SUBMISSION TO CP309 UPDATE TO REGULATORY GUIDE 209: CREDIT LICENSING: RESPONSIBLE LENDING CONDUCT

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I. INTRODUCTION

The lasting effects of the Global Financial Crisis (GFC) subsist to this day and governments globally have acted to implement regulatory laws to impose greater restrictions on the industry. However, the economy and confidence in financial institutions remain cautious of what the future holds. For one, the National Consumer Credit Protection Act 2009 (NCCPA) has shifted the responsibility of lending towards financial institutions to verify and assess a customer's ability to repay their loan and the suitability of the loan.[1] The Comprehensive Credit Reporting, mandatory as of 1 July 2018, encourages more data points be used in this assessment of a consumer's financial capabilities.

The role of financial institutions and access to credit are fundamental to the operation of the economy in both the commercial and domestic landscape. The sector has been met with scandals and distrust during and after the GFC and its practices in the Australian context have been heavily criticised by the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Banking Royal Commission). While Commissioner Hayne concluded that the NCCPA does not need to be amended, greater enforcement of institutional obligations must occur.[2] Being placed under scrutiny, financial institutions have responded by tightening access to credit and imposing stricter conditions on its customers. Clearer guidance by regulators that can encourage more responsible lending and a resilient economy is much welcome.

[1] *National Consumer Credit Protection Act 2009* (Cth) ss 128, 133.
[2] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (2019) vol 1, 20 [Recommendation 1.1].

ASIC's review of Regulatory Guide 209 (RG 209) is timely in light of the Banking Royal Commission and increased uptake of technology use in businesses over the recent years. This submission focuses on proposal C1: Verification of consumer's financial situation, in particular C1Q3 on data aggregation services.[3] Two interrelated issues should be considered in terms of data aggregation service usage. First to do with the importance of financial inclusion, and secondly the use of data to promote compliance with responsible lending. Against this backdrop, we set forth our comments below.

II. CONCERNS ABOUT DATA-DRIVEN APPROACHES IN UPDATING RG 209

The use of big data and analytics in businesses is becoming increasingly commonplace and it can be a cost effective solution to assessing a consumer's financial capabilities. This can allow a holistic examination of a consumer's financial circumstances with minimal error. Similarly, more modern approaches to availability of credit is emerging in Australia including fintech which often uses data-driven methods to assess creditworthiness. While this reduces costs and shortens the assessment process, there have been concerns of inherent biases introduced by computer programs which prevent access to certain consumers. Big data can assist a lender in better decision making. The ability to consider more personal factors can give a more reflective and holistic view of a consumer's financial circumstance instead of relying only on their credit score. Furthermore, it can also greatly assist those who do not yet have a credit score or have been endeavouring to improve it.[4] It can also contribute to a more robust financial institution as a whole by more accurately pricing riskier consumers while improving fairness by offering less risky borrowers cheaper loans.[5]

Concerns of bias can be tricky to address or pinpoint as it often involves a systemic fault in the construction of the algorithm and data, which can go unnoticed. The Fair Lending laws in the United States makes it illegal to discriminate based on certain characteristics such as age, gender, race, religion, nationality, and marital status.[6] While not in the context of lending, Australia has Federal and State anti-discrimination legislation which prevents discrimination on the provision of goods and services based on age, disability, race, and sex.[7] Even though discriminatory characteristics are excluded, other proximate characteristics which are not illegal may correlate with these protected characteristics resulting in inherent biases despite no explicit intention. For example, postcodes may be discriminatory where people from a certain nationality tend to reside. As a result, consumers may be treated as part of a larger group despite their other individual characteristics. Greater risk of hidden bias will also occur where variables in the data-driven approaches include those with a speculative nexus to creditworthiness like choice of email address or brand of car.[8]

Artificial intelligence (AI) utilising data with seemingly no correlation to creditworthiness and machine learning/deep learning can lead to strange outputs that even its designer does not explain. It is problematic when a lender cannot explain why certain loans are made and this may further impact disadvantaged groups.[9] There is a delicate balance between allowing consumers

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[3] Australian Securities & Investments Commission, *Update to RG 209: Credit licensing: Responsible lending conduct* (February 2019) <https://download.asic.gov.au/media/5008524/cp309-published-14-february-2019.pdf> 11.
[4] Matthew A. Bruckner, 'The Promise and Perils of Algorithmic Lenders' Use of Big Data' (2018) 93 *Chicago-Kent Law Review* 3, 6.
[5] Ibid.
[6] *Equal Credit Opportunity Act*, 15 USC § 1691 (1974).
[7] *See, eg, Age Discrimination Act 2004* (Cth), *Disability Discrimination Act 1992* (Cth), *Racial Discrimination Act 1975* (Cth), *Sex Discrimination Act 1984* (Cth), *Equal Opportunity Act 2010* (Vic), *Anti-Discrimination Act 1977* (NSW).
[8] Matthew A. Bruckner, 'Regulating Fintech Lending' (2018) 37(6) *Banking and Financial Services Policy Report* 1, 2.
[9] Ibid.

access to credit but also protecting consumers if they do not have the ability to repay the debt. Studies have shown that access to finance can improve poverty, income inequality,[10] and encourage upward financial mobility.[11] Falsely excluding consumers from credit can have drastic consequences on an individual's livelihood.

III. RECOMMENDATION AND CONCLUSION

Presumably, in the aftermath of the Banking Royal Commission and considering ASIC's proposed update to RG 209, it will be more difficult for consumers to access credit. To ensure that the disadvantaged receive equal treatment while acknowledging the importance of financial inclusion, it is crucial to ensure lending institutions do not assess applications based on factors that might have discriminatory effects. Thus, while ASIC places greater emphases on the role of data-driven approaches, one should bear in mind the hidden problems that may come hand in hand in this context. ASIC's guidance should focus on how financial institutions can achieve credit scoring systems which are "*accurate, transparent, and unbiased*".[12] Big data can be used to cost effectively analyse a large audience of potential borrowers; however it cannot be the only method used to assess consumers. Individual circumstances must also be considered to prevent the risk of creditworthiness by association to a certain group or spending habit.

ASIC should provide clear guidance on how financial institutions can avoid systematically disadvantaging certain groups of society from accessing credit due to their data points. Methods have been suggested such as training credit algorithms to remove implicit bias, designing data systems from their inception and throughout their lifespan to promote fairness and remove discrimination.[13] Other methods can include using representative samples, being aware of biases, checking big data outcomes against traditional statistical models and regular monitoring.[14] The burden of ensuring accuracy of data should fall on the institutions and they be required to regularly review their data and ensure compliance.[15] An algorithm is only as good as its inputs. The best machines trained by poor data can only generate poor outputs. The Australian banking and financial industry should avoid "garbage in, garbage out" (GIGO) problem while embracing the data-driven future.[16]

Furthermore, when credit assessment tools become more complex and greater data points are used, there is a serious risk of data privacy and non-transparency issues.[17] Consumers may have little to no choice of which of their online or offline data points are used in their assessment which can further limit disadvantaged groups from accessing credit. It is therefore advised to encourage transparency in terms of what data points are used and support financial institutions to provide reasons as to why credit was rejected and inform consumers what steps they can take in order to improve their credit scores. This can help prevent adverse consequences of when consumers are rejected from credit due to a dysfunctional algorithm and/or poor dataset. Despite the existence of responsible lending scheme, ASIC should also seek to prevent credit assessment tools from

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[10] Kwangbin Bae, Dongsook Han & Hosung Sohn, 'Importance of Access to Finance in Reducing Income Inequality and Poverty Level' (2012) 17(1) *International Review of Public Administration* 55.
[11] Mikella Hurley & Julius Adebayo, 'Credit Scoring in the Era of Big Data' (2017) 18(1) *Yale Journal of Law and Technology* 148, 148.
[12] Ibid 149 (emphasis added).
[13] Bruckner, above n 8, 4.
[14] Workfront, *Data Discrimination: The Dark Side of Big Data* <https://www.workfront.com/blog/data-discrimination-the-dark-side-of-big-data>.
[15] Hurley & Adebayo, above n 11, 198.
[16] *See eg* What is Garbage in Garbage Out?, WISEGEEK, <http://www.wisegeek.org/what-is-garbage-in-garbage-out.htm>
[17] Hurley & Adebayo, above n 11, 152.

being used to target vulnerable consumers. This is a serious risk in the payday lending industry where consumer data is used to specifically target those at risk, to help alleviate this, institutions can be required to assess a consumer's future financial stability as well.[18]

ASIC's proposed update to RG 209 has made various valid points to further improve the quality of lending practice of the Australian banking and financial institutions. Our submission's recommendation represents a small, but crucial change, by underscoring the risks and unwanted consequences while we are moving towards an automated, data-driven world. ASIC should ensure that those who tap into the potential of algorithms and big data are accountable in their responsible lending practices.

[18] Ibid 200-201.