



ASIC
Australian Securities &
Investments Commission

**Australian Securities
and Investments Commission**

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24 April 2020

Ms Anna Bligh AC
Chief Executive Officer
Australian Banking Association

By email: [REDACTED]

Dear Ms Bligh

Regulatory approach to lending during Coronavirus (COVID-19) pandemic

I refer to your letter dated 9 April 2020, which sets out a number of matters on which the Australian Banking Association (ABA) seeks guidance from the Australian Securities and Investments Commission (ASIC), as well as requests for relief under s203A of the National Credit Code.

I will respond to each of these matters but at the outset express ASIC's support for the members of the ABA taking a flexible and facilitative approach to customers during this challenging time. We encourage ABA members to continue to work closely with their customers to develop options that provide both short-term assistance to customers experiencing difficulty due to COVID-19 and also longer-term viability post COVID-19.

Application of responsible lending obligations

As you have noted in your letter, in the current circumstances there is a need to support how customers manage their commitments on existing credit products as well as to ensure the continued flow of credit in the economy. We agree with your comment that the desire to provide credit must be balanced with taking the appropriate steps to ensure decisions made today will not have an adverse impact on customers over the longer term.

Responsible lending obligations are not a barrier to agreeing contract changes in response to hardship situations

The ABA, and some individual lenders, have described a number of different options for reducing short-term repayment obligations of consumers experiencing financial hardship, including changing the repayment terms

from principal and interest (P&I) to interest only (IO), 6 month repayment deferrals with capitalisation of interest, and extending the term of the loan. We confirm our view that changes of this kind can typically be achieved through variations to the existing contract, as opposed to entry into a new contract on different terms. As you are aware, the responsible lending obligations only apply before a contract is entered into or a credit limit under an existing contract is increased. Accordingly, we consider these obligations will not be triggered for variations of the kind described.

While capitalisation of interest may result in an increase to the balance of a credit contract, that does not necessarily involve an increase to the credit limit under the contract. We note that under s3(2) of the National Credit Code interest charges under the contract are taken not to be a part of the 'amount of credit' and so are not included as part of the maximum amount of credit that is provided under the contract.

One option referred to for home loan customers includes debt consolidation to reduce total repayments across a wider credit portfolio. While this may be an appropriate strategy for some borrowers, this kind of response is more likely to involve an increase to the credit limit under the home loan and may significantly increase the consumer's exposure to loss of their home. If there is an increase in the credit limit under the home loan as a result of the debt consolidation, the responsible lending obligations will apply.

New lending

We note that the government has made temporary changes to the test for when responsible lending will apply. That is, responsible lending obligations do not apply in circumstances where credit is provided to existing customers who operate a small business and a part of the credit provided will be used for the purposes of that business.

For those loans where responsible lending will continue to apply, we consider there remains sufficient flexibility for lenders to take a range of actions to reduce the difficulty likely to be experienced by significant numbers of consumers. We are conscious of the importance of responsible lending obligations in providing key protections so that short-term assistance does not become a longer-term, unmanageable burden for consumers. Managing these objectives (including flexibility, providing assistance and reducing the risk of harm) is likely to require a nuanced approach in many circumstances and we welcome the opportunity to further discuss with you and members various options as this situation evolves.

You have sought clarification of whether it is appropriate for lenders making unsuitability assessments to make certain assumptions, including:

- (a) that income of persons adversely impacted by COVID-19 economic conditions are likely to regain previous income within a reasonable period after restrictions are removed;

- (b) any deterioration in asset values is unlikely to be permanent; and
- (c) that the consumer's requirements and objectives relating to their COVID-19 impacted financial position is likely to be a prominent consideration.

In general, we note that the effect of the current economic conditions on asset values may be temporary, and it may be reasonable in some circumstances to assume that asset values will improve in the longer term. We note that assets are not generally the primary basis for an assessment of a consumer's capacity to meet loan repayments (other than where those assets contribute to income), and that assumptions about the value of assets are less likely to result in a failure to identify that a loan is unsuitable. However, this will depend on whether, and in what circumstances, it is anticipated assets will be used to meet repayment obligations. We recognise that the value of assets may be a more general commercial consideration for lenders in relation to their own credit risk modelling and policy application.

We agree that the consumer's requirements and objectives during this period are likely to be affected by the current situation. Our revised (*December 2019*) guidance about requirements and objectives on RG 209 focusses on communicating with the consumer to understand the consumer's requirements and objectives, including by identifying their priorities, and so enabling an assessment of whether the credit contract meets those requirements and objectives. There is no impediment to high priority being given to meeting a shorter-term funding need. The guidance recognises that in some circumstances consumers may be prepared to make significant short term changes to their lifestyles that they would not ordinarily be willing to make. However, the consumer's longer-term requirements and objectives should also be considered, with regard to the length of the loan to be entered.

We note that the consumer's income is a key consideration affecting capacity to meet financial obligations. The position outlined by the ABA involves making assumptions about a consumer's income (that it will return to pre-COVID-19 levels) without any regard to the consumer's actual circumstances which may indicate that such a recovery is more likely or less likely. While we agree that ensuring the ongoing flow of affordable credit is important, it is also important that provision of new credit is not based upon assumed changes where these are unlikely to be met, and which will result in unmanageable debt burdens for consumers.

There may be a range of circumstances that lenders can consider when assessing the consumer's current and likely future capacity to meet repayment obligations under the terms of the loan – including:

- availability of immediate repayment deferral periods for managing current obligations;

- eligibility for Government support (e.g. through the JobSeeker or JobKeeper programs);
- whether the consumer's employer has registered for the JobKeeper subsidy – this may, for example, provide an indication of ability and intention to reemploy the consumer (conversely, not accessing the subsidy may be an indication that the consumer will not be reemployed, or the business itself will not continue);
- if the consumer's employer is not accessing JobKeeper subsidies because of its size/nature (e.g. local council, university, larger business or insufficiently affected turnover), whether the employer is able to provide any assurance about prospects of reemployment.

There may be different individual circumstances that will affect the lender's consideration of what the consumer's likely financial position will be, such as previous employment history, qualifications and the industry of ordinary employment. We consider lenders should seek to form a justifiable view of what is likely, based on their understanding of the circumstances affecting the particular consumer.

If a lender does rely on assumed changes to the consumer's financial position, consideration should be given to how the lender will respond if the assumed recovery does not in fact occur or only over an elongated period. For example, the lender may need to consider whether it would be prepared to provide hardship arrangements for an additional period to give the consumer a further opportunity to recover their financial situation.

Application of the obligation to act efficiently, honestly and fairly

We agree that application of the general obligations set out in s47 of the *National Consumer Credit Protection Act 2009* (NCCP Act), including the obligation to act in an efficient, honest and fair way, may be affected by the circumstances in which a licensee is operating that are beyond its control, including the broader economic conditions. For example, in the current circumstances and given the volume of hardship applications being made to the banks, it will not necessarily be unfair to take longer in processing some of the applications for hardship than would otherwise be the case.

This obligation should not be regarded as a barrier to offering consumers appropriate hardship arrangements. Hardship arrangements ordinarily do not reduce the amount ultimately payable by the consumer and may result in a larger amount being paid for credit in the longer term. On its own, this increased cost would not suggest a failure by the lender to act fairly.

We consider that fairness to the consumer may involve advising the consumer of different available options that may assist and the longer-term implications for the consumer, to enable an informed decision to be made. Lenders should determine the best way to achieve this kind of fair treatment having regard to the circumstances. It may be unfair to encourage the consumer to

undertake a particular contract change that reduces risk exposure for the lender (such as through debt consolidation) but ignores longer term priorities for the consumer.

Disrupted property settlements

We have previously confirmed the industry view that the responsible lending obligations do not apply to require a further unsuitability assessment to be completed after entry into a credit contract, even if there are significant changes to the financial situation that was considered before entry into the contract. Accordingly, the responsible lending obligations do not raise a barrier for proceeding with 'in-flight' property transactions where there is a change of circumstances between entry into the loan and drawdown of funds on settlement of the property transaction.

The lender may elect to terminate the contract before providing any credit if the credit contract allows the lender to take that path. This is a commercial decision for the lender to make in accordance with the terms of its contract.

We expect the obligation to act in a way that is efficient, honest and fair may affect how the lender chooses to exercise their discretion to terminate the contract, rather than funding it. For example, the lender may consider it appropriate to discuss the changed circumstances with the consumer, determine what flow on effects the decision will have in relation to the property transaction (e.g. loss of deposit, loss of home, potential contractual liability for the consumer) and whether it is fair in all the circumstances to terminate the contract.

We understand that some lenders may be concerned that they would be at risk of breaching the obligation to act efficiently, honestly and fairly if they proceed to fund a home loan in these circumstances, and immediately offer hardship arrangements such as repayment deferrals.

In the current circumstances we would not consider that proceeding to fund the loan and offer immediate hardship arrangements would be an indication of a failure to act efficiently, honestly and fairly.

Approach to procedural requirements under the Code for making contract changes

The ABA has requested that ASIC give class relief under s203A of the National Credit Code that gives exemptions from or modifications to a number of provisions that affect the process of changing contract terms, providing written documents to consumers and executing contracts and guarantees.

ASIC's powers under s203A of the National Credit Code are more limited than its ordinary relief powers under other parts of the NCCP Act and the Corporations Act. These powers are limited to a power to exempt a person or

contract from specified provisions of the Code. ASIC does not have a power to modify provisions in the Code.

Electronic transactions

In relation to electronic transactions, the ABA has sought an exemption from s187 of the National Credit Code. That provision provides that specified kinds of contracts may be made in accordance with the *Electronic Transactions Act 1999* (ET Act), and that requirements in the Code to give or record information in writing may be met in accordance with the ET Act.

An exemption from this provision would not be effective to disapply the procedural requirements in the ET Act and Regulations. This is because:

- An exemption can only switch off a requirement or prohibition. As s187 does not impose any requirements on lenders (but rather permits use of electronic communication), it is not possible to give an exemption. If this provision were disapplied, it would instead have the effect that lenders do not have the option of providing written documents in an electronic form.
- The requirements to be met for using electronic communications are contained in the ET Act and Regulations, in relation to which ASIC does not have any relief powers.

While we note the ABA's reference to relief given under the Corporations Act to enable a 'publish and notify' approach (using modification powers under that Act), we are unable to take similar action in relation to the Code provisions as ASIC does not have a modification power under the Code.

Given these restrictions on our powers, we do not consider that ASIC can provide relief from these procedural matters. However, we acknowledge that strict compliance may be difficult due to the number of hardship requests to be managed and the widespread social distancing measures. ASIC will take a facilitative approach to support lenders to make their best endeavours to comply with the procedural requirements (i.e. form of documents and timeframe for giving documents) and will not take action in relation to strict failures to comply where lenders have made reasonable efforts to comply in the circumstances. We note that this position does not affect the legal rights of debtors and guarantors under provision of the Code, or the legal validity of documents executed in a way that is contrary to the ET Act and Regulations.

Approach to substantive requirements under the Code

The ABA has requested that ASIC give class relief under s203A of the National Credit Code that gives exemptions from:

- the guarantor notice and acceptance requirements in s61 of the Code, where liabilities are increased due to repayment deferral of up to 182 days.
- the requirements in s71 and s73 of the Code to give written notice with particulars of changes to a credit contract resulting from a repayment deferral of up to 182 days.

Guarantor notice and acceptance requirements

The ABA appears to be seeking relief on the basis that this requirement creates a barrier to the offer of repayment deferrals. We do not agree that the provision of appropriate hardship arrangements is dependent upon the guarantee being extended. This provision restricts circumstances in which a guarantor's liabilities can be increased as a result of a change to the credit contracts. It does not require that the guarantor's consent be obtained before a contract change is made.

An exemption from this requirement would involve a transfer of additional credit risk from the lender to the guarantor without the guarantor's knowledge or consent. We note that guarantors are likely to be individuals who may also be in financial positions that are impacted by COVID-19. Removal of their right to refuse to accept an extension to their guarantee to provide further security to the lender, would involve a risk of significant consumer harm.

However, as noted above, we consider that it is appropriate to take a facilitative approach to use of electronic communications if the lender chooses to seek an extension to the guarantee.

Written notice documenting contract changes

The ABA seeks an extension of existing relief (in s71(2) of the Code and ASIC class order [CO 14-41]) to cover 182-day repayment deferrals. The existing relief removes the requirement for written notice documenting contract changes due to 'simple arrangements', being a change that defers or otherwise reduces the obligations of a debtor for a period not exceeding 90 days.

As these deferrals are proposed as a response to hardship situations, it is not clear why such changes would be made by agreement under s71 of the Code, rather than the prescribed framework for hardship notices. We note that under s72(1) of the Code a hardship notice is given if 'a debtor considers that he or she *is or will be* unable to meet his or her obligations under a credit contract' and gives notice of that inability (*emphasis added*).

We consider it would be inappropriate to give an exemption from the requirements in either s71 or s73 of the Code. The provision of a written description of the changes made is important to enable consumers to understand the effect of the change on their obligations. For example, so

they are aware of what their changed repayment obligations are, when those obligations commence, frequency of repayments, changes that will be made to their credit balance through capitalisation of interest, and changes that will be made to the term of their loan. Relief would involve a real risk of consumers not being properly informed about the obligations with which they must comply, once the deferral period ends.

However, as noted above, we consider that it is appropriate to take a facilitative approach to the timeframes for complying with these requirements and use of electronic communications.

In addition to the views outlined in this letter, ASIC is publishing guidance on our website to address the main questions raised about compliance in the current circumstances. This guidance will highlight matters we consider are particularly important when dealing with hardship requests at this time.

Thank you again for your proactive approach to addressing challenges likely to be faced by your members and their customers in the current environment. We are happy to meet to discuss our comments or any other proposed approaches you may be considering.

If so, my executive assistant Connie Poloni [REDACTED] will be able to assist with coordinating diaries.

Yours sincerely



Sean Hughes
Commissioner