Summary of ASIC's New Responsible Lending Guidelines | RG209

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Contents of this review document

1. Background

ASIC issued consultation paper CP309 in February 2019 seeking feedback on proposed changes to the responsible lending guidelines document RG209 which was last revised in 2014. The review was intended to reflect market and regulatory changes that had occurred since the original document was released, and in particular to consider issues arising from recent case law and the Banking Royal Commission. Industry feedback was provided from February to May and the revised Regulatory Guide paper RG209 was issued on December 9 2019.

The purpose of the Regulatory Guide is to set out ASIC's views on what the responsible lending (RL) obligations of the National Consumer Credit Protection Act 2009 (NCCP) require and to explain how credit providers can minimise their risk of non – compliance with those obligations. ASIC notes that the guidance is not law and that it is the responsibility of the credit provider to interpret the new guidelines in respect of consumer credit legislation.

A key requirement of the NCCP is that credit providers must provide a customer with a credit product (including an increased credit limit) that is "not unsuitable". A product will be unsuitable if it is likely that the consumer will be unable to comply with their financial obligations under the product terms or will only be able to do so with "substantial hardship", or if the product does not meet a consumer's requirements and objectives.

2. Overview

The "Overview" section provides a summary of the existing legislation and credit providers' obligations and seeks to clarify that business loans are not covered by the RL obligations providing that the purpose of the loan is predominantly for business not consumer purposes (i.e. over 50% of the loan will be used for business purposes or the assets acquired with the loan will be mostly used for business). The credit provider must form a view of the purpose of the loan and cannot simply rely on a declaration by the customer but must make reasonable inquiries about the purpose of the loan. These clarifications do not introduce new provisions, but still leave unresolved the potential for conflict with AFCA and other consumer protection bodies who may not agree with this position, for example when considering loans to sole traders and small businesses.

New guidance is provided for small amount credit contracts, reverse mortgages and for credit cards. For the latter there is now a requirement to assess a consumer's requirements and objectives in determining product "non - unsuitability".

3. Making reasonable inquiries and verifications

Obligations under the NCCP are to make "reasonable enquiries" about the consumer's financial situation, their requirements and objectives; and to take "reasonable steps" to verify that information.

While a number of market participants had requested ASIC to prescribe the specific or minimum requirements for inquiries and verification steps, ASIC has retained its approach of stating the overall principles but has included numerous indicative examples of the steps and inquiries that credit providers should be making.

Much discussion has been generated in recent months over how to meet RL obligations in assessing income and expenditure, particularly relating to the use of HEM (or other benchmarks) in lieu of making assessments based on a consumer's actual financial position.

To substantiate income, the new guidance requires credit providers to obtain information from each applicant about the amount, frequency and source of income and whether that income is likely to be consistent for the term of the loan. ASIC does not consider it sufficient to merely identify income received in the last pay period. The guidance requires credit providers to consider future changes in the consumer's expenses or income that are likely to affect servicing capacity and provides specific examples about consumers with "lumpy" or small business income, casual or gig economy participants and retirees.

The use of benchmarks is restricted to comparing information from the consumer with a reasonable benchmark in certain defined circumstances. If justifiable, a credit provider can accept an application which shows expenditure below the HEM minimum benchmark. The Guide states that "income and expense benchmarks do not confirm or verify that the information about the consumer is true " and adopts the position that using benchmarks does not meet the requirement to make "reasonable enquiries" or to verify the consumer's financial position.

For the verification of expenditure, ASIC requires a credit provider to obtain detailed information about current outgoings and "reasonably foreseeable" changes to those outgoings, including where outgoings are shared with another person.

ASIC provides an extensive set of tables identifying the range of information that a credit provider should consider using in assessing a consumer's financial position, much of which will require detailed interaction and discussion with the consumer.

Given these non – trivial requirements, ASIC has sought to provide guidance on what kinds of inquiries and validation steps are reasonable, given that consumers will vary, as will their product requirements. The concept of *scalability* is supported, with more information being needed for more complex products, higher value loans, and for new to bank customers compared with long - term existing customers, for example. While the concept is stated as appropriate there is little further detailed guidance as to what will be deemed acceptable practice by credit providers operating within that principle.

Interestingly, the new guidance allows for a minimal verification threshold (anticipating a future open banking environment) where a consumer's "good" historical performance on a loan that meets their requirements can be used as evidence of "non - unsuitability". This means that if the consumer applies for a similar type of loan with another credit provider, or applies for refinance, fewer enquiries need to be made. Note that there is no clear guidance as to what "fewer enquiries" actually means in practice.

Circumstances are defined and examples given where more information is needed, along with circumstances where less may be required. Particular emphasis is given to identifying "red flags" and to the "risk of consumer harm" where new financial commitments represent a *proportionally* significant part of a consumer's available income. ASIC notes that the ability to service a loan should be assessed on the basis of income and expenditure, not (in general) from the use of assets.

Specific requirements are defined for certain credit products which may have more potential for harm, for example reverse mortgages, some credit cards and small account credit contract loans.

For customers in hardship, or with a negative repayment history, ASIC advises that more enquiries should be made of the customer's circumstances but does not consider that the occurrence of repayment difficulties on one product should necessarily mean that *any* new credit product will always be unsuitable.

Specific guidance is given when using information provided by a broker including the requirement for a credit provider to form its own view on whether information from a broker is reliable and up to date.

4. Assessing whether a credit contract is “not unsuitable” for a consumer

A credit provider’s obligations to assess a product as “non – unsuitable” needs to go beyond a financial assessment of ability to repay and should include an understanding of a consumer’s requirements and objectives. The information obtained must be specific and enable the credit provider to understand why the credit product is sought by consumers, and what terms and features are important to them.

New guidance is provided on key terms that have previously been undefined: the terms “likely”, “unable” and “substantial hardship” are considered. “Likely” is defined as including the need for credit providers to consider reasonably foreseeable changes in a customer’s future circumstances. “Unable” references both the customer’s individual circumstances and allows for the use of a “conceptual minimum” level of outgoings. “Substantial hardship” exists where a consumer cannot meet repayment obligations where the amount available for expenses that are necessary for living and taking part in society is insufficient.

ASIC acknowledges that some expenses can be reduced or eliminated but this needs to be discussed with the consumer, rather than the credit provider assuming that all kinds of expenditure can be eliminated. There is much discussion of discretionary vs non – discretionary or essential forms of outgoings and the need to enquire about special circumstances that a consumer may have (for example high medical costs). The Guide also covers the need for a credit provider to inquire about future intentions or events likely to impact the consumer. Again, ASIC provides a number of worked examples that illustrate its views.

ASIC has provided specific guidance around the use of statistical benchmarks, particularly HEM. ASIC has indicated a number of limitations around using HEM, for example the need to know what spending items are excluded from HEM, to only use the estimates of spending on the kind of items included in the benchmark and to ensure that the up to date HEM is understood and used.

Given the now widespread adoption of automated decisioning systems, ASIC now requires that these are subject to periodic review and testing.

ASIC makes it clear that the RL obligations are separate from, and not satisfied by, credit or risk decisioning. The role of credit risk scores (predicting likelihood of default) is seen as a necessary but not sufficient condition for meeting RL obligations, but may be used as a basis for requesting less (or more) information from the applicant.

New guidance is provided on the consequences of using unreliable information, including that provided to the credit provider by intermediaries such as brokers. ASIC makes it clear that the credit provider must make their own inquiries or verification steps, and not just rely on third party information if it is not reasonable to believe that it is true.

Also new are guidelines to permit fewer inquiries to be made where a consumer is switching to a similar credit product or refinancing an existing loan.

5. Making and providing an assessment to the customer that the product is “not unsuitable”

The purpose of a written assessment is more clearly defined.

Previous guidance was that an assessment had to be provided for customers that requested it. The new guidance states that, over and above this requirement, an assessment and explanation of why a product is “not unsuitable” should be produced and documented for every approved loan.

The new guidelines require records to be kept of all applications/fact finds/needs analysis and relevant customer communications that set out in plain English why the product provided to the customer is “not unsuitable”.

Credit Assistance Providers (including brokers) are required to follow the same process in forming a “preliminary assessment” of the customer’s financial position, requirements and objectives.

ASIC may require sight of such documents when undertaking monitoring or surveillance activities. Assessments need to be stored for 7 years.

Lengthy guidance and several examples are provided in this regard, including a template (Appendix 2).

About the author

David Grafton is a Director at PwC Australia and the Head of Business Development for PwC Protect.

David has over 20 years' risk management experience including eight years as Chief Risk Officer for CBA's retail bank and seven years managing the credit bureau and software/analytics businesses at Experian and Equifax.

David was a founding member of ARCA, its first chairman and a director for 10 years, promoting Australia's move to comprehensive credit reporting and open banking.

In 2018, David joined PwC Australia as a Director in the banking analytics area and has since moved into the role of Head of Business Development for PwC Protect, a fraud detection software platform built by PwC Australia. Get in touch with David via david.grafton@pwc.com