REPORT 643

Response to submissions on CP 309 Update to RG 209: Credit licensing: Responsible lending conduct

December 2019

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 309 *Update to RG 209: Credit licensing: Responsible lending conduct* (CP 309) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the National Credit Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

Contents

A Overview/Consultation process

1 On 14 February 2019, ASIC released Consultation Paper 309 *Update to RG 209: Credit licensing: Responsible lending conduct* (CP 309). CP 309 raised three broad matters for consideration:

(a) whether it is appropriate to change the approach to our guidance;

(b) aspects of the current guidance that may need to be updated or clarified; and

(c) whether our guidance should also include additional guidance on specific issues.

2 This report highlights the key issues that arose out of the submissions received on CP 309 and our responses to those issues. This report is not intended to be a comprehensive summary of all responses received; rather, we have limited this report to the key issues.

Purpose and scope of consultation

3 Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) contains ASIC's guidance on the responsible lending obligations that apply to consumer credit. RG 209 was issued in 2010 and last revised in November 2014.

4 Since 2014, there have been relevant judicial decisions, ASIC enforcement actions, ASIC thematic reviews and reports, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), changes in the law and changes in technology and other tools available to Australian credit licensees (licensees) in the credit application and assessment process.

5 We consider it is appropriate to update our guidance, to ensure that it remains relevant and effective and provides a central source for information on compliance with the responsible lending obligations. The purpose of the revision and proposals is not to set minimum requirements, but rather to improve our guidance to help licensees determine what compliance with the obligations may involve.

6 In recognition of the importance of this guidance to a very wide range of stakeholders, and significant public interest in how the responsible lending obligations apply and are complied with by licensees, a three-month period was allowed for the submission of written responses.

7 We note that recent reforms to the broader range of laws that apply to participants in the credit industry—in particular, the design and distribution obligations in the *Corporations Act 2001* (Corporations Act) and the proposed best interest duty for mortgage brokers—will operate alongside the responsible lending obligations. The revised guidance does not directly address these other laws and obligations. ASIC's guidance on those laws and obligations will be addressed in separate regulatory guidance.

Responses to consultation

8 We received 74 responses to CP 309 from a range of stakeholders, including:

(a) a range of lenders (including large authorised deposit-taking institutions (ADIs), smaller ADIs and non-bank lenders);

(b) some consumer lease providers;

(c) mortgage brokers, aggregators and other credit assistance providers;

(d) industry associations that represent a range of lending businesses and credit assistance providers;

(e) consumer representative organisations;

(f) academics;

(g) legal advisers; and

(h) several individuals.

9 Sixty-five responses were provided as non-confidential submissions. For a list of the non-confidential respondents to CP 309, see the appendix. Copies of these submissions are currently on the ASIC website at http://www.asic.gov.au/cp under CP 309.

10 We are grateful to all respondents for taking the time to send us their feedback and suggestions.

Public hearings

11 After an initial review of the submissions, we identified particular issues raised in the written responses that we considered would be useful to discuss further in a public forum to help inform public understanding about the responsible lending obligations and help us develop an appropriate balance in our approach to the revised guidance.

12 These issues related to:

(a) the value of information about 'variable' or 'discretionary' expenses for the unsuitability assessment, compared to information about income, liabilities and other fixed expenditure commitments;

(b) costs and difficulties involved in verifying variable or discretionary expenses, and whether those costs may be mitigated by technological solutions and tools that are currently available or that are emerging;

(c) whether expectations about post-loan spending reductions are a matter that should be considered as part of the consumer's objectives in relation to the credit product to be, or being, applied for; and

(d) risk factors that should be considered when determining the level of inquiry and verification steps that are reasonable, and whether a lower level of inquiry and verification steps may be appropriate for some credit products (subject to circumstances of the individual consumer).

13 We note three key themes that emerged from the discussions at the hearings:

(a) Industry participants generally prefer that the flexibility of principles-based guidance be maintained. However, they would appreciate more clarity through guidance (e.g. illustrative examples) to improve consistency in standards applied across industry and help licensees to:

(i) establish an appropriate starting point for inquiries and verification steps;

(ii) identify circumstances when more inquiries and verification steps may need to be taken; and

(iii) identify exceptions, where fewer inquiries and verification steps may be reasonable.

(b) Consumer representative groups would prefer mandatory minimum requirements to be identified, as the observed tendency of licensees has been to use flexibility only to reduce steps taken.

(c) Technological developments have a demonstrated potential to improve the standard of inquiries and verification steps undertaken, and subsequent assessments that use that information. However, they have not yet been used by many licensees.

14 The written submissions from industry participants suggested that the responsible lending obligations, and the regulatory approach to those obligations, have resulted in tighter credit conditions, longer processing times, and poor consumer experiences due to onerous documentation requirements.

15 In contrast, the discussions at the hearings highlighted the following matters:

(a) The obligations and the existing regulatory guidance do not contain requirements that necessarily inhibit efficient and effective application processes.

(b) Licensees currently take diverse approaches to the obligations and what they consider to be ‘reasonable’ to meet those obligations. Decisions about what is reasonable are affected by their perception of what is expected by both regulators and the broader community after the Financial Services Royal Commission. (In this context, the criticism of the existing guidance is that it does not provide licensees with sufficient comfort to decide that a lower level of inquiries and verification steps is reasonable.)

(c) Other factors are significant contributors to a perceived slow down. These include changes to demand for credit (including demand for underlying property and spending), regulatory and operational changes relating to credit risk exposure, and lack of investment in technology and systems to enable more efficient and effective processes.

16 The public hearings were held over two days and in two locations: Sydney and Melbourne.

17 The hearing in Sydney primarily dealt with these issues in the context of how credit providers meet their obligations. Participants included Commonwealth Bank of Australia, Westpac Banking Corporation, Bank of Queensland, Athena Home Loans, Tic:Toc Online Pty Ltd, illion Open Data Solutions, Australian Retail Credit Association, and Financial Rights Legal Centre.

18 The hearing in Melbourne also dealt with these issues in the context of how brokers meet their obligations. The industry and consumer representative participants at the hearing were Australia & New Zealand Banking Group, National Australia Bank, Mortgage Choice, Connective, AFG, Auscred Ltd, Consumer Action Law Centre, and Consumer Credit Legal Service WA.

19 Each participant was selected from entities that had provided a non-confidential written submission to ASIC. In addition, the Melbourne hearing was attended by:

(a) the Australian Financial Complaints Authority (AFCA);

(b) Professor Guyonne Kalb from the Melbourne Institute—to provide background about the development of the Household Expenditure Measure (HEM); and

(c) LIXI Limited—to provide background about the development of data message standards for expense categories, as an industry-led initiative to improve inquiries about expenses.

20 We are very grateful for the time and willing participation of all those who were invited. All participants were invited to attend the hearing on a voluntary basis, and not subject to any of ASIC's compulsory powers.

21 The hearings were available for public attendance and were live streamed on ASIC's website. The transcript of the hearings has been published on our website.

22 The hearings were well attended—the live-streamed audio was accessed by over 2,000 listeners.

Roundtable meetings with stakeholder groups

23 After the public hearings ASIC held five separate roundtable meetings to speak to broad stakeholder groups to give key stakeholders, including industry associations and their members and consumer groups, a further opportunity to express views on how our guidance can be improved.

24 The roundtable meetings were held over a week in Melbourne and Sydney with the following key stakeholder groups participating through relevant industry associations: ADIs, non-bank lenders, brokers, small amount lenders and consumer lease providers, and consumer representatives.

25 Some of the submissions received asked ASIC to include more examples throughout the guidance to give greater clarity about our views on what the responsible lending obligations would involve in particular circumstances. We asked participants in the roundtable meetings to provide suggestions for examples that would be considered most useful.

26 Some of the submissions received also raised additional areas and issues that could benefit from further guidance. Issues raised in those submissions were reiterated during the roundtable meetings. These included:

(a) requests for recognition of circumstances in which fewer steps are reasonable, to improve customer experience and process time and costs;

(b) concerns that review of bank statements need to be 'forensic' and seek dollar accuracy;

(c) requests for guidance on 'non-standard' situations—for example, different income situations (income from small business, gig economy and casual/new employees), joint accounts and split liabilities/expenses;

(d) requests for recognition of the obligation on consumers to be truthful in information provided; and

(e) requests for specific guidance about the role of brokers, status of 'preliminary' assessments and the practice of seeking information based on known lender policies.

27 We have taken into account these requests for additional guidance and suggested examples in preparing revisions to our guidance.

28 The roundtables, as part of the wider consultation, were a valuable part of the revision process and we appreciate the contributions received.

Westpac litigation

29 The decision of Justice Perram in *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244 (*ASIC v Westpac*) was handed down on 13 August 2019 and found in favour of Westpac. ASIC has filed an appeal with the Full Federal Court of Australia against this decision.

30 The decision will be reflected in the revised guidance, along with earlier decisions of the Federal Court.

Financial Services Royal Commission

31 Compliance by credit licensees with the responsible lending obligations was one area of focus for the Financial Services Royal Commission.

32 The interim report released on 28 September 2018 included the following observations:

> The responsible lending provisions of the [*National Consumer Credit Protection Act 2009*] introduced new and additional requirements. They require more than the lender being satisfied that the loan is an acceptable credit risk
>
> …
>
> [A]s the case studies examined in the first round of hearings show, credit licensees too often have focused, and too often continue to focus, only on “serviceability” (which is to say credit risk) rather than making the inquiries and verification required by law.
>
> …
>
> Verification calls for more than taking the consumer at his or her word.
>
> … The evidence showed that, more often than not, each of ANZ, CBA, NAB and Westpac took some steps to verify the income of an applicant for a home loan. But the evidence also showed that much more often than not none of them took any step to verify the applicant’s outgoings. The general tenor of the evidence was that a lender satisfied responsible lending obligations to verify a borrower’s financial position if the lender assessed the suitability of the loan by reference to the higher of a borrower’s declared household expenses and [HEM] published by The Melbourne Institute (or some equivalent measure) and that verifying outgoings was “too hard”.
>
> But what was meant by verifying outgoings being “too hard” was that the benefit to the bank of doing this work was not worth the bank’s cost of doing it.

Note: See Financial Services Royal Commission, Interim report, paras 2.2.1–2.2.3.

33 In the final report, Commissioner Hayne observed that:

> Since the first round of the Commission’s hearings, a number of banks have altered their lending processes and procedures by introducing additional inquiries about a borrower’s financial situation and by taking some further steps to verify that situation. These changes may in part be responses to concerns expressed by the Australian Prudential Regulation Authority (APRA) as a result of the targeted reviews undertaken in 2016 and 2017 … [which] identified a number of deficiencies in the processes that banks used to verify borrower expenses, including insufficient controls to verify information and a significant rate of default to the [HEM] …

Note: See Financial Services Royal Commission, Final report, para 1.2.1.

B Proposal on our general approach to guidance in RG 209

Key points

In Proposal B1, we raised a question of whether we should provide additional guidance by identifying particular inquiries and verification steps that we would generally consider to be 'reasonable'.

We received strongly divergent responses. On balance, the prevailing view from industry respondents was that more guidance and examples would help to provide greater certainty about what their obligations involve in different circumstances. However, most industry stakeholders do not want this certainty to detract from the current flexible guidance that recognises their discretion to determine what steps they should undertake in individual circumstances.

Feedback suggested that industry uncertainty about the responsible lending obligations after the Financial Services Royal Commission (which licensees consider is not adequately addressed by the current guidance) results in divergent approaches, an unlevel playing field and inappropriate competition on compliance processes, rather than on the quality of products and services.

In light of the responses received, we think we should continue the existing principles-based approach but make changes to our guidance to more clearly articulate the principles that we consider licensees should apply when determining how to comply with their obligations, and provide more illustrative examples of how those principles should be applied in individual circumstances.

34 In CP 309, we indicated that we are considering whether to identify particular inquiries and verification steps that we think would generally be reasonable, to provide greater certainty to licensees about complying with their obligations (Proposal B1).

35 This proposal was not to set minimum requirements, but rather to provide guidance that:

(a) identifies what we would generally consider to be reasonable;

(b) indicates that licensees are not prevented from determining that it is reasonable to undertake a lower level of inquiries or verification steps, although they should be able to demonstrate why they consider lesser inquiries and steps to be reasonable in the circumstances of the particular consumer involved (CP 309, paragraph 15); and

(c) identifies 'red flags' that could indicate that there is a higher likelihood that the consumer is operating at the margins of their disposable income and not able to afford additional financial obligations (CP 309, paragraphs 16–17).

36 We sought feedback on:

(a) whether this kind of guidance would be useful;

(b) examples of industry practice that could be reflected;

(c) whether there are certain inquiries and verification steps that should be undertaken in all circumstances; and

(d) whether there are any kinds of credit products, consumers or circumstances for which it is generally reasonable to undertake fewer inquiries and verification steps.

37 We also sought information to help us to consider the effect on consumers, business costs and competition if ASIC were to provide this kind of guidance.

Feedback received

Should ASIC provide additional guidance to identify inquiries and verification steps that are generally considered ‘reasonable’?

38 A strong majority of the submissions that responded to this proposal were supportive—36 respondents across different industry sectors and consumer representative groups supported additional guidance, while seven disagreed.

39 The reasons given for these positions varied greatly.

40 Eight credit providers generally supported the proposal, noting that additional guidance would provide greater certainty and ensure a transparent level of consistency across all competitors in the industry, providing a level playing field for all banks and non-banks. They also considered this would give consumers assurance that all credit providers follow a common inquiry and verification process, delivering a consistent outcome and a ‘clear understanding of the pathway to credit’. Each of these credit providers also supported retaining flexibility to allow for tailored processes to achieve appropriate consumer outcomes and innovations for improving customer experience.

41 However, among these credit providers there were differing views about how ASIC should identify particular inquiries and verification steps:

(a) Three providers supported more prescriptive ‘minimum standards’, to allow no room for ambiguity and ‘regulatory arbitrage’. However, these providers also noted that the minimum standards need to be proportional to consumer risk and able to be met by all licensees across industry, and that, if set too high, they could stifle innovation and remove licensee discretion. It appears that these providers support prescription of a fairly low minimum standard, together with guidance on circumstances when the licensee should exercise their discretion to increase those standards.

(b) One provider supported standards being provided as a ‘safe harbour’ and recognition that reasonable alternatives are acceptable.

(c) Other providers indicated that principles-based guidance is the most effective option, and supported identification of particular inquiries and steps that ASIC considers to be important and reasonable, as opposed to a set of minimum requirements.

42 Five other credit providers did not directly support the proposal, but support continuation of principles-based guidance, rather than prescription, and guidance on differences in what is reasonable between types of products (e.g. home lending and other lending or secured and unsecured lending).

43 Four industry associations for credit providers generally supported the proposal for similar reasons—that is, to better enable compliance, provide more certainty for business operations, assist in staff training, allow for a consistent approach across competitors, provide more certainty for consumers about what will be required and reduce regulatory arbitrage. These associations noted that additional guidance is good, but prescription is not—they support a focus on what needs to be done, rather than how it is done.

44 Six credit assistance providers agreed that identifying particular inquiries and steps would help to improve consistency across industry and consumer expectations. Two of these entities noted that current uncertainty results in a wide variation in standards and practices across credit providers. These entities consider that this uncertainty makes it difficult for service providers to be confident their practices are adequate and causes confusion, delay and additional cost when finalising loan applications. They consider this encourages consumers to look for the easiest process and to not use service providers that ask for too many supporting documents.

45 One industry association for credit assistance providers noted that its members strongly supported the establishment of ‘base requirements’ for different product classes.

46 Five consumer representative groups supported stronger guidance to specify particular inquiries and verification steps that should be undertaken. These groups generally considered the guidance should be more prescriptive, setting out a comprehensive list of mandatory minimum processes and clear expectations.

47 These consumer representative groups considered that such guidance would set clear and unequivocal standards, enable compliance requirements to be reflected in compliance manuals and process designs, prevent a ‘race to the bottom’ by removing allowance to ‘scale down’, and enable consumers and their advisers to check the standards of particular licensees. Some also submitted that mandatory requirements need to be supported by clear and transparent procedures for investigation and enforcement by ASIC of failures to conduct reasonable inquiries and verifications.

48 Six other respondents (including law firms and compliance service providers) considered that more prescription would have the benefit of being more transparent and certain, and that a 'safe harbour' approach would provide greater clarity while retaining discretion for the licensee to decide whether more needs to be done. One indicated this would assist automated processes, which struggle with scalability. One considered it important that guidelines be provided for different types of borrowers.

49 Seven respondents expressly disagreed with the proposal:

(a) Some (including four large industry associations) appear to have interpreted the proposal as necessarily involving ASIC expressing or 'codifying' minimum requirements for all circumstances, rather than proving guidance on inquiries and steps that ASIC generally thinks would be important. These submissions support continuation of flexible principles-based guidance.

(b) Two associations noted that if the guidance is provided as prescribed minimum requirements, there is danger that some would regard the prescribed steps as a 'safe harbour', that the guidance would encourage 'tick box' compliance behaviour, and that it would be impossible to define an appropriate level for each type of product or consumer.

(c) Others noted that prescribed minimum verification steps would be unnecessarily onerous and have the effect of slowing credit approvals, inhibiting innovation, reducing competition and increasing the cost but not the efficacy of compliance.

Examples of industry practices that should be reflected in the guidance

50 Many of the responses to this question did not identify existing industry practices that could or should be reflected. Instead responses tended to more generally identify issues that could be dealt with or expanded on in the guidance.

51 These issues included:

(a) discounting of living and discretionary expenses to a 'post-loan' amount (with respondents seeking guidance on what is a reasonable basis to accept that reductions to spending are realistically achievable for the consumer);

(b) appropriate categorisation of kinds of expenses to encourage more consistent usage;

(c) when account statements are required and what they should be used to verify;

(d) use of expense benchmarks to validate estimates;

(e) treatment of joint account information; and

(f) practical examples of differences between the standards of inquiries and verification steps that would be expected for different credit products and different consumer circumstances (e.g. strata corporations or natural persons, high net worth clients, existing customers or new customers).

52 Some responses referred to specific industry practices and developments, including:

(a) traditional principles of credit assessment—character, capacity and collateral and indicators (e.g. credit scores, debt servicing ratios and debt-to-income ratios that are considered robust predictors for the likelihood of financial difficulty);

(b) improvements to inquiry practices through standardised expense categories developed by LIXI Limited;

(c) the Broker Interview Guide that has been developed for home lending through the Combined Industry Forum;

(d) the *Customer Financial Position Verification Standards and Recommended Best Practice* for brokers adopted by the Mortgage & Finance Association of Australia;

(e) mandatory review of transaction statements for some industry sectors; and

(f) development of technological solutions to support verification processes, including digital data capture and optical character recognition tools.

Inquiries and verification steps that are important in all circumstances

Inquiries

53 Most of the submissions that responded to this question indicated that inquiries should always be made about:

(a) income and employment information; and

(b) liabilities and existing debts.

54 A smaller number also indicated that inquiries should always be made about:

(a) living expenses (although some restricted this view to fixed or recurring expenses, rather than those described as ‘discretionary’ or ‘variable’);

(b) relationship status;

(c) number of dependants;

(d) foreseeable changes in financial position;

(e) credit history and previous experience with financial difficulty or hardship; and

(f) assets.

55 Only three submissions indicated that in their view there is not anything that needs to be inquired about in all circumstances.

Verification steps

56 Most of the submissions that responded to this question indicated that licensees should always take steps to verify income. Many also indicated that liabilities and existing debts should always be verified.

57 A smaller number of submissions suggested that it is always necessary to verify living expenses, although it was indicated by several (including larger industry associations) that it is usually appropriate to take some steps to verify 'fixed' expenses, and not 'discretionary' expenses.

58 A few submissions also indicated that it is usually appropriate to verify other aspects of the consumer's financial situation, including credit history, relationship status and number of dependents, and assets.

Circumstances in which it is reasonable to undertake fewer inquiries and verification steps

59 The submissions that responded to this question broadly identified the following kinds of credit products and consumers for which, and circumstances in which, fewer inquiries and/or verification steps may be reasonable.

Credit products

60 Several submissions from lenders, credit assistance providers and industry associations referred to typical unsecured products, such as smaller personal loans and credit cards, that generally involve lower repayment amounts and/or shorter terms. In particular, it was considered that these kinds of loans should be considered differently to, and require fewer inquiries or verification steps than, home loans, because the respondents consider these kinds of loan involve a lower risk of resulting in substantial hardship.

61 Consumer leases were also referred to, noting that the risk of consumers being caused hardship is limited where goods can be voluntarily returned to end payment obligations and/or arrears may be written off.

62 In contrast, submissions from five consumer representative groups expressed the view that there are no credit products for which licensees should take fewer steps. It was noted that, as recognised in the existing guidance, small loans do not necessarily involve less harm for consumers. As these kinds of loans may often be sought by people with lower incomes, the impact of incorrect assessment can be more detrimental and result in a debt spiral.

63 Some of these submissions outlined a concern that the existing concept of 'scalability' has been used only to reduce steps that are taken, and not to increase them as appropriate for individual circumstances.

64 During the roundtable discussions, stakeholders did not agree that whether a credit product is 'secured' or 'unsecured' is a factor that justifies different treatment. It was recognised that the existence of a security is relevant to the lender's credit exposure and pricing for the product but does not affect the likelihood of default or of harm for the consumer. Instead, stakeholders considered that the broader differentiation may be between larger, longer term loans and other credit products.

Consumers and circumstances

65 Several submissions from lenders, credit assistance providers and industry associations referred to the following consumers and circumstances requiring less extensive inquiries and verification steps:

(a) strata corporations, 'high net worth' or 'high income' customers and other 'sophisticated borrowers' that are generally familiar with credit products and significant assets and/or income;

(b) existing customers, for whom the lender already has information and a good understanding of their financial situation (although this may depend on how recently existing information has been obtained), or who have demonstrated a clear savings pattern; and

(c) borrowers who are seeking to refinance a loan, either to restructure an existing loan with the same credit provider or to switch to a 'like for like' loan (i.e. no new credit) with a new credit provider on better terms, where the borrower has a clear history of meeting repayments under the current loan.

66 Generally, consumer representatives considered that consumer circumstances should be referred to as indicators that more inquiries or verification steps are required, rather than less. The one exception was for home loan refinance situations, where there is no new credit or extension of the loan term, and the consumer switches to a loan that would reduce the repayment obligations.

67 It was noted that in this situation it would still be important to establish that the consumer is comfortably meeting repayments under the current loan, that their income has not been subject to recent change, and that there are no 'ticking time bombs' apparent in their transaction statements.

68 This submission noted that there is a qualitative difference between creating new financial obligations or increasing obligations, and reducing financial obligations or even replacing them with 'like for like' obligations. It was considered that recognising lower base standards for these situations would enable competition.

ASIC's response

We have considered the feedback received and think that we should continue the existing principles-based approach, but make changes to our guidance to more clearly articulate the principles that we consider licensees should apply when determining how to comply with their obligations, and provide more illustrative examples of how those principles should be applied in individual circumstances.

Some broad principles should be applied by licensees when determining how to comply with their responsible lending obligations, including when determining what inquiries and verification steps are reasonable. These principles include:

- the licensee should have regard to what the obligation is intended to achieve and what consumer harm it is intended to address;
- the licensee should have regard to the circumstances of the individual consumer the licensee is dealing with;
- the licensee should have regard to whether the credit product involves a higher risk of harm to the consumer if it is unsuitable; and
- the obligations are not static—what is 'reasonable' will be affected by the broader professional and regulatory environment in which licensees operate. For example, legislative developments (e.g. open banking and comprehensive credit reporting) and other developments and innovations adopted by industry will affect the measures a licensee could reasonably be expected to undertake.

We consider our guidance should have the effect that licensees are less likely to compete on the amount of information they have regard to when assessing an application. That is, a consumer who applies for a particular type of product should expect that a similar level of information will be considered regardless of who they choose to deal with.

However, the way the information is gathered may depend on the processes and capabilities of the licensee and whether the consumer has had previous engagement with it, so there should continue to be competition on service delivery and consumer experience.

The following kinds of guidance may be provided to help licensees apply these principles in individual circumstances:

- an explanation of the purpose which ASIC considers each obligation is designed to meet;
- identification of kinds of information ASIC considers it is important to obtain to meet these purposes; and
- recognition of particular circumstances that we consider should affect the licensee's decision of what level of information is reasonable to obtain, including through illustrative examples.

Other options considered

Maintain the status quo

69 Under this option, we would maintain the existing principles-based guidance, without making any material changes to the way that guidance is structured.

70 This option would minimise costs for businesses in reviewing and understanding ASIC's guidance and reflecting changes in their processes and procedures. However, we acknowledge comments in the written submissions and the public hearings that stakeholders do not consider the current guidance to be sufficiently clear, and that licensees have developed divergent standards, resulting in an unlevel playing field and associated costs for business.

71 While a majority of respondents supported a continuation of the current approach of providing principles-based guidance, they also sought additional certainty about ASIC's expectations to guide licensees in their application of those principles in individual circumstances.

Identify base-level requirements and provide guidance on indicators to 'scale up'

72 We acknowledge there was a level of support for ASIC to give more prescriptive guidance that identifies:

(a) 'core' or 'base' requirements that should be met in all circumstances; and

(b) indicators of circumstances in which we would expect that more inquiries or verification steps would need to be taken.

73 Some submissions (primarily from consumer representative groups) supported these identified requirements being expressed as mandatory minimum requirements.

74 Benefits of this approach would include greater certainty for licensees about ASIC's expectations, and consistency in the standards applied across the industry.

75 However, we note that submissions raised concerns about the potential for significant difficulties and costs, including:

(a) difficulties in identifying relevant core standards for a broad range of credit products and consumer types—with a risk of those standards being unduly onerous in some circumstances, and inadequate in others, and therefore unreliable as a 'safe harbour' for licensees;

(b) inflexible standards increasing costs for processing applications, which may be passed on to customers, without improving the quality of assessment and decisions made by licensees; and

(c) inhibition of innovation in application processes.

C Proposals on updating or clarification of current guidance

Key points

In Section C of CP 309, we suggested some adjustments to the existing guidance about verification steps, the use of benchmarks and assessment of the consumer's requirements and objectives.

The responses received were broadly supportive of additional *non-prescriptive* guidance. However, responses from industry stakeholders generally indicated that if guidance were framed as requirements or expectations, it would be likely to result in additional business costs, which could be passed on to consumers.

Almost all responses received strongly disagreed with the 'if not, why not' approach suggested in Proposal C2.

In light of the responses received, we will proceed with the proposed guidance, other than the 'if not, why not' approach.

Proposal C1: Clarification of guidance on verification of consumer's financial situation

76 In CP 309 we proposed amendments to our current guidance to:

(a) clarify our guidance on kinds of information that could be used for verification, and provide a list of sources of information that we consider are readily available in common circumstances; and

(b) clearly state that views on what are 'reasonable steps' will change over time, as different forms or sources of verifying information become available.

77 We sought feedback about the appropriateness of the sources of information identified in the proposal. Noting concerns that have previously been raised about the use of data aggregation services (now referred to as digital data capture), we also sought specific feedback about those services.

Feedback received

Kinds of information that can be used to verify consumer's financial situation

78 The responses to this proposal were generally supportive, but with a range of qualifications.

79 Submissions from industry stakeholders generally welcomed additional clarity about a broader range of information that can be used but noted that this information should only be provided as guidance, and not as a more prescriptive expectation that licensees will or should necessarily have regard to these kinds of information.

80 Some submissions questioned ASIC's view about whether certain kinds of information are 'readily available', noting that this will be affected in many cases by the consumer's consent or willingness to provide the information. Credit assistance providers noted that it should be recognised that they may not have access to the same information as credit providers—in particular, credit history information, which they can only obtain with the consumer's consent and involves an additional business cost.

81 In contrast, submissions from consumer representative groups supported ASIC's guidance being more prescriptive and expressing a minimum requirement that licensees obtain transaction statements that cover a sufficiently long period depending on the nature of the credit product (e.g. a 90-day period for personal loans and credit cards, and a 12-month period for home loans).

82 In relation to the list of information sources identified in Appendix 1 of CP 309, most responses considered the lists on income and liabilities to generally be relevant and appropriate. During the public hearings, it was also highlighted that review of transaction statements can be helpful to verify income and identify undisclosed liabilities. Some submissions also suggested additions to these lists, such as home loan, personal loan and credit card statements, and consumer lease agreements.

83 However, the list of expenses (Tables 3 and 4) was an area of disagreement.

Treatment of living expenses

84 Submissions from most, but not all, industry stakeholders (including most lenders, brokers/aggregators and industry associations) questioned the value of information about the consumer's current living expenses to the assessment of whether a contract is unsuitable, and therefore whether it is reasonable to attempt to verify those kinds of expenses.

85 These responses made the following observations:

(a) *Reviewing living expenses may not accurately reflect the future living expenses of the applicant.* Some responses indicated that an applicant's living expenses can vary significantly as the borrower changes their spending habits, and that verifying living expenses does not help to predict future spending or likelihood of hardship.

(b) *Spending reductions can generally be made if needed without substantial hardship*. Some responses indicated that it may be appropriate to verify 'fixed' expenses that the consumer has no or limited ability to reduce. However, most submissions from industry stakeholders considered that it is not necessary to take any steps to verify 'discretionary' expenses, and that it is sufficient to complete inquiries about these expenses and rely on estimates that are determined to be plausible or realistic (e.g. by comparing an estimate to a statistically relevant benchmark).

86 These responses also suggested there are significant difficulties and costs involved in using transaction statements to verify living expenses. These difficulties and costs include:

(a) the inability to identify a transaction as 'discretionary' or as a living expense that cannot be easily adjusted, including uncertainty about use of cash withdrawals;

(b) unreliable results that do not adequately reflect the likely future living expenses of the applicant;

(c) difficulties with multiple accounts, joint accounts or mixed personal and business accounts;

(d) privacy issues—consumers consider inquiries about expenses intrusive, transaction statements may reveal very personal information, and these issues are more complicated where the licensee needs to consider joint accounts, income and expenditure for an application by a single borrower.

87 These views were also expressed during the public hearings by the banks that participated in the hearings.

88 A small number of industry stakeholders expressed the view that it is important to take reasonable steps to verify estimates of expenses by consumers, that transaction statements currently provide the best means of doing this and that they can be used without undue difficulty or cost. These views were also discussed in more detail during the public hearings. Notably, comments were made that:

> The substantial expansion in data sets over recent years, the enhancement of comprehensive credit reporting and new technologies, such as digital data capture, mean that it's now both highly efficient and inexpensive for credit providers to obtain the insights they need to make responsible lending decisions. (Simon Bligh, Chief Executive Officer, illion Australia Pty Ltd)

> To talk to metrics on efficiency, our understanding through qualitative research of some of, some of our partners who use traditional methods, they reckon it's anywhere between two to four hours is what they will do, sitting there highlighting, highlighting bank statements to come to the same outcome that we can come to in 20 [minutes]. So there's, that's sort of the efficiencies that we're picking up by using a combination of the data aggregation technology and an investment that we've made in technology over the top of that information. (Daniel Price, Chief Enterprise Officer, Tic:Toc Online Pty Ltd)

89 Consumer representative groups expressed a clear view that it is essential to understand both the incoming and outgoing aspects of the consumer's financial situation. During the public hearings it was noted that:

> To understand someone's financial position, you necessarily have to look at income indebtedness as well as living expenses. And to understand whether it is possible in that particular consumer circumstances to cut down on expenses. That may be a possibility for some applicants but it may not be for other applicants. And to understand that, you need to look at their expenses, you need to have a conversation with them about their financial position. (Gerard Brody, Chief Executive Officer, Consumer Action Law Centre)

ASIC's response

Given the feedback provided, we consider that we should proceed with this proposal.

We understand that licensees find it frustrating being asked to obtain information to verify expenses when they consider those expenses to have little relevance for the assessment of unsuitability.

We think it will be helpful for ASIC's guidance to more directly address the treatment of living expenses and recognise the different kinds of expenses. We think it is important for licensees to understand that consumers will give more priority to some expenses and expenditure than others. This will affect whether these outgoings are likely to continue, or whether the consumer expects they will continue, after new credit financial obligations have been taken on. An understanding of current expenditure, and the consumer's views about what is important and likely to be maintained, provides a starting point for assessing whether the credit product is unsuitable for that consumer.

We note that some of the concerns expressed about the difficulty and cost of reviewing transaction statements are based on a review being undertaken in a 'forensic' way, to attempt a line-by-line reconciliation of declared expenses to transactions. We consider transaction statements can be appropriately used to obtain a general overview of the consumer's incoming and outgoing cash flows, a general indication of whether the consumer's estimates are realistic and whether there are obvious inconsistencies or omissions.

Proposal C2: Expanded guidance on use of verifying information

90 In CP 309 we proposed to expand our guidance on what are reasonable steps to verify the financial situation of a consumer. This expansion would involve:

(a) more clearly stating that it is not sufficient merely to obtain verifying information but not have regard to it, or to use it for verifying only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects of the consumer's financial situation; and

(b) including an 'if not, why not' approach, that involves an expectation that licensees be able to explain a choice not to obtain or refer to readily available verifying information.

Feedback received

Proposed guidance on information obtained

91 The majority of submissions that responded to this proposal supported the further guidance outlined in CP 309:

(a) Large lenders generally supported ASIC's views that guidance on reasonable verification would be useful and that it would create consistency across all lenders. These submissions noted that further guidance should be reasonable and proportionate to the harm to be addressed by the obligations (i.e. the risk of substantial hardship due to new financial obligations). This support therefore needs to be read in light of comments that question the relevance of information about living expenses for the assessment of whether the contract is unsuitable and the usefulness of information in transaction statements.

(b) Brokers and aggregators were generally supportive of the additional guidance but noted that this guidance needs to take into account the different roles, and resources available to, credit assistance providers compared to lenders. These respondents noted that while transaction statements may be obtained to be passed on to the credit provider in support of an application, they would often not be reviewed by the broker for the purpose of verifying declared expenses. It was commented that it would be unfair for brokers to be deemed to be 'on notice' of all information contained in transaction statements.

(c) One credit assistance provider expressed strong support for guidance that licensees should be able to justify not having regard to all the information that is obtained. They believed this approach would benefit consumers by providing a better picture of consumers' financial circumstances.

(d) Industry associations were also generally supportive of this guidance. However, they also requested additional guidance on how this would affect the way licensees handle information in more complicated circumstances, such as the use of information about joint accounts, income from indirect sources and foreseeable changes.

(e) Consumer representative groups strongly supported clarification that it is not enough for providers to obtain verifying information without having 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 information. These groups noted that a general review of transaction statements can provide licensees with the following useful kinds of information:

  (i) an overall view into a consumer's financial situation and obvious inconsistencies;

  (ii) patterns of income and expenditure;

  (iii) whether the majority of income is withdrawn on the consumer's pay day;

(iv) if and how often an account has been overdrawn;

(v) whether direct debits have been declined;

(vi) whether the consumer is 'living from pay to pay'; and

(vii) the types of credit obligations a consumer may have (e.g. debts being paid to debt collectors).

Proposed guidance for an 'if not, why not' approach

92 The vast majority of submissions that responded to this proposal disagreed with it.

93 Industry respondents appeared to interpret the proposal as involving a requirement to justify failure to use each form of information referred to in the tables, even if they verified the consumer's information using one of the other forms of information. This was not the intention of the proposal—that is, it was merely intended to indicate that if a licensee decides that it is not reasonable to verify information at all, despite verifying material being readily available, they should be prepared to justify that decision.

94 The particular concerns raised by industry stakeholders were that this approach could have the effect of:

(a) placing onerous obligations on licensees by:

(i) requiring licensees to focus on verifying all available documentation and removing their flexibility to determine how to meet the responsible lending obligations;

(ii) reversing the onus of proof (i.e. starting with an assumption of wrongdoing rather than focusing on the reasonable level of discretionary spending a consumer requires to live on); and

(iii) exceeding the obligation to take 'reasonable steps' which can cause undue delays; and

(b) increasing process costs by:

(i) requiring consideration at either portfolio level or individual level of each kind of verification information identified by ASIC;

(ii) recording the licensee's justification of why it was not reasonable to obtain and consider each form of information; and

(c) focusing efforts of the licensee on what has not been considered, rather than the adequacy of what has been considered.

95 Consumer representative groups were also not supportive of this proposal, but for a significantly different reason. These groups noted that in theory this approach should encourage lenders to be more accountable when considering the type of information obtained. However, they were concerned that in practice licensees would use it as a loophole. That is, these groups considered that there is a high risk that licensees would merely indicate that they did not obtain any form of verification material because 'it was not reasonable to do so in the circumstances'.

96 Consumer representative groups also noted that lenders often build automated systems to manage their credit risks as opposed to considering an individual consumer's financial capabilities to repay a loan. To illustrate this concern, some groups referred to comments of the Financial Services Royal Commission noting that systems which used highly automated processes, while convenient to industry, often fall short of meeting responsible lending obligations which require an individual assessment of a consumer's needs, objectives and financial capacity. Consumer groups were concerned with any guidance which gives lenders the ability to choose not to verify both a consumer's income and overall expenses.

97 Only one submission expressed strong support for this approach and considered that it should be rigorously applied. This submission stated that the approach would provide clarity and direction, that credit providers would become more innovative in product development, and that it would increase competition and lead to positive consumer outcomes.

ASIC's response

Proposed guidance on information obtained

Noting the general support expressed in submissions, we have included this more express statement in our guidance.

Many licensees consider that transaction statements are a useful and convenient source of information to verify income and liabilities. We consider it would be a poor outcome if licensees were discouraged from using transaction statements for this purpose.

In this context, we consider that clarification about the level of review that may be taken in relation to expenses (as noted above under 'Proposal C1: Clarification of guidance on verification of consumer's financial situation') should provide comfort that a licensee is not expected to consider, and would not be taken to be aware of, all expenditure at a transaction level.

Proposed guidance on an 'if not, why not' approach

As a general comment, we note that the responses from industry stakeholders appear to have misunderstood the intent of this proposal.

However, based on the feedback received we do not consider that there would be a significant benefit in proceeding with this proposal. Conversely, we recognise there may be a risk that this approach would inadvertently encourage licensees to concentrate on justifying why particular steps are not reasonable, rather than considering what steps are reasonable in the circumstances of the individual consumer and application that is being considered.

Although we will not explicitly include this approach in the revised guidance, we note that, as for any decision on how to comply with regulatory obligations, it is important for licensees to be able to explain what they have done and why that action is adequate to meet their obligations.

Proposal C3: Clarification of guidance on use of benchmarks

98 In CP 309 we proposed to clarify our guidance about the use of benchmarks, broadly to:

(a) indicate that a benchmark figure does not provide any positive confirmation of what a particular consumer's income and expenses actually are, but can be a useful tool to help determine whether information provided by the consumer is plausible; and

(b) outline steps that we consider licensees should generally take, if a benchmark figure is used to test expense information and to reduce the risk that the estimate is nevertheless materially lower than actual expenses, and that the consumer will be entering a contract they cannot afford and that is unsuitable.

Feedback received

Proposed guidance on use of benchmarks

99 The majority of submissions that responded to this proposal were supportive of further guidance being provided on the use of benchmarks, but differed about what that guidance should cover.

100 Most industry respondents considered benchmarks to be a useful tool to measure the reasonableness of information provided by consumers and were generally supportive of guidance that recognises the use of an appropriately scaled benchmark. Lenders and industry associations submitted that the use of benchmarks reduces the burden on consumers to determine the amount of their actual expenses, which is considered a flawed and inaccurate process.

101 However, many of these submissions considered it would not be helpful to add a buffer amount to expense benchmarks and noted that such measures could restrict access to credit. The submissions highlighted that many licensees already apply other buffers and rules designed to sensitise their credit assessment for future changes (e.g. interest rate buffers and discounts on rental income). While these measures are generally applied by ADIs under prudential standards, other lenders may also apply similar rules to manage their credit risk exposure.

102 Some also noted potential increased business costs that could be involved in processes suggested for ensuring appropriate use of benchmarks. These included costs of adjusting benchmarks, changing software, increasing verification practices and increasing the time required to process loan applications.

103 A small number of industry respondents noted that if expenses are verified using transaction statements, comparison to a benchmark provides no extra information. They noted that using a benchmark figure as a floor can potentially restrict access to credit to consumers who genuinely have lower expenses. This negative effect on consumers is increased if a buffer is added to the benchmark figure.

104 Consumer representative groups were not supportive of the use of a benchmark for anything other than a plausibility check. They expressed concern that a benchmark which relates to a poverty line would not be a useful measure of what a consumer should reasonably be expected to reduce expenses to. They also expressed concerns about the validity of proprietary benchmarks developed by licensees and stated that use of such benchmarks should be prohibited. Consumer groups sought further guidance on the use of buffers added to benchmarks and referred to saving buffers as an example.

Use of the Household Expenditure Measure (HEM)

105 The written submissions and comments at the public hearings indicate that the HEM is the most commonly used expense benchmark. However, the comments received also highlighted that this benchmark is not applied consistently by all those who use it.

106 Different versions can be used, including by:

(a) using older versions of the benchmark (e.g. a version made available prior to August 2018, which was based on the Household Expenditure Survey (HES) data from 2009–10);

(b) not updating systems to reflect the scheduled quarterly updates; or

(c) using the up-to-date calculations, but with different parameters (e.g. by referring only to household composition but not income band).

107 In addition, the newer methodology for HEM (as released in August 2018) adjusted the categories of expenses that are included and not included in the calculation. Importantly, some expenses are identified in the HEM guidelines as ‘excluded’, but the guidelines recognise that these items are absolute basic expenditures and need to be collected from the loan applicant separately from any other expenditure.

108 The excluded items currently include:

(a) housing costs (e.g. rent, mortgage payments, land tax and body corporate fees on own dwelling);

(b) private school fees;

(c) life insurance;

(d) sickness and personal accident insurance;

(e) superannuation;

(f) alimony/maintenance payments;

(g) interest repayments on loans;

(h) lease payments; and

(i) HECS.

109 A concern was expressed that licensees who use versions of the HEM benchmark that provide a lower figure, or who do not use the benchmark in accordance with the guidelines provided by the developers of the benchmark, may inappropriately obtain a competitive advantage over licensees who use an up-to-date version in accordance with the guidelines.

110 Some submissions also referred to use of HEM figures as a useful measure for what a household could be expected to reduce expenditure to without experiencing 'substantial hardship'. These submissions note that the HEM methodology has been designed to reflect a 'modest level' of household expenditure, and that this is therefore an amount that it is realistic to expect will enable the household to continue to experience a modest lifestyle. As context for these views, we note that the HEM figures for some households (e.g. for some lower income households) are below the Henderson Poverty Line.

Request for additional guidance

111 Some written submissions noted that the proposed guidance is helpful and implies that it may be appropriate in some circumstances to only check expense information against a benchmark, but that it does not help to clarify what those circumstances might be. These respondents requested further guidance on when it would be appropriate to rely on a comparison of an estimate to a benchmark figure.

ASIC's response

We consider it will generally be useful to proceed with the clarification proposed in CP 309.

In relation to applying a buffer to the benchmark figure, we note that in the proposal this additional measure was not expressed as a requirement, but rather as a step licensees may consider to reduce the risk that the amount used is actually an underestimate.

We think this may be a useful practice for some licensees, but it is a matter that is for the licensee to decide on in light of their broader assessment process (e.g. given the combined effect of other floors, buffers and rules that they apply to their overall consideration of the consumer's financial situation).

We consider the guidance should make it clear that comparison to a benchmark figure (with or without a buffer) as a floor is not required. We recognise that some people will have expenditure that is lower than the HEM benchmark (and that this is implicit in the methodology).

We consider that if a consumer provides estimates that are lower than the HEM benchmark, there is a higher likelihood that they have underestimated (as the methodology is based on the majority of households having a higher expenditure). This should therefore trigger additional information-gathering steps.

However, if the lower estimate is confirmed by that additional information, we do not consider it is necessary to then raise the verified amount to a higher floor.

In addition, on the basis of the feedback received through written submissions, and the further discussions at the public hearings, we think it would be useful to provide guidance about:

- circumstances where comparison to a benchmark, but not verification, may be a reasonable step to take; and
- the importance of only using benchmark figures in a way that is consistent with their design, and in accordance with any instructions for use from the designer and scheduled updates by the designer.

Proposal C4: Update to guidance on requirements and objectives

112 In CP 309 we proposed to update our guidance to reflect the findings and guidance set out in Report 493 *Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives* (REP 493).

Feedback received

Proposed guidance on requirements and objectives

113 Most submissions were generally supportive of the proposed guidance, if provided as best practice guidance only. Many submissions expressed concerns that if these practices are included as requirements there may be significant additional process costs.

114 Some credit assistance providers, industry associations and credit providers also expressed a concern that while these practices may be appropriate in the context of home loans and inquiries undertaken by mortgage brokers, they may be less appropriate for other kinds of credit products or where applications are made directly to the credit provider.

115 Some credit assistance providers and industry associations referred to tools that have been developed by industry. An example is the Broker Interview Guide. This guide was developed by industry for use by brokers when introducing loans for regulated lending secured by residential property. It sets out the minimum level of inquiries as well as a way to record the results of those inquiries. It has been suggested that this tool be applied to determine a consumer's requirements and objectives but be used differently as appropriate for different credit products.

116 However, a concern was raised that using tools which set increased standards for inquiries to be made of consumers could lead to an increase in complaints from consumers about intrusions into their privacy, and that consumers may select licensees who do not ask intrusive questions and delay the application process.

117 Consumer representative groups were supportive of further guidance being provided on the level of inquiries required to determine a consumer's requirements and objectives. These groups noted that when making

assessments of unsuitability, credit providers focus heavily on whether a consumer can afford a loan, and insufficient consideration is given to whether the credit product adheres to what a consumer wants.

118 Some industry respondents suggested that the upfront costs of changing systems and processes along with the time spent recording inquiries would significantly increase business costs. Most lenders noted the risk of these extra business costs being passed on to consumers, while a small number of lenders and other respondents indicated that this process would increase transparency and ensure that the credit products provided match up to a consumer's needs.

119 However, others indicated that as part of their current processes they collect this information and provide a 'playback' to the consumer, for acknowledgement by the consumer.

Post-loan spending reductions

120 A number of submissions suggested that guidance should deal more expressly with post-loan spending reductions, commenting that ASIC should recognise that consumers generally expect to make some changes to their current lifestyle in order to afford a loan (or an important asset to be purchased with a loan). We note that some of these respondents did not appear to be aware that RG 209 already recognises that licensees may wish to take into account any discussion with a consumer about their willingness to make reasonable changes to their lifestyle so that they can afford a loan without substantial hardship.

121 One submission from an industry association did refer to the current guidance but noted that this guidance has been given in the context of the assessment of substantial hardship and that it may be appropriate to instead include this in guidance about the consumer's objectives.

122 During the hearings, consumers' expectations for 'belt-tightening' and other spending reductions to afford a loan were discussed. The banks represented at the hearings indicated that, at least in the context of home loans, these kinds of conversations are regularly held with consumers to determine their attitude to more material expenses (e.g. private school fees and personal insurance).

123 This issue was also discussed further during roundtable discussions. As part of that process, we noted that:

(a) the submissions generally referred to easy examples of 'belt-tightening' (e.g. cutting back on luxury items), but did not provide views about other spending that the consumer is more likely to see as material and want to maintain after the credit product is entered into (even if it may not be considered as committed expenditure that the consumer has no or limited ability to reduce); and

(b) the submissions also focused on the 'capacity to meet repayments without substantial hardship' test for unsuitability, but did not refer to the test of meeting the consumer's requirements and objectives.

124 We sought views about the appropriate treatment of outgoings that are more likely to be considered important to consumers, even if they could potentially be reduced or foregone. Examples that were raised include:

(a) personal, life and health insurance;

(b) non-compulsory asset insurance (motor vehicle and home contents), especially if maintenance of the asset is important for maintaining the consumer income;

(c) non-compulsory superannuation contributions;

(d) private schooling;

(e) memberships/subscriptions that involve contractual commitments that cannot be exited without cost or difficulty; and

(f) special medical needs.

125 The responses we received suggested that most stakeholders consider it would not be appropriate to make assumptions that consumers will reduce or eliminate these kinds of outgoings. Some indicated that reductions of these expenses (e.g. insurance and special medical needs) should not be accepted at all, while others thought they should only be accepted after discussion with the consumer.

126 It was requested that any guidance provided by ASIC on treatment of spending reductions be capable of applying consistently to all licensees, regardless of their information collection methods. A concern was raised that licensees with more robust methods that collect information about actual expenditure (e.g. using transaction statements and digital data capture services), and that have a higher level of knowledge about the consumer's expenditure, could be disadvantaged if this knowledge requires more significant engagement with the consumer about reductions compared to licensees with less robust information collection processes.

ASIC's response

The proposed guidance outlined in CP 309 is expressed as principles-based guidance, outlining at a high level matters a licensee should be able to identify (during the inquiry stage), consider and demonstrate (during the assessment stage) and record.

We consider this guidance would be useful to help licensees put in place processes that are appropriate for their business that will enable them to understand the consumer's objectives and requirements, and assess whether the offered credit product will meet those objectives and requirements.

We think it is appropriate for licensees to determine how they achieve these high-level outcomes. We do not consider that it is necessary or appropriate to specify particular processes that should be implemented.

We note the useful feedback and discussion at the public hearings and roundatable meetings about spending reductions and practices of licensees for discussing reductions with consumers.

We have included guidance that expressly recognises that the type and scale of spending reductions may be relevant to an assessment of both:

- whether the consumer has capacity to meet financial obligations under a credit product without substantial hardship; and
- whether a credit product that can only be repaid if the consumer undertakes certain reductions will meet the consumer's requirements and objectives in relation to credit.

D Proposals to include additional guidance on specific issues

Key points

In Section D of CP 309 we suggested including additional guidance on the following matters, which are not currently covered in any detail in our guidance:

- scope of the obligations—credit products and activities to which the obligations do not apply;
- effect of circumstances of fraud on compliance with the obligations;
- use of negative repayment history information;
- good recording practices; and
- the purpose of the obligation to give a written copy of the unsuitability to consumers on request, and the level of information that should be included to achieve this purpose.

The responses received were divided on the benefit this additional guidance would provide. However, on balance, responses received were broadly supportive of additional *non-prescriptive* guidance. Responses from industry stakeholders generally indicated that if guidance was framed as requirements or expectations, it would be likely to result in additional business costs, which could be passed on to consumers. In light of the responses received, we will proceed with the proposed guidance.

Proposal D1: Guidance on areas where the responsible lending obligations do not apply

127 In CP 309 we proposed to include new guidance to address some apparent uncertainty or confusion about kinds of lending and activities where the responsible lending obligations do not apply. In particular we noted that there has been anecdotal feedback that some licensees may be applying the responsible lending obligations to some small business lending.

Feedback received

128 The written submissions demonstrated some confusion about the need for this addition to the guidance. Some raised legal and factual issues that are beyond the scope of ASIC’s guidance in RG 209. For example:

(a) some credit providers and industry associations took this as an opportunity to raise issues about the provisions in the National Credit Code that determine whether credit is regulated or unregulated, referring to circumstances where there is uncertainty about the predominant purpose for the provision of credit; and

(b) one credit assistance provider similarly raised an apparent uncertainty about when the provision of information about options becomes a form of credit assistance that is subject to the licensing and responsible lending obligations.

129 Consumer representative groups raised a concern that the inclusion of this guidance could inadvertently cause greater confusion if ASIC's guidance is not aligned to the approach taken by AFCA.

130 During the public hearings, AFCA representatives described the differences between:

(a) ASIC's jurisdiction in relation to consumer credit and the responsible lending obligations and AFCA's remit in relation to both consumer credit and small business lending; and

(b) the responsible lending obligations that apply under the National Credit Act to consumer credit, and the broader obligations to act fairly that apply under the Banking Code of Conduct to small business lending.

131 AFCA indicated that it is developing its guidance on its approach to responsible lending and small business lending complaints, and that it will be adopting terminology that seeks to make the distinction between those obligations clear.

ASIC's response

The feedback received and recent public commentary has expressed some mistaken views and concerns about the effect of applying the responsible lending obligations to business lending.

To correct these views and address related concerns, we think that it is useful to include additional guidance about the scope of the obligations. This guidance will make it clear that lending that is predominantly for business purposes, including to individuals who operate a small business, is not regulated (even if the loan is secured over personal assets, such as residential property).

Guidance on the provisions that determine the scope of the consumer credit regime, including the 'predominant purpose' test set out in the National Credit Code, is already contained in Regulatory Guide 203 *Credit licensing: Do I need a credit licence?* (RG 203). The additional comments included in our revised guidance refer to and expand on that existing guidance.

In some circumstances, it may be difficult to determine the predominant purpose for the provision of credit, or the point at which information provided to the consumer becomes a suggestion that they apply for credit (i.e. credit assistance). We consider that in these circumstances, licensees should seek their own legal advice having regard to the particular factual circumstances they are considering.

Proposal D2: Guidance on fraud risks and impact on the responsible lending obligations

132 In CP 309 we proposed to include new guidance to outline factors that can be indicators of a higher fraud risk, and which might indicate that it is reasonable to undertake additional verification steps. We consider this guidance would reflect the findings of the Federal Court in *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2018] FCA 155.

133 We also proposed that this additional guidance highlight that compliance with the responsible lending obligations, and in particular the verification requirements, may have a role in mitigating risks involved in loan fraud (and so have an additional benefit for licensees).

Feedback received

134 The responses in written submissions were divided:

(a) A significant number of submissions (30 submissions, across a range of stakeholders) considered that any guidance that ASIC can provide would be helpful, particularly for smaller businesses who may not be as experienced or not have the oversight and resources of their larger counterparts

(b) A small number of submissions (five submissions, from two large lenders, industry associations and a compliance service provider) considered that fraud management is purely a matter for the credit provider, and that guidance from ASIC would be unnecessary. These submissions also noted a concern that by referring to risk indicators ASIC could inadvertently provide a 'how to' guide to potential fraudsters.

135 Disappointingly, some submissions from industry respondents failed to recognise that our proposal related to the importance of identifying false or unreliable information provided by credit assistance providers or other third parties (see paragraphs 74–76 of CP 309), and instead focused their comments on circumstances of consumer fraud.

136 These respondents did not appear to understand the relevance of taking steps to identify potential fraudulent information in meeting the responsible lending obligations, and the risk of harm for consumers where fraudulent conduct is engaged in by intermediaries. They also did not appear to understand that if they have reason to believe information is not true, they should not have regard to it for the purpose of making an assessment of whether a credit contract is unsuitable.

137 Consumer representative groups considered that further guidance about loan fraud and the impact on responsible lending obligations of the licensee would be beneficial particularly in improving a licensee's processes and minimising online fraud risk. Examples provided by both consumer groups and industry indicate that fraudulent payslips are fairly common and the hardest to detect.

138 It was generally acknowledged that the extra verification processes, if adopted, would be beneficial for consumers. However, a small number of submissions across licensees and industry associations also commented on the potential for increased business costs including changes to systems and processes, greater manual intervention, training, and possible delays associated with the loan application process.

ASIC's response

We consider that additional guidance of the kind outlined in CP 309 should be included. On balance, we think that the responses that understood the proposal to be referring to the reliability of information provided by third parties (rather than the consumer making the application) considered the proposed guidance to be useful.

We also note that the guidance that is proposed reflects the issues considered, and findings of the Federal Court, in *Australian Securities and Investments Commission v Australia and New Zealand Banking Group Limited* [2019] FCA 155.

Proposal D3: Guidance on use of repayment history information

139 In CP 309 we proposed to include new guidance about use of repayment history information, which is becoming more readily available through developments in comprehensive credit reporting (CCR). The guidance proposed is to clarify that the occurrence of repayment difficulties does not necessarily mean that a new credit product will be unsuitable for the consumer in all cases, and that such information should be considered as a trigger for additional inquiries.

Feedback received

140 The responses in written submissions were divided:

(a) The majority of submissions that responded to this proposal (27 submissions, across a range of stakeholders) considered that the proposed guidance would be useful, because it would provide credit providers with comfort that past repayment difficulties or hardship does not necessarily mean that a consumer cannot be granted credit, and confidence to proceed with considering their application in a way that is appropriate to their circumstances.

(b) A third of the submissions that responded to this proposal (14 submissions, including from four large lenders and two industry associations) considered that the decision to refuse to grant credit is a matter solely for the credit provider to determine in accordance with its own policies and risk appetite. These responses considered that the proposed guidance would not have any significant value. These responses noted that there could be some negative cost impact for credit providers if they were required to undertake the additional inquiries referred to in the proposal.

(c) Credit representative groups were generally supportive of further guidance on the use of negative repayment history information and financial hardship indicators. Some consumer representative groups noted examples of licensees refusing credit based on difficulty encountered with a high-interest product when the consumer would clearly benefit from and could afford a lower interest product.

141 Industry respondents expressed a concern that there could be an increase in business costs and manual processing times associated with making further inquiries into the reasons behind the negative repayments history and financial difficulties.

ASIC's response

We consider that additional guidance of the kind outlined in CP 309 should be included.

We consider that the proposed guidance will involve benefits for both licensees and consumers, by giving licensees confidence to continue with inquiries and the assessment process to determine whether the consumer is able to afford additional credit notwithstanding past repayment difficulties.

We note that the decision to refuse to grant credit is a matter for the credit provider, and we do not consider this guidance will undermine the credit provider's discretion. The guidance would not prevent a credit provider from refusing an application, without further inquiry, should they wish to do so.

However, it should be understood that this decision is made on the basis of credit provider's internal policies and risk appetite, and not as a result of the operation of the credit reporting and responsible lending obligations.

Proposal D4: Guidance on records of inquiries and verification steps

142 In CP 309 we proposed to include new guidance that reflects the findings and recommendations on good recording practices included in REP 493.

Feedback received

143 The submissions received were generally supportive of further guidance to ensure consistency in the industry, resulting in a better consumer experience. Licensees and industry associations indicated that any guidance in this area should be broad-based and flexible, to allow for innovation in how assessments are developed and delivered to consumers (including by digital means) and how records are maintained.

144 Thirteen submissions referred to the additional costs involved in making changes to processes, systems and training. However, some also noted that these costs, while significant in the short term, would likely lead to a greater understanding by both consumers and industry as to the way credit assessments are being conducted.

145 Consumer representative groups were supportive of further guidance on good record-keeping practices which would prove useful to both consumers and industry with dispute resolution. One group noted that given the poor record-keeping practices they have seen, and how difficult it is to resolve complaints, ASIC should make it clear that a negative inference will be drawn if there is no record of the inquiries and verifications made.

> *ASIC's response*
>
> We consider that additional guidance of the kind outlined in CP 309 should be included.

Proposal D5: Guidance on content of written assessment

146 In CP 309 we proposed to include new guidance about the purpose of the written assessment, and on the kind of information we think should be included in a written assessment, with an example to illustrate the level of information we think should be included.

Feedback received

147 The responses in written submissions were divided:

(a) Most submissions that responded to this proposal (22 submissions) considered that providing an example of the kind suggested would be useful and give licensees more certainty about the level of information ASIC considers should be included in the written assessment. They also generally agreed that the level of information included in the example is appropriate (although some disagreed with aspects of the example, such as the amount of information about expenses, reference to information provided by the consumer that has not been relied upon and information about support from third parties).

(b) Six submissions considered that it would not be helpful to include additional guidance about the written assessment. These submissions also raised concerns about the level of information provided in the example, noting that it would involve significant system changes and costs involved in staff training to collate and provide that level of information.

148 More generally, submissions noted that:

(a) in preparing an example, ASIC should take into account whether the level of information included is useful for consumers and is clear, concise and effective (some suggested that the example should be consumer tested); and

(b) it should be made clear that the example is only to provide guidance on the level of information ASIC considers appropriate and is not intended to be a template or prescribed format (i.e. the form of the assessment should continue to be a matter for the licensee to determine, which would minimise additional business costs).

149 The main concerns raised by industry around the costs associated with the proposal related to changes in systems and processes as well as staff training. Some submissions also noted that these costs are time sensitive and that, while there may be an initial period of adjustment, these costs should not be significant if licensees were provided with a reasonable time to comply with any new process.

150 Consumer representative groups strongly supported the proposal. Some submissions provided examples of written assessments that had been provided to clients, which demonstrate the concern that documents provided to clients in practice may not, in at least some cases, be fit for the purpose of informing the consumer or the basis on which a credit product has been assessed as 'not unsuitable' for them.

151 Consumer representative groups also commented that a further problem is that written assessments are only provided on request and are created at that time (instead of before the contract is entered, or credit assistance provided). These groups requested imposition of a requirement to prepare and give the written assessment before entry into the credit contract.

ASIC's response

We consider that additional guidance of the kind outlined in CP 309 should be included. We note that the guidance should make it clear that this is provided as an example to demonstrate the level of information ASIC considers appropriate for a written assessment to be fit for purpose, and not a requirement about the format of the written assessment.

While we understand the concern expressed about when written assessments are prepared and provided, we note that the legal obligation is only to provide a written assessment upon request, for a period of up to seven years after the contract is entered (or credit assistance provided). ASIC's guidance cannot impose a requirement to provide this document at an earlier time. However, we would more generally encourage licensees to make the consumer aware that they have a right to request a written assessment, either before or after entry into the credit product.

Appendix: List of non-confidential respondents

- 86 400 Ltd
- Australian Banking Association
- Australian Finance Group Ltd
- Australian Finance Industry Association
- AHL Investments Pty Ltd
- Australia and New Zealand Banking Group Limited
- Australian Retail Credit Association
- Athena Home Loans
- Auscred Ltd (Lendi)
- Australian Retailers Association
- Better Mortgage Management
- Bank of Queensland Limited
- Consumer Action Law Centre
- Commonwealth Bank of Australia
- CHOICE (The Australian Consumers' Association)
- Code Compliance Monitoring Committee
- Connective Credit Services Pty Ltd
- Consumer Credit Legal Service (WA) Inc.
- Consumer Law Centre and Care Inc.
- Controlabill Pty Ltd
- Customer Owned Banking Association
- Dentons
- Economic Abuse Reference Group
- Equifax Pty Limited
- Finance Brokers Association of Australia
- Financial Counselling Australia
- Financiers Association of Australian and Min-it Software (joint submission)
- Finance Industry Delegation
- Financial Rights Legal Centre
- Firstmac Limited
- Haselgrove, Simon
- Hazadonis, Peter
- HSBC Bank Australia Limited
- illion (formerly Dun & Bradstreet)
- Jamie
- Law Council of Australia—Business Law Section
- Legal Aid Commission of New South Wales
- Legal Aid Queensland
- Legal Practice Holdings Pty Ltd
- Lend Assess Pty Ltd
- Loan Market Pty Ltd
- Macquarie Group Limited
- Maurice Blackburn Lawyers
- McGowan, Tracey
- Monash University
- Mortgage and Finance Association of Australia
- Mortgage Choice Limited
- Motor Traders Association of Australia
- National Australia Bank Limited
- National Credit Providers Association
- Neve, David
- Piper Alderman
- Prospa Advance Pty Ltd
- QED Risk Services Pty Ltd
- Quantium Group
- RACQ Bank (Members Banking Group Limited)
- RateSetter Australia RE Limited
- Rent4Keeps
- South Australian Financial Counsellors Association
- SocietyOne Australia Pty Ltd
- Tic:Toc Online
- The Polygon Group
- University of Sydney Policy Reform Project
- Verifier Holdings Pty Ltd
- Westpac Banking Corporation