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What's new in ASIC Regulatory Guide 209 on responsible lending conduct — Part 3: reducing expenses and use of benchmarks

Leonie Chapman *LAWYAL SOLICITORS*

Introduction

This is the third and final article in a three-part series exploring in greater detail the updated guidance from the Australian Securities and Investments Commission (ASIC) released on 9 December 2019 to Australian Credit Licence (ACL) holders in Regulatory Guide 209 *Credit licensing: Responsible Lending Conduct* (RG 209). The updated RG 209 sets out ASIC's latest views on what responsible lending under ch 3 of the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act) requires, and steps ACL holders can take to minimise the risk of non-compliance with their obligations.

The first article, published in March 2020 in the *Australian Banking & Finance Law Bulletin*,[1] tackled ASIC's updated guidance regarding when credit ACL holders should undertake more, or less, detailed inquiries and verification steps before making an unsuitability assessment. The second article, also published in the *Australian Banking & Finance Law Bulletin,*[2] focused on explaining important new examples provided by ASIC in RG 209 as well as how foreseeable changes should be considered in a broker or lender's assessment of a consumer's financial situation. This final article analyses ASIC's updated views on how spending reductions may be considered as part of an ACL holder's assessment, appropriate apportionment of shared outgoings, and the use of benchmarks to check the plausibility of expenses.

Spending reductions

The NCCP Act requires licenced brokers and lenders to make reasonable inquiries about a consumer's requirements and objectives in order to assess whether a proposed loan meets those requirements and objectives and is "not unsuitable" for the consumer.[3] Information being gathered by a licensee should be reliable.[4] ASIC's revised RG 209 goes into greater detail about some of the nuances involved in making those inquiries and how to make an assessment, including the importance of understanding the affordability for a consumer of a credit product and whether they are willing and able to reduce current expenditure to afford repayments.[5]

In these circumstances, it is vital that brokers and lenders collect from consumers enough additional information about how those reduced expenses will impact the customer's lifestyle and whether these are lifestyle changes that are reasonable, and the customer is prepared to make, in order to afford the new loan. ASIC provides a new example[6] to help lenders and brokers understand the detailed discussions they need to make with consumers in this regard. In the new example, the consumer is asking for a 20 year home loan, however affordability is an issue unless she can significantly reduce her expenditure, including moving her children to public school. This is not a lifestyle change the consumer is willing to make, so the licensee then discusses whether the shorter loan term was a priority and if not, whether a longer loan term with higher ultimate interest paid would meet her requirements and objectives. In a further new example,[7] ASIC illustrates a consumer willing to cancel her monthly streaming service to take out a small amount credit contract, for which the lender requested evidence of the cancelation. As you can see, the expectation from ASIC is for detailed discussions to be occurring with customers to ensure any expenditure reduction is acceptable for that consumer. These discussions should be documented by licensees to evidence compliance.

ASIC's updated guidance goes further, providing useful and quite detailed paragraphs covering how spending reductions may be considered during the licensee's unsuitability assessment process. ASIC recognises that consumers may be able to reduce their spending and change their lifestyle without substantial hardship,[8] however it also warns of the importance of minimum outgoings that consumers must make to live and participate in modern Australia society. The examples provided include existing debts and liabilities; housing costs; insurance; reasonable food, drink, clothing and other household items; various transport costs; utilities; health costs; communication and connectivity; education and childcare; and superannuation.[9] ASIC references *Australian Securities and Investments Commission v Westpac Banking Corp (Liability Trial)*[10] (*ASIC v Westpac)* when suggests these outgoings may not be realistic or achievable for the consumer to reduce without substantial hardship for the consumer,[11] or that doing so may not meet the consumer's requirements and objectives.

While ASIC recognises that many reductions can in fact be made without the consumer experiencing "substantial hardship",[12] some outgoings may be more important to the consumer than others and reducing those expenses are less likely to meet the consumer's objectives.[13]

ASIC further explains that as part of a lender or broker's assessment, a licensee must consider whether higher outgoings must be maintained due to the consumer's individual circumstances, including a consumer's location, employment, household composition, dependants, and health issues.[14]

Brokers and lenders should consider whether the proposed expense reduction is realistic or achievable, having regard to whether the consumer would likely have enough money at a realistic level to take part in society (for example, by benchmarking against Household Expenditure Measure (HEM) or the Henderson Poverty Line, noting that an amount of spending that represents poverty is less likely to be realistic or achievable), or whether those expenses would be difficult or unlikely to be able to be reduced given the consumer's personal circumstances, for example consumers with particular needs, location, and spending patterns.[15]

Helpfully, ASIC also provides its views on spending reductions which may be realistic or achievable without specific discussion with the consumer, citing recreational items as an example. However, if an expense could be important or necessary for the consumer, some discussions will be necessary to determine if the expense can be reduced without substantial hardship,[16] ensuring the consumer is aware about any assumptions you make, as well as lifestyle and behaviour changes you expect them to make.[17] To illustrate[18] this, ASIC describes a customer willing to make serious cut backs to expenditure that may even result in short-term hardship, in order to borrower money to take a course that in the longer term should improve their financial prospects. ASIC feels comfortable that the proposed loan could meet the customer's requirements and objectives, however it is important to note that in this case, the customer appears to be making an educated and informed decision regarding those expense reductions, and has a realistic plan for ensuring in the short and longer term that they can meet those repayments.

Apportionment of shared outgoings

Brokers and lenders must also make reasonable inquiries about a consumer's financial situation and take reasonable steps to verify the financial situation in order to assess whether or not a proposed loan is "not unsuitable" for the consumer.[19] The information gathered should enable a lender or broker to understand the consumer's ability to meet all the financial obligations they will commit to if they enter into the credit product or loan increase.[20] As part of this, in the new RG 209[21] ASIC quotes *Australian Securities and Investments Commission v Channic Pty Ltd (No 4)*[22] (*ASIC v Channic*) to describe that at the very least "an accurate understanding of the consumer's actual expenses"[23] would be required. Again, describing in greater detail some of the nuances that may result, ASIC provides updated guidance to lenders and brokers about how to deal with the sharing of expenses between consumers who are in shared living situations.[24]

ASIC describes various reasonable methods of proportioning the outgoings of two or more consumers for the purposes of an ACL holder's unsuitability assessment, including asking the consumer to explain the sharing arrangements, or considering transaction statements to identify the pattern of outgoings to support their explanations.[25] In a new illustration,[26] ASIC describes a university student living in shared rental accommodation, applying for a personal loan. The applicant's name is not on the lease, so rather than requiring the applicant to seek confirmation from his housemates, the lender may rely on transaction statements to check the amounts regularly being paid by the applicant are consistent with the shared rent and bills arrangement he described. ASIC qualified this by saying that if the applicant's name was on the lease, the assessment should be made at the higher amount given the applicant would be legally liable to meet the repayments if another housemate moved out.

In a second new example,[27] ASIC illustrates where the apportioning of shared expenses was applied incorrectly by a lender, in circumstances where the living expenses were split equally between a borrower and his wife (who receives Centrelink payments), when in fact it should have been clear to the lender, after reasonable inquiry, that the wife had loans of her own which her income covered. In this case, ASIC explains that the husband should have been apportioned most of the household expenses as part of the assessment.

In a third new example,[28] ASIC makes clear the importance that lenders and brokers properly consider, and in this illustration verify, the income of a joint household member who shares expenses with an applicant, as well as evidence of the sharing of any declared debts. In saying this, ASIC also recognises that there are a range of other matters to consider, such as the privacy rights of individuals and the need for consent to access documents of non-applicants, although these things should not be a barrier.[29] Licensees can also use account statements to determine the percentage to apply when apportioning expenses, according to a further example[30] provided by ASIC in RG 209, in which the consumer with the higher income in a joint household was apportioned the higher percentage of expenses share based on the transaction statement data.

Using benchmarks

Benchmarks are commonly used by lenders and brokers as a part of their responsible lending assessments as a way of testing the reliability of a consumers' declared expenses (and sometimes income) to get an idea of a conservative amount of expenditure that could be expected for a household with the same number of adults, dependants, income range and location.[31] ASIC has previously expressed concern (and states this again in the updated RG 209) that ACL holders also seek to rely on expense benchmarks as a way of streamlining the verification steps undertaken for the responsible lending obligations.[32] This may be true for some, but is not always be the case, however as expected in light of the Federal Court's dismissal of ASIC's appeal in September 2019 in *ASIC v Westpac,*[33] ASIC goes into greater detail in the updated RG 209 to guide lenders and brokers on the appropriateness of using benchmarks as a way to check the plausibility of expenses, as well as additional guidance about the HEM benchmark.

ASIC's Report 643[34] makes a brief reference to this Federal Court's decision, 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" and is not obliged under the NCCP Act to take into account a prospective borrower's actual or declared expense. ASIC has recently expressed a view that a judgment which stands as an understanding of the proposition that a lender may do what it wants in an assessment process, creates uncertainty about what is required in order to comply with responsible lending laws.[35]

Despite the judgment, it is still ASIC's view that sole reliance should not be placed on HEM benchmarks (which is most commonly used[36]), as benchmarks 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,[37] referencing *ASIC v Channic*[38] that said benchmarks should not be a substitute for making reasonable inquiries and taking reasonable steps to verify a customer's financial situation.

While ASIC's appeal has not yet been decided, it is important for licensees to consider ASIC's current views that benchmarks are a reasonable and useful way of testing whether information is plausible and within the expected range, as long as you cannot reasonably confirm that information another way, or for consumers who do not currently have expenses but will after the loan is entered into, or to test whether any reduction in outgoings to meet loan repayments is plausible.[39]

Naturally, lenders and brokers should ensure benchmark tools are the most up-to-date version, are realistic in their calculations and inclusion of expense categories, expense figures are adjusted for different income ranges, and consider applying buffers to conservative expense figures over and above existing buffers used. Lenders and brokers should also separately take reasonable steps to verify expenses, and should periodically review the benchmark expense figures being relied upon.[40]

ASIC does recognise that some consumers may even spend less than a benchmark figure, in which case it could be reasonable for a lender or broker to use a lower figure if satisfied that the figure is a true statement of the consumer's financial situation, and reasonable steps have been taken to verify the consumer's expenditure.

In the new RG 209, ASIC references a re-developed version of HEM in August 2018,[41] and notes that the methodology used could result in an expected outcome that most households would spend more than the benchmark figures being produced, warning that the HEM figures do not include spending on a range of items that are commonly part of a consumer's overall outgoings.[42] For example, the HEM benchmark does not include gardening and home help services, hospital, medical and dental insurance, counselling; recreational vehicle expenses, and second dwelling or overseas travel expenses, among other excluded expenses.[43] These matters should be carefully considered by lenders and brokers when revisiting responsible lending policies and processes in light of the revised RG 209, as until an appeal of *ASIC v Westpac*[44] is decided, ASIC will continue to apply its own views on the use of benchmarks, expressed through its new guidance, when considering a licensees compliance with responsible lending laws.

Conclusion

It is evident from the revised RG 209 that ASIC determined there was a need to provide more extensive guidance on how lenders and brokers should consider a customer's willingness and ability to reduce expenses to pay a proposed loan under responsible lending laws, how licensees should apportion expenses between joint households, and the use of benchmarks to check the plausibility of expenses. In unsuitability assessments, the inquiries and verification of expenses can sometimes be given less priority by licensees than, for example, ensuring the income of the consumer has been properly established. However, in light of ASIC's updated guidance, it is highly recommended that lenders and brokers take a very close look at how they make inquiries about a customer's expenses, what reasonable steps they take to verify those expenses and how benchmarking tools are used to enhance (not replace) that process, and how licensees apply the expense data they obtain in their assessments to make absolute sure a credit product is not unsuitable for the customer.

Leonie Chapman
Principal Lawyer and Director
LAWYAL Solicitors
leonie.chapman@lawyal.com.au.
www.lawyal.com.au

Footnotes

1. L Chapman "What's new in ASIC Regulatory Guide 209 on responsible lending conduct — Part 1: reasonable inquiries and verification" (2020) 35(10) *BLB* 175.
2. L Chapman "What's new in ASIC Regulatory Guide 209 on responsible lending conduct — Part 2: New illustrative examples and understanding foreseeable changes" (2020) 36(3) *BLB* 39.
3. National Consumer Credit Protection Act 2009 (Cth), ss 117, 130, 140 and 153.
4. Australian Securities and Investments Commission (ASIC), *Credit licensing: Responsible lending conduct*, Regulatory Guide 209 (2019) para 209.45.
5. Above n 4, para 209.57.
6. Above n 4, Example 3.
7. Above n 4, Example 4.
8. Above n 4, para 209.194.
9. Above n 4, para 209.195.
10. *Australian Securities and Investments Commission v Westpac Banking Corp (Liability Trial)* (2019) 139 ACSR 25; [2019] FCA 1244; BC201907218 at [78] per Perram J.
11. Above n 4, para 209.196.
12. Above n 4, para 209.220.
13. Above n 4, para 209.221.
14. Above n 4, para 209.197.
15. Above n 4, para 209.199.
16. Above n 4, para 209.200.
17. Above n 4, para 209.201.
18. Above n 4, Example 30.
19. Above n 3.
20. Above n 4, para 209.58.
21. Above n 4, para 209.60.
22. *Australian Securities and Investments Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174; BC201608412.
23. Above n 22, at [1773] per Greenwood J.
24. Above n 4, para 209.75.
25. Above n 4, para 209.76.
26. Above n 4, Example 9.
27. Above n 4, Example 10.
28. Above n 4, Example 11.
29. Above n 4, para 209.124.
30. Above n 4, Example 29.
31. Above n 4, para 209.135.
32. Above n 4, para 209.133.
33. Above n 10.
34. ASIC, *Response to submissions on CP 309 Update to RG 209: Credit licensing: Responsible lending conduct* Report 643 (2019).
35. ASIC, *ASIC's Vision for a Fair, Strong and Efficient Financial System for all Australians*, *Keynote address by ASIC Commissioner Sean Hughes at the ARCA National Conference, Gold Coast, 14 November 2019*, available at https://asic.gov.au/about-asic/news-centre/speeches/asic-s-vision-for-a-fair-strong-and-efficient-financial-system-for-all-australians/.
36. Above n 4, para 209.140.
37. Above n 4, para 209.134.
38. Above n 22, at [1736] per Greenwood J.
39. Above n 4, para 209.136.
40. Above n 4, para 209.138.
41. Above n 4, para 209.141.
42. Above n 4, para 209.142.
43. Above n 4, para 209.143.
44. Above n 10.