

What's new in ASIC Regulatory Guide 209 on responsible lending conduct — Part 1: reasonable inquiries and verification

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Introduction

Following consultation, on 9 December 2019 the Australian Securities and Investments Commission (ASIC) released updated guidance to Australian Credit Licence (ACL) holders in Regulatory Guide 209 *Credit Licensing: Responsible Lending Conduct*¹ (RG 209) setting out ASIC's updated views on what the responsible lending obligations under Ch 3 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act) require and the steps that ACL holders can take, to minimise the risk of non-compliance with their obligations. Separately, ASIC also released Report 643² outlining key issues raised in the 74 submissions to CP 309³ and ASIC's responses.

This is the first article in a series of three articles exploring what's new in the latest RG 209, focusing on some of ASIC's key new guidance about when credit licensees could undertake more, or less, detailed inquiries and verification steps before making an unsuitability assessment, based on different consumer circumstances and the type of credit that is being sought. This first article aims to assist lenders and brokers in understanding some main changes that might impact their responsible lending policies in the immediate future.

The second article in the series will explore in greater detail key new examples that ASIC included in their updated RG 209 and the importance of understanding foreseeable changes to a customer's financial situation. Finally, the third article will analyse ASIC's more detailed guidance about how spending reductions may be considered as part of the licensee's consideration of the consumer's financial situation and requirements and objectives, and the use of benchmarks as a way to check the plausibility of expenses.

In this series, as in the new RG 209, "lender" refers both to the credit provider of credit contracts and lessor of consumer leases (which are referred to as "credit products"), and "broker" refers to any ACL holder providing credit assistance.⁴

Scope of responsible lending

While by now all ACL holders have a good understanding of their obligations, it is useful to summarise again when responsible lending obligations apply, now

phrased in a clearer manner by ASIC in the updated RG 209.⁵ Responsible lending obligations apply when a person engages in "regulated conduct", defined by ASIC in RG 209 as:

- (a) *if you are a broker* — suggesting or assisting a consumer to apply for a credit product, or an increased credit limit, or suggesting the consumer remain in a credit product; or
- (b) *if you are a lender* — entering into a credit product with a consumer, increasing a credit limit of an existing credit product, or making an unconditional representation to the consumer that you consider they will be eligible to enter into a credit product or increase a credit limit.⁶

Before engaging in that regulated conduct, lenders and brokers must gather certain information about the consumer through reasonable inquiries and verification of information,⁷ to assess whether a credit product or credit limit increase is unsuitable for a client.⁸ Licensees are prohibited from engaging in regulated conduct in relation to unsuitable credit products and credit limit increases.⁹

Under what is now described as the "prescribed test", the credit product will be unsuitable if entered into or increased in circumstances where:¹⁰

- (a) the consumer will be unable to comply with their financial obligations under the product (eg they would not be able to make repayments as they fall due for the term of the product); or
- (b) the consumer will only be able to comply with their financial obligations under the product with substantial hardship [being hardship of substance, which is something more than merely a situation that is hard to bear¹¹]; or
- (c) the product will not meet the consumer's requirements or objectives ...

A regulated credit product is credit provided to individuals and strata corporations for residential, personal, domestic or household purposes or for the purchase or improvement of residential investment property.¹² A useful new addition to RG 209, in response to feedback received, is the inclusion of a section outlining the scope of responsible lending and clarifying activities

that are *not* subject to the responsible lending obligations,¹³ including small business lending irrespective of the nature of the security used for the loan, credit to purchase investment products like shares and interests in managed funds, loans to companies including small proprietary companies, and margin loans.

A focus on legislative intent and principles-based law

The updated RG 209 continues an already understood principles-based approach, however, it provides more detail and additional clarity about the principles that ASIC considers credit licensees should apply when determining how to comply with their obligations. There is more emphasis on the purpose of the responsible lending obligations, and more illustrative examples of how those principles should be applied in individual circumstances, which we will explore in more detail in the second article of this three-part series, and provides more direct guidance about the treatment of living expenses, the use of benchmarks, and considering spending reductions, which we will explore in the third article of the series.

In response to CP 309,¹⁴ in which ASIC sought prior industry feedback on its proposed changes to RG 209, several ACL holders called for ASIC to more explicitly confirm that credit licensees could decide for themselves how to comply with their responsible lending obligations flexibility and in light of their own systems, processes and a consumer's individual circumstances. Helpfully, ASIC now reiterates a number of times that RG 209 is ASIC's guidance only, for the purpose of providing their views on what the responsible lending obligations in Ch 3 of the NCCP Act require, and the steps that lenders and brokers can take to minimise the risk of non-compliance with the responsible lending obligations. ASIC does not seek to mandate any particular behaviour or prescribe required actions in RG 209, which has now been updated to reflect technological developments including open banking and digital data capture services, and ASIC confirms again that obligations are "scalable" and can be met online.¹⁵

Determining reasonableness

When determining for themselves what inquiries and verification steps are reasonable, ASIC suggests lenders and brokers should have regard to what the particular obligation is intended to achieve and what consumer harm it is intended to address, the circumstances of the individual consumer, whether the credit product involves a higher risk of harm to the consumer if unsuitable, and that what is "reasonable" may be impacted by the broader professional and regulatory environment in

which the lender or broker operates (for example, open banking and comprehensive credit reporting, available developments, technology and innovations).¹⁶

Requirements and objectives inquiries

ASIC discusses when it believes more, or less, inquiries should be made about a consumer's requirements and objectives. ASIC's guidance regarding what a licensee is likely to need information about is the same,¹⁷ but it now emphasises the need for information to be sufficiently specific so that the licensee understands what is important to the consumer in relation to the credit product, citing several recent case law¹⁸ substantiating their views.¹⁹ RG 209 now also discusses affordability of the credit product as being an important requirement for most consumers, as many consumers may need to reduce their current expenditure to afford the repayments on a loan including spending reductions and lifestyle changes that will need to align with their requirements and objectives.²⁰

The new RG 209 provides more insight to brokers and lenders about the level of inquiries that may be needed before engaging in regulated conduct in relation to a continuing credit contract such as a credit card. Whereas under the previous RG 209²¹ the market generally interpreted ASIC's guidance to mean there was less need to understand a customer's requirements and objectives before taking out a credit card as a credit card has no particular purpose, ASIC now expands on its guidance by clarifying that there may be a need to understand the various different purposes of a credit card (for example, a customer may want a basic, low cost card, or access to additional benefits like loyalty schemes, or to transfer the balance on existing cards).²²

ASIC also now says more inquiries should be made of consumers who will obtain no or limited benefit from the loan,²³ aligned with the updated Banking Code of Practice²⁴ according to which lenders must not approve a loan to a co-borrower where there is no substantial benefit to that co-borrower from the loan, unless the lender has taken reasonable steps to ensure the consumer understands the risks as co-borrower, considered the reasons the consumer wants to be a co-borrower and the lender is satisfied the consumer is not experiencing financial abuse.²⁵

According to the updated RG 209, generally brokers and lenders should make more inquiries about a customer's requirements and objectives where the consequences for the consumer if they don't understand the credit product or obligations are likely to be relatively serious for them, particularly if the credit product is more complex or has options that may impact the ultimate cost to the consumer; or the licensee can see the customer has difficulty understanding the terms.²⁶

On the other hand, ASIC says it may be reasonable for a lender or broker to decide that fewer inquiries about a consumer's requirements and objectives are needed where consumers had already taken out similar credit products previously and that product was used by the consumer in a way consistent with their requirements and objectives, the consumer is a strata corporation seeking the kind of credit product commonly obtained by strata corporations, or the licensee had previous dealings with the consumer and reasonably believes the consumer has an appropriate level of experience or understanding in relation to financial matters.²⁷

Financial situation inquiries and verification

ASIC now frames a credit licensee's obligation to make enhanced inquiries and verifications in terms of the risk or likelihood that a consumer will be harmed by taking on the new financial obligations under the credit contract, and considers the risk of overestimating income or underestimating expenses is higher where the consumer's obligations will take on a *proportionately significant part of the consumer's available income*.²⁸

ASIC also provides "red flag" examples which it says should trigger further inquiries, including where there is no available income left outside the consumer's estimated expenditure plus their new financial obligations, or the consumer has recently ended multiple credit-related debts, or their credit history shows an increasing net debt position, their savings is regularly overdrawn, or direct debit transactions reversed, or income is withdrawn in small transactions early in the income period, or the consumer has payment delinquencies on essential utilities.²⁹

While ASIC also describes home loans as potentially requiring more inquiries given the larger commitment over a longer term secured against residential property, it also notes that there may be other consumer circumstances that indicate the consumer is at a lower risk of the loan being unsuitable,³⁰ which presumably would include refinances into what ASIC now call "like for like" or "lower cost" products.³¹

Importantly for licensees, ASIC clarifies a long held industry view that fewer financial situation inquiry and verification steps may be reasonable where the consumer has a comfortable surplus available after the new financial obligations are added to the consumer's *reasonable estimate of their current outgoings*, which indicates a potentially new streamlined set of consumers who may require less verification for licensees.³²

ASIC also says that in the absence of "red flags" that a consumer may be in higher risk financial situation, it may be reasonable to obtain less information or take fewer steps to verify information in relation to a personal loan or credit card contract.³³

In relation to consumers switching "like for like" loans or to a lower cost product, ASIC responded to some licensee feedback to CP 309 by agreeing that if the consumer is currently meeting repayments at the same or higher level than proposed loan, a licensee (most relevantly here, a broker) may determine the consumer's ability to meet financial obligations under the new product by confirming those repayments have previously been comfortably met over a reasonable period of time (which ASIC suggests is 12 months). This could be verified through loan statements, rather than requiring information about income and outgoings from the consumer to determine their ability to service the loan.

In addition, ASIC believes a credit history report would be needed to ensure there are no other indicators of financial difficulty, as well as confirmation that the consumer's financial situation has not changed significantly including any recent or foreseeable changes, and confirmation that the new product meets the consumer's requirements and objectives.³⁴

This opens up an opportunity for digital brokers in particular to achieve a more positive experience and outcome for consumers simply wanting a better deal than they are currently on, including the potential for brokers to help customers negotiate lower rates with their existing lender without triggering disproportionately onerous responsible lending inquiries and verifications with the consumer.

While ASIC also specifically addresses switching with existing lenders to a new credit product with that same lender but with more favourable terms,³⁵ ASIC's guidance that less inquiries may be needed relates to a lender assessing their consumer for another internal product having more knowledge and information about their customer, and not a broker suggesting such a switch or suggesting a customer remain in their existing product with that lender. The current market has seen the rise of brokers recommending or assisting customers to remain in their existing lender credit product but with a negotiated reduced rate, or switching to a new credit product with that same lender, and therefore it is important that ASIC's guidance could equally apply to brokers who have enhanced knowledge and information about the customer.

ASIC further describes that in assessing refinances to "like for like" or lower cost credit products, less weight may be given to matters outside the consumer's repayment history under their existing loan, and goes even further to say that it is:

... likely a refinance will be suitable where the consumer has regularly made payments on the home loan when they fall due, the amount of the repayments will reduce following a refinance to a lower interest rate, and there have been no adverse changes to the consumer's circumstances.³⁶

This is incredibly helpful guidance by ASIC and positive for the broker industry in particular. Again, the other indicators like financial stress and stability should still be considered and that it meets the consumer's requirements and objectives.³⁷

In terms of verification of the financial situation of customers refinancing into a "like for like" loan, it does appear that at the very least ASIC views bank statements and a credit report as being necessary verification of a customer's financial situation *prior to* the licensee engaging in regulated conduct, which includes for brokers making a suggestion that a customer take out a new credit product or remain in an existing credit product.

Conclusion

ASIC's Report 643³⁸ makes a brief reference to ASIC's appeal against the Federal Court's decision in *Australian Securities and Investments Commission (ASIC) v Westpac Banking Corp (Liability Trial)*, which ASIC is now appealing in relation to the decision by Perram J that a lender "may do what it wants in the assessment process"³⁹ under the NCCP Act. Although this appeal has not been heard, it is still important for lenders and brokers to review ASIC's updated RG 209 against their current policies and procedures to adjust to ensure ASIC's revisions have been properly considered. Further, the Australian Financial Complaints Authority (AFCA) and Australian Banking Association (ABA) both issued a statement confirming they support the updated RG 209 and AFCA further confirmed that its approach to responsible lending will be fully aligned to ASIC's guidance. Given consumer disputes with licensees will be judged by AFCA according to ASIC's revised guidance, lenders and brokers should ensure their own standards reflect that guidance also.



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Footnotes

1. Australian Securities and Investments Commission (ASIC) "ASIC updates responsible lending guidance" media release (9 December 2019).
2. ASIC Response to Submissions on CP 309 Update to RG 209: Credit Licensing: Responsible Lending Conduct Report No 643 (2019) 5 para 8.
3. ASIC Update to RG 209: Credit Licensing: Responsible Lending Conduct Consultation Paper 309 (2019).
4. ASIC Credit Licensing: Responsible Lending Conduct Regulatory Guide 209 (2019) para 209.5.
5. Above n 4, para 209.6.
6. Above n 4, para 209.6.
7. National Consumer Credit Protection Act 2009 (Cth), ss 117, 130, 140, 153.
8. Above n 7, ss 116, 118–19, 129, 131, 139, 141–2, 152, 154.
9. Above n 7, ss 123–4, 133, 146–7, 156.
10. Above n 4, para 209.8.
11. Above n 4, para 209.192.
12. Above n 4, para 209.4; above n 7, Sch 1 cl 5.
13. Above n 4, paras 209.28–209.42.
14. Above n 3.
15. Above n 4, paras 209.20, 209.82, 209.123.
16. Above n 4, para 209.23.
17. Above n 4, para 209.51.
18. *Australian Securities and Investments Commission (ASIC) v Cash Store Pty Ltd (in liq) (No 2)* [2015] FCA 93; BC201500806; and *Australian Securities and Investments Commission (ASIC) v Channic Pty Ltd (No 4)* [2016] FCA 1174; BC201608412.
19. Above n 4, para 209.52.
20. Above n 4, para 209.57.
21. Above n 4, para 209.37.
22. Above n 4, paras 209.55–209.56.
23. Above n 4, para 209.85.
24. Australian Banking Association "Banking Code of Practice" (2019) www.ausbanking.org.au/wp-content/uploads/2019/06/Banking-Code-of-Practice-2019-web.pdf.
25. Above n 24, at cll 54 and 55.
26. Above n 4, para 209.85.
27. Above n 4, para 209.86.
28. Above n 4, para 209.87.
29. Above n 4, para 209.88.
30. Above n 4, para 209.90.
31. Above n 4, para 209.109.
32. Above n 4, paras 209.87–209.89.
33. Above n 4, paras 209.91–209.92.
34. Above n 4, paras 209.109–209.110.
35. Above n 4, para 209.111.
36. Above n 4, para 209.245.
37. Above n 4, paras 209.244–209.248.
38. Above n 2.
39. *Australian Securities and Investments Commission (ASIC) v Westpac Banking Corp (Liability Trial)* (2019) 139 ACSR 25; [2019] FCA 1244; BC201907218 at [82].