

RESPONSIBLE LENDING: ASIC PUBLISHES SIGNIFICANT NEW GUIDANCE AIMED AT HELPING CREDIT PROVIDERS APPLY THE LAW IN PRACTICE

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Legal Briefings - By **Tony Coburn, Danielle Briers and Beth Waterfall**

Consumer credit providers in Australia have been eagerly awaiting ASIC's updated regulatory guide on the responsible lending laws (**RG 209**), which landed on 9 December 2019 and is another significant development in the understanding of these laws.

This follows an extensive consultation process, with ASIC receiving more than 70 responses to its consultation paper of February this year (**CP 309**) and conducting public hearings for the first time in more than 15 years.

Earlier this year we also saw Westpac's win in *ASIC v Westpac* [2019] FCA 1244, where Justice Perram held that a lender "may do what it wants in the assessment process; what it cannot do is make unsuitable loans".

ASIC believes that the Westpac decision left too much uncertainty around which steps are required of a lender.¹ It is appealing Justice Perram's decision but has nonetheless sought to reflect it in the new RG 209 pending that appeal.

This is the first time the regulatory guide has been substantially changed since 2011, other than minor edits made in 2014 to clarify ASIC's expectations about making inquiries into expenses. ASIC Commissioner Sean Hughes recently commented that "all the ingredients necessary" for an update to RG 209 are here - "judicial decisions, ASIC enforcement action, thematic reviews, the Royal Commission, and changes to technology among other developments".²

In this article we highlight the main aspects of the new RG 209 and comment on its role in the wider responsible lending landscape as we near the end of 2019.

REASONABLE INQUIRIES AND VERIFICATIONS - PRINCIPLES-BASED APPROACH REMAINS

Since its introduction the *National Consumer Credit Protection Act 2009* (NCCP Act) has contained two separate, but interlinked “responsible lending” obligations for lenders assessing consumer credit applications:

1. make reasonable inquiries about the applicant’s requirements and objectives, and reasonable inquiries and verifications about their financial situation, and
2. not enter into a credit contract that is unsuitable for the applicant.

In CP 309, ASIC said it was considering whether to identify particular inquiries and verification steps that ASIC thought would generally be reasonable.

Many submissions in response to CP 309 supported this idea, noting that it would promote consistency in lender approaches and therefore customer expectations. Some went so far as to suggest that ASIC should establish minimum standards of conduct, or “safe harbours” (standards of conduct which ASIC would view as sufficient).

Despite these submissions, ASIC has opted to “continue the existing principles-based approach” but make changes to its guidance to more clearly articulate the principles that it considers 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.³

GENERAL PRINCIPLES

New RG 209 introduces four general principles that ASIC will have regard to when considering whether a lender is complying with the responsible lending obligations:

- The lender should have regard to what the obligation is intended to achieve and what consumer harm it is intended to address.
- The lender should have regard to the circumstances of the individual customer.

- The lender should have regard to whether the credit product involves a higher risk of harm to the individual consumer if unsuitable.
- The obligations are not static – what is “reasonable” will be affected by the broader professional and regulatory environment in which the lender operates. For example, legislative developments (eg open banking and comprehensive credit reporting) and other developments and innovations adopted by the credit industry will affect what measures would be reasonable for the lender to take.

As under the old RG 209, ASIC will also take into account other obligations that apply to credit licensees, such as the consumer protection provisions in the ASIC Act and the obligation to do all things necessary to ensure that its credit activities are engaged in “efficiently, honestly and fairly” (NCCP Act, section 47).

TREATMENT OF LIVING EXPENSES

ASIC’s new guidance acknowledges that “there are different kinds of outgoings” and “some are likely to be more important than others for the consumer”. Lenders “are likely to need enough information to determine how much of the consumer’s income is, and will continue to be, needed for **outgoings the customer is unable or unwilling to forego**”.

This is consistent with Justice Perram’s view in the Westpac case that declared living expenses were not necessarily relevant to whether the customer could afford the loan repayments. They were only relevant if they were “living expenses which simply [could] not be foregone or reduced beyond a certain point”.

ASIC’s new guidance includes examples of the kinds of expenses that a consumer is less likely to be able to reduce or eliminate (eg existing loan repayments, child maintenance payments, and “expenditure essential to a person living and participating in modern Australian society”, such as housing, food, clothing, personal items, utilities, transport, health, education, childcare and “communication and connectivity”).

ASIC also points out that a consumer may have higher essential expenditure due to their particular circumstances – eg their number and kind of dependants, any special medical needs, or living in a location that necessitates extra travel.

LIFESTYLE CHOICES / DISCRETIONARY SPENDING

ASIC recognises that there will be categories of expenditure that are higher because of lifestyle or other choices of the consumer – eg private schooling, private health insurance, other non-compulsory insurances, additional superannuation contributions, and memberships/subscriptions. Where the proposed loan would affect the customer’s ability to pay such expenses, the lender “is likely to need additional information to determine whether it is important to the consumer that this expenditure continue”.

The implication is that a lender should not form the view that an existing expense can be forsaken in order to afford the loan, or that forsaking it would not cause “substantial hardship”, without discussing that issue with the consumer.

Indeed, ASIC later states in its discussion of “substantial hardship” that lenders should “ensure the consumer is aware of any assumptions [the lender] makes about changes to [the consumer’s] outgoings which enables [the lender] to assess their capacity to meet repayments using a lower figure for their future outgoings. Such engagement enables the consumer to understand the factual basis of [the lender’s] assessment and the lifestyle or behavioural changes [the lender] expects the consumer to make”.

USE OF BENCHMARKS (EG HEM)

Although benchmarks (such as the Household Expenditure Measure (HEM)) “do not provide any information about the individual consumer” and “do not confirm or verify that the information that has been obtained about the consumer is true”, ASIC acknowledges that they “have a role in the broader verification and assessment processes”.

ASIC’s guidance indicates that benchmarks can be useful:

- to test whether the expenses declared by the customer are plausible (because they are within a range expected for a person in broadly similar circumstances)
- to help estimate expenses that the customer does not yet have, but will have after the loan is entered (eg a first home buyer who is moving out of their parents’ home), and
- to test what types of reductions to current expenditure are plausible, where the consumer proposes to reduce certain expenses in order to afford the loan

Significantly, RG 209 no longer states that “use of benchmarks is not a replacement for making inquiries about a particular consumer’s current income and expenses, nor a replacement for an assessment based on that consumer’s verified income and expenses”. This suggests that, at least until the outcome of its appeal in the Westpac case, ASIC will not be pursuing its former view (also taken by Commissioner Hayne in the Final Report in the Royal Commission) that reliance on HEM alone was not appropriate verification of a borrower’s expenditure.

BENCHMARK NEED NOT BE USED AS A MINIMUM

ASIC confirms that it is not necessary to use a benchmark as a minimum level of expenditure. This likely stems from the common industry practice of using the higher of declared expenses and the relevant HEM figure. ASIC now expressly recognises that some consumers will spend less than a benchmark figure, and “it is reasonable to use a lower amount if you are satisfied that it is a true statement of the customer’s financial situation and you have taken steps to appropriately verify the consumer’s expenditure”.

ASSESSING WHETHER THE CREDIT PRODUCT IS “NOT UNSUITABLE” FOR THE BORROWER

A credit product is unsuitable for the consumer (and therefore cannot be offered) if, at the time of the assessment, it is **likely** that:

- a. the consumer will be unable to comply with their financial obligations under the product, or
- b. the consumer will only be able to comply with their financial obligations under the product with substantial hardship, or
- c. the product will not meet the consumer’s requirements or objectives.

There is a temporal tension in this assessment because it relates to a future state of affairs (eg “will be unable...”) but the lender will only have concrete information about the past and present (eg the applicant’s current income and current or past expenses).

ASIC notes that the word “likely” has been held to mean “a real and not remote chance or possibility” in the responsible lending context. In considering whether it is likely one of the indicia of unsuitability will occur, ASIC’s guidance is that the lender should:

1. have regard to the information obtained about the consumer’s current financial situation, requirements and objectives
2. consider whether changes are foreseeable and make appropriate adjustments to reflect those changes, and
3. where appropriate, engage with the consumer to confirm whether future changes anticipated (eg a reduction in expenses or increase in income) will be realistic and achievable for the consumer.

ASIC acknowledges that it might not be possible to verify statements by the consumer about some future matters, such as behavioural changes, and that lenders will need to exercise their own judgment about whether to accept these statements.

CONSEQUENCES OF USING UNRELIABLE INFORMATION

When assessing whether a credit product is unsuitable for the applicant, the credit provider may only take into account information:

- that is about the consumer's financial situation, requirements and objectives, and
- that the credit provider has reason to believe is true, or would have had reason to believe was true if it had made the required reasonable inquiries and verifications.

ASIC notes that this means that "if there is... additional information... that could have been obtained through reasonable inquiry and verification steps and that you would have had reason to believe is true, that additional information is also taken into account for the purpose of determining unsuitability under the prescribed test". ASIC notes the importance of testing inconsistent information in light of this – eg if the lender does not make inquiries into obvious inconsistencies between the applicant's bank statements and their application, there is a higher risk that the lender will have failed to identify that the applicant was unable to make the loan repayments, and therefore failed to assess the loan as unsuitable in accordance with its obligations.

ROLE OF TECHNOLOGY

As reliable data becomes more freely accessible (eg through the upcoming open banking regime), it is widely expected that at least some lenders will start to incorporate it into their assessment processes. However, not all lenders will have access to the same amounts of data, nor the budgets to harness that data in a meaningful way for responsible lending purposes. It is important that smaller lenders can afford to comply and compete.

Consistent with this, ASIC's guidance remains "technology neutral" and leaves the way open for open banking or technological advances (eg in the reading of bank statements) to be harnessed where appropriate, whilst not suggesting this is mandatory or the only way to achieve compliance.

CLARIFYING WHO THE RESPONSIBLE LENDING LAWS APPLY TO

RG 209 has a new section entitled “Circumstances where the obligations don’t apply”, which was partially motivated by perceived uncertainty among licensees and the public about whether the obligations applied to small business loans.⁴

The guidance in this new section includes that:

- the obligations do not apply to licensees who are ‘acting as an intermediary’ but not providing ‘credit assistance’ (that is, they are not suggesting, or assisting the consumer to apply for, a particular credit product or provider)
- credit to purchase investments other than residential property are not for “personal, domestic or household purposes”, so are not covered by the obligations – so, for example, loans to purchase shares or interests in managed funds are not covered
- lenders must not rely on a borrower’s declaration as irrefutable evidence that the loan has a non-consumer purpose. Such a declaration is only effective where it is reasonable to believe the declaration was true. So, for example, if a borrower seeks a loan of \$50,000 for “business purposes” but gives no details of their business and has only recently obtained an ABN, and the lender takes no steps to verify the existence of the borrower’s business, it is unlikely the lender could rely on the customer’s declaration to establish that the loan was outside the responsible lending obligations, if it had in fact been used for consumer purposes.

Whilst lenders to small business remain relatively untouched by these laws, they must still be alert to other laws that seek to promote responsibility in business lending – for example, the consumer protection provisions in the ASIC Act and the responsible lending provisions in Chapter 17 of the Banking Code of Practice (if they subscribe to that Code).

WHERE TO FROM HERE?

New RG 209 and ASIC’s accompanying Report 643 will provide some additional guidance to credit providers and legal practitioners in understanding, complying with and applying the responsible lending laws in different factual scenarios. However, it is plain that a degree of uncertainty and inconsistency in application of the law will continue, given ASIC’s principles-based approach and emphasis on tailoring processes to the customer, and given other factors such as emerging technologies and the pending appeal in the Westpac case. As ASIC Commissioner Sean Hughes put it in his recent speech, “there is little doubt that [ASIC] will continue to be engaged in conversation with industry about responsible lending.”

It will also be interesting to see if ASIC's active stance in the enforcement / deterrence space for these laws continues, particularly in view of its new "why not litigate?" approach and its view that the outcome in the Westpac case left the law uncertain. Mr Hughes in his November 2019 speech stated that "ensuring robust and balanced standards of responsible lending to consumers has been, and will continue to be, a key priority for ASIC". In comments in August 2019 on enforcement generally, he said that ASIC has "resolved to give particular focus to cases with a high deterrence value and where there has been egregious harm, especially impacting vulnerable customers" and "will also continue to pursue cases where the law is unclear". ASIC has also flagged in its Corporate Plan 2019-23 that its responsible lending review of car finance will result in a "report... on [its] findings" and "potential enforcement action in response to serious non-compliance".

The sometimes vexed issues in applying these laws are not going away, but hopefully ASIC's new guidance brings credit providers closer to clarity on some of the issues, with further guidance to come when ASIC's appeal in the Westpac case is heard.

ENDNOTES

1. Keynote address by ASIC Commissioner Sean Hughes at the ASF Conference, Sydney, 18 November 2019.
2. Ibid.
3. ASIC Report 643, 'Response to submissions on CP 309 Update to RG 209: Credit licensing: Responsible lending conduct' December 2019, page 10.
4. See for example ASIC Commissioner Sean Hughes' keynote speech on 18 November 2019, footnote 1 above.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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