation of her financial capacity. The major bank refinanced her loan, without proper review of her financial situation. Abebe promptly defaulted on the loan due to an inability to meet repayments. Pro bono legal intervention was needed to ensure that her loan with the big bank was reduced to an affordable amount. Abebe was unable to sell or vacate her property whilst the caveat remained on the house.

It took approximately 18 months of pro bono legal intervention to resolve the issues affecting Abebe with the big bank and broker. Given Abebe's economic hardship and the complexity of the rent-to-buy schemes, it would have been impossible for her to negotiate or resolve this issue with the bank on her own.

*N.B. Please note that some dates and personal details have been change to protect client confidentiality