

Our Ref: APB
Your Ref:



20 May 2019

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

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

Dear Ms Grey

Consultation Paper 309 - update to RG 209 Credit licensing: Responsible lending conduct

1. Piper Alderman Background

- 1.1 Piper Alderman is a long established national law firm with offices in Sydney, Melbourne, Brisbane and Adelaide.
- 1.2 Piper Alderman's specialist banking and financial services team assists our clients to navigate the complex financial landscape by providing specialist legal advice which takes into account the business imperatives of financiers.
- 1.3 We advise large, mid-tier and boutique domestic and overseas banks, financial institutions and other financiers as well as Australian and foreign government instrumentalities. We act for borrowers of all sizes and offer banking and financial advice to private clients including entrepreneurs, investors and family groups.
- 1.4 Our banking and finance team is headed by five partners across Sydney and Adelaide:
 - (a) Andrea Beatty, a financial services and regulatory lawyer with over 20 years experience in the industry;
 - (b) Shannon Adams, who has been providing specialist legal advice and services to the financial services sector for over 35 years;
 - (c) Joshua Annese, a specialist banking and financial services Partner;
 - (d) Mark Gordon, a specialist banking and finance lawyer with over 30 years' experience; and
 - (e) Martin Lovell, a partner in the corporate and financial services team.

Lawyers

**Sydney • Melbourne
Brisbane • Adelaide**

ABN 42 843 327 183

Level 23
Governor Macquarie Tower
1 Farrer Place
Sydney NSW 2000
Australia

DX 10216 Sydney Stock Exchange

t +61 2 9253 9999
f +61 2 9253 9900

www.piperalderman.com.au

Partner:

Andrea Beatty
t +61 2 9253 3818
abeatty@piperalderman.com.au

2. Introduction and summary

2.1 Credit licensees must comply with the responsible lending conduct obligations enshrined in Chapter 3 of the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP Act**). This means that credit licensees cannot enter into a credit contract with a consumer, suggest a credit contract to a consumer or assist a consumer to apply for a credit contract if it is unsuitable for the consumer. Responsible lending requires the credit licensee to fulfil the following steps:

- (a) make reasonable inquiries in regards to the consumer's financial situation, their requirements and objectives;
- (b) take reasonable steps to verify the consumer's financial situation; and
- (c) make a preliminary assessment or final assessment about whether the credit contract is 'not unsuitable' for the consumer.

2.2 Regulatory Guide 209 Credit licensing: Responsible Lending Conduct (**RG 209**) was issued in 2010 and contains ASIC's guidance on responsible lending for consumer credit. Since RG 209 was last revised in November 2014, a number of ASIC enforcement actions, judicial decisions and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Banking Royal Commission**) have increased the necessity for ASIC to update its guidance on responsible lending obligations. Updating these obligations is also vital towards ensuring that all relevant information is accessible from a central location.

2.3 Further to this, improvements in technology, the introduction of open banking and comprehensive credit reporting (**CCR**) have implications on responsible lending conduct. Open banking will provide consumers with more control over their financial data. When consumers apply for credit cards, their profile will be shared, enabling banks to make more informed, and responsible, lending decisions. Similarly, credit files with CCR will offer greater insights into a person's financial capability. This will reduce reliance on the limited insights offered by traditional, negative reporting that can expose applicants to potential financial risk if they disguise their accurate financial circumstances.

2.4 Below are responses to a number of the questioned raised by ASIC in CP 309. These responses are provided by Piper Alderman as a law firm that provides advice and other legal services to a range of credit providers in the industry.

3. **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?**

3.1 ASIC identifying specific inquiries and verification steps that constitute a minimum acceptable level of inquiries and verification would provide greater certainty for licensees. We believe this will be welcomed by the consumer credit industry.

3.2 Outlining the inquiries and verification steps necessary for responsible lending would be of great utility and value for licensees and would enable a high degree of transparency. The introduction of 'Safe Harbour' procedures for responsible lending inquiries and

verification would provide greater clarity and certainty for licensees to demonstrate they have adhered to the best interests of the consumer. 'Safe Harbour' provisions, which currently exist under the *Corporations Act 2001 (Cth)* (**Corporations Act**) outline minimum requirements to satisfy a legislative obligation. This would provide licensees with a level of discretion as to what further steps are necessary depending on the particular consumer, and implementing minimum standards would aid in extinguishing ambiguity.

- 3.3 However, detailing with specificity ASIC's view of what the minimum requirements are for making reasonable inquiries and taking reasonable steps to verify does risk undermining the principles-based nature of the responsible lending provisions in Chapter 3 of the NCCP Act. What is 'reasonable' will depend on the circumstances of the case, which includes factors specific to the consumer and to the kind of credit contract being contemplated. It requires the situation to be considered as a whole. Defining the obligations by a set of identified steps distracts from the need to consider the circumstances in which the credit is proposed to be arranged or given.
- 3.4 The proposal put forward by ASIC may be an improvement on the concept of 'scalability' in the current RG 209. The current RG 209 discusses the factors that may result in inquiries or steps to verify information being scaled up or down, without identifying the starting point from which such scaling is to occur. We have received feedback from the consumer credit industry that automated processes often struggle with the concept of scalability. The introduction of 'Safe Harbour' provisions would likely be beneficial to the increasing use of automated processes by lenders, as a minimum standard can be met which may then prompt further review.
- 3.5 Establishing a high level of minimum inquiries and verification steps to be made, with the option to 'scale down' where justifiable, is likely to provide a better balance between licensees' desire for regulatory certainty and the situation-specific nature of reasonableness than the current scalability concept.
- 3.6 Identifying the minimum steps applicable in all circumstances may risk reducing compliance with the 'reasonable inquiries' and 'reasonable steps to verify' obligations to a box-ticking exercise. Independent obligations in the NCCP Act are not ends in themselves, they are preliminary steps to the ultimate end of not entering into, or providing credit assistance in relation to, a credit contract or consumer lease that is unsuitable for the consumer. It may be helpful to provide guidance on how the information collected and verified should be connected with assessment of the unsuitability or otherwise of the credit contract or consumer lease. This could be in addition to, or in substitution for, specific required steps.
- 3.7 There are a multitude of credit providers in Australia, ranging from high-value home loans to small amount credit contracts and small consumer leases. This means that the nature of inquiries and verifications required for each type of consumer credit will vary in accordance with the risk and value of the loan. As a consequence, we believe it is important that guidelines are provided for different types of debtors. We propose that ASIC should specify the level of inquiry and verification that would enable licensees to fulfil their responsible lending requirements, which is discussed further in B1Q3 below.

4. 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.

4.1 Strata corporations are a sophisticated type of credit consumer whereby it would be reasonable to undertake fewer inquiries and verification steps. This can be attributed to the fact that often newer strata corporations do not have a strong transactional history despite a strong credit backing, and that the strata corporation's financial statements may not be an accurate reflection of the strata members' actual financial position.

4.2 Similarly, we believe that fewer inquiries and verification steps would be suitable for small amount consumer lease contracts. Consumer leases with low weekly repayments (for example, under \$50) are low-value products for lease providers and carrying out credit checks on these consumers places a financial burden on lease providers. To prevent these lease providers transitioning into the unregulated buy-now-pay-later industry, adhering to minimal requirements for these types of customers would foster efficiency for lease providers.

4.3 Fewer inquiries about a consumer's discretionary expenses for home loans to owner-occupiers can be justified on the basis that, as a basic need, housing costs can be expected to take priority over discretionary expenses, so that the consumer can eliminate discretionary expenses if they lack the free cash flow after making payments on their home loan.

4.4 Fewer inquiries and verification steps would be acceptable for customers who have been recently or consistently involved with the credit provider. The need to conduct similar or repeated verifications on a customer may unnecessarily increase operational costs for credit providers.

4.5 In addition to the above suggestions, we believe that ASIC should consider introducing a sophisticated borrower for the purposes of inquiries and verifications. In determining which consumers would be categorised as a sophisticated borrower, a similar approach to wholesale and retail clients under the Australian financial services licence regime in the Corporations Act could be appropriate, by considering both financial status and credit experience with similar credit products.

5. 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.

5.1 We believe that income, liabilities and non-discretionary living expenses, being expenses covering basic needs such as food, housing, clothing, transport and education, would need to be inquired about in all circumstances.

5.2 For some types of credit, such as housing and vehicle loans, we do not believe it is necessary to consider or inquire into many discretionary expenses as it is reasonable to expect the consumer to prioritise repayment of these debts over other discretionary expenses.

5.3 Credit providers should ensure they inquire into whether there are any personal circumstances that require unique payments to be made, and whether the consumer's personal circumstances may change in the future.

5.4 In circumstances where it is generally assumed that a consumer will reduce their living expenses when entering into a credit contract, we are of the opinion that there should be a conversation and/or written documentation with the consumer concerning whether they are willing to make changes to their discretionary spending (as opposed to non-discretionary expenses). Although discretionary expenses may well reduce when consumers enter into credit contracts, these spending patterns may not be reflective of future spending and it should not be assumed that the consumer will reduce their level of spending significantly or at all.

6. 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?

6.1 If ASIC identifies particular inquiries and verification steps that lead to an industry-accepted 'Safe Harbour', consumers intending to obtain credit will be able to adjust their expenditure in the months preceding a credit application in an effort to maximise the likelihood of success. This however, may impact certain borrowers such as the self-employed who may currently experience difficulty in accessing loans with high documentation requirements.

6.2 Any measure that increases the amount of information that must be collected and verified will increase the cost of providing credit to consumers, and therefore likely increase the cost of credit to the consumer, as well as the timeliness of securing credit.

7. 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?

7.1 We believe the following types of information should be considered appropriate and readily available forms of verification:

- (a) comprehensive credit reporting information from credit reporting bodies;
- (b) account data once the consumer data right is implemented;
- (c) payslips; and
- (d) tax returns/notices of assessment.

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

8.1 We believe the examples in Appendix 1 are appropriate as a minimum starting point. However, if a consumer's circumstances are unique, various types of information will be necessary. For example, in the case of a spouse or partner that is not employed, the financial statements of their working partner would be relevant to the inquiry process.

To: Australian Securities and Investments Commission
Date: 20 May 2019
Our Ref: APB
Page: 6



8.2 Further, the examples in Appendix 1 allow licensees to develop a relatively detailed picture of a consumer's lifestyle and can be quite invasive. They may therefore raise privacy concerns among some people. With the introduction of open banking, concerns may arise that certain expenditures on a consumer's account statements should not be made available due to potential bias (for example, charges at an oncology centre or an IVF clinic).

9. 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?

9.1 We believe that greater specificity would be helpful from the perspective of managing compliance risk. However, guidance about the level of certainty to which information must be verified, and the amount of information that must be verified, would also be helpful. For example, some expenses are immaterial or discretionary and so can be immaterial to whether or not new credit is unsuitable for the consumer. In that case, there would be no need to verify these expenses.

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

10.1 Whilst the proposed clarification regarding benchmarks is useful, further information would bolster its effectiveness. Importantly, it is unclear about whether the reliance on a benchmark is a breach of the NCCP Act if the consumer's declared living expenses are higher than the benchmark, or if reliance on benchmarks at all is a breach of the NCCP Act.

10.2 It is hoped that further guidance on this issue will be provided in the upcoming Federal Court decision of *Australian Securities & Investments Commission v Westpac Banking Corporation* [2018] FCA 1733. We believe that the outcome of this case should be used as guidance in the updated RG 209. In particular, we note ASIC's contention that relying solely on a benchmark figure is a breach of the NCCP Act may contradict the comment of Clarke SC quoted in *The Australian* that the HEM benchmark could be employed when expenses appeared grossly understated by a potential borrower.¹

10.3 We believe that benchmarks are effective in providing an indication of a consumer's expected living expenses. However, we agree with ASIC's proposition that a debtor's individual circumstances must be factored in when a credit provider utilises a benchmark. A benchmark can help to validate expense disclosures, rather than verify them.

10.4 We are of the opinion that the introduction of Open Banking and CCR will likely mean the use of benchmarks will no longer be a critical component of the responsible lending process, due to the increase in information available to creditors. When this occurs, we believe it is important to emphasise to credit providers that a consumer's actual expenses should be considered as opposed to relying on benchmarks.

¹ Joyce Moullakis, 'Westpac 'ignored' credit checks on loans, ASIC tells court', *The Australian* (13 May 2019).

To: Australian Securities and Investments Commission
Date: 20 May 2019
Our Ref: APB
Page: 7



Yours faithfully
Piper Alderman

Per: 

Andrea Beatty
Partner