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What's new in ASIC Regulatory Guide 209 on responsible lending conduct — Part 2: new illustrative examples and understanding foreseeable changes

Leonie Chapman *LAWYAL SOLICITORS*

Introduction

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 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.

This is the second in a series of three articles exploring in greater detail the latest RG 209. The first article, published in March 2020 in the *Australian Banking and Finance Law Bulletin*,[2] tackled ASIC's updated guidance regarding when ACL holders should undertake more, or less, detailed inquiries and verification steps before making an unsuitability assessment. This second article focuses on explaining some 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. The third and final article will analyse ASIC's 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.

New illustrative examples

ASIC provides more illustrative examples in the latest RG 209 to demonstrate how it believes the responsible lending principles should be applied in individual circumstances. The key new examples we explore in this article cover:

- reliance on an ineffective business purpose declaration[3]
- requirements and objectives and financial situation considerations
- the treatment of a range of different credit products (personal loans, credit cards, consumer leases and small amount loans)
- examples of how ACL holders should deal with consumer hardship indicators and negative repayment history and
- different kinds of consumer circumstances (seasonal workers, the "gig economy", probation and small businesses)

Ineffective business purpose declaration example

While already an established legal principle under s 13(3) of the *National Credit Code*,[4] ASIC now emphasises that ACL holders must consider the purpose of the loan, not the kind of borrower or security,[5] to determine whether the loan is regulated under the NCCP Act.[6] This must be established through inquiry with an applicant, and a declaration regarding the business purpose of a loan is not irrefutable evidence of the purpose of the loan.[7] ASIC includes a new example[8] describing an ineffective business declaration, where an application was submitted through a broker seeking a loan for business purposes, contained no details about the business and was supported only by a signed business purpose declaration and a newly obtained Australian Business Number. The borrower ultimately uses the loan funds to pay home loan arrears, and this example provides ASIC's clear view that ACL holders need to make reasonable inquiries to establish the existence of any legitimate business in these circumstances.

Inquiries about requirements and objectives

ASIC provides new examples illustrating requirements and objectives inquiries lenders and brokers should make, the first[9] of which outlines a lender offering a credit card distributed through retailers as an option for consumers wanting to finance purchases. Here, ASIC says a lender should find out the maximum credit limit that is wanted by the consumer, and if the consumer only wants enough credit to finance the particular purchase, then a credit card with a higher limit is likely to be unsuitable (even if the consumer could afford the higher repayments). Responsible lending policies should therefore ensure that the consumer's desired maximum credit limit is always obtained, and then met through the ultimate product approved.

Further inquiries about requirements and objectives

In article 1 of this series, we discussed ASIC's revised guidance on the circumstances in which more information may be needed to establish a customer's requirements and objectives.[10] To support this guidance, ASIC provides two new examples. In the first,[11] a consumer is looking to finance the purchase of both a washing machine and a smart phone, but after inquiries by the lender regarding what the consumer actually wants to achieve, it is established that a consumer lease would be unsuitable to finance the washing machine as the consumer wants to own it outright, but suitable for the phone as the consumer is interested in upgrading to newer models. This level of inquiry to uncover the objectives of the consumer with regard to each separate purchase should be incorporated into ACL holder policies, paying particular attention to mixed purpose loans and multiple asset purchases.

ASIC now also describes where more inquiries should be made of consumers who will obtain no or limited benefit from the loan,[12] to align with the updated Banking Code of Practice.[13] ASIC illustrates this through a new example[14] of a consumer not receiving the benefit of a loan they are borrowing and servicing in their name, being taken out to purchase a car for another person. Lenders and brokers must ensure a consumer in this situation understands and is comfortable that they will have all the repayment obligations, even though they will not be getting the benefit of the car purchase. Policies put in place by ACL holders to comply with the new Banking Code of Practice should be revisited to ensure they also align with this targeted responsible lending guidance from ASIC, and clear documentation of the consumer's acknowledgment and understanding should be kept by licensees.

Assessment of requirements and objectives

ASIC makes it clear through a new example[15] that when assessing a consumer's requirements and objectives, describing a consumer's stated requirements and objectives as to "obtain credit to purchase a home" will not be a sufficient description of the analysis of the consumer's requirements and objectives in respect of the proposed credit. Reliance on such a statement by an ACL holder would suggest that any credit product enabling a consumer to purchase a home would be not unsuitable, and the consumer is therefore indifferent to matters such as price, term or loan features.

Whether or not a product meets the consumer's requirements and objectives is further guided by ASIC through illustrations describing how, for example,[16] it will be difficult for lenders or brokers to show that a balloon payment loan meets a borrower's requirements and objectives without a record of why this loan is suitable. In another example,[17] ASIC demonstrates its view that in assessing the suitability of a home loan, ACL holders need to assess whether the likely savings from using the offset account are less or more than the additional costs from any higher interest rate or fees applicable to the offset loan.

ASIC outlines another example[18] where a fast settlement from another lender is available at a higher cost. In this case, the lender must record why the more expensive loan meets the borrower's requirements and objectives. In another example,[19] an interest-only loan may meet the borrower's initial requirement to have initially lower repayments even though it is more expensive in the long term, but a licensee should also ensure the interest-only term is no longer than the period for which the lower repayments are required by the consumer. ACL holder policies should be reviewed and updated to cater for these new examples.

Inquiries about financial situation

As discussed in the first article of this series, ASIC suggests that lenders and brokers should have regard to, among other things, whether the credit product involves a higher risk of harm to the consumer if unsuitable. To illustrate this, ASIC provides a useful new example[20] in which a consumer pays rent which will stop if it is able to purchase a property to live in. Together, the consumer's fortnightly rental and additional savings amounts are higher than the required fortnightly repayments under the new loan, which the lender establishes the consumer has capacity to meet. In this scenario, ASIC describes the lender verifying clear repayment record on the rental agreement, regular and consistent savings from bank statements (with no inconsistencies), as well as a good credit history. The lender may be satisfied here that it does not need to obtain further information about outgoings, as there is no need for the consumer to reduce them to meet repayments.

ASIC also provides a new example[21] to illustrate how ACL holders may consider high net worth applicants. Here, ASIC describes a semi-retired CEO wanting a further advance to undertake extensive home renovations. While the CEO earns sporadic consulting income which is insufficient to meet repayments, following discussions the lender becomes comfortable with the consumer's financial situation after receiving further information about the consumer's investments, and preparedness to sell investments to meet loan repayments. After identifying that the value of the investments far exceeds the value of the loan increase and could be sold to meet loan repayments, the loan was approved. This demonstrates the importance of considering individual consumer circumstances when determining the level of financial situation inquiries to make.

Verification of financial situation

In terms of verifying a consumer's financial situation, ASIC provides a new example[22] of how it considers lenders should use transaction statements to analyse a consumer's overall financial situation, being (in ASIC's description) the most "convenient and efficient" way to do so. In this new example, the lender gives the consumer the option to use a digital data capture service or provide electronic or hard copies of statements, but in both cases ASIC describes the lender as analysing the data in the statements (for example, by using recognition and analysis tools) to identify patterns in income and outgoings. ASIC also makes it clear that ACL holders must undertake a due diligence process to satisfy themselves of the appropriateness of outsource providers, the quality of the information they provide, and privacy and data security policies.

ASIC also describes through illustration how an ACL holder should treat inconsistent information provided by the borrower, and the importance of reviewing bank statements received. In a new example,[23] a consumer applies for a personal loan and provides the lender with a copy of its bank statements, and declares in the loan application form its income and expenses as well as one credit card liability. However, the consumer's bank statements showed the consumer had recently been making payments to another lender, which was not declared in the application. The lender did not see this inconsistency as it looked at statements only to verify the consumer's income. This example makes clear ASIC's view that an obvious inconsistency should be picked up by ACL holders during review of the bank statements, triggering their requirement to make further inquiries with the consumer where inconsistencies are found. Where bank statements are obtained by lenders and brokers, they must be weighed up against all the information received to decide what is reliable, and in this example, ASIC believes the lender could not ignore the information in the statement and rely solely on the consumer's declaration.

There is also a helpful new example[24] included by ASIC to demonstrate how the verification obligations may apply differently to a lender and a broker in circumstances where the lender has access to additional information. In this illustration, the broker relies on declarations by the consumer about whether the consumer has other liabilities or unpaid bills, and reviews bank statements to verify those declarations, assessing the loan as not unsuitable and submitting an application to a lender. ASIC explains that where that lender then obtains a credit report which uncovers unpaid utility bills, according to ASIC it does not automatically follow that the broker did not comply with its obligations where it was reasonable for it to rely on the consumer's declarations, and where it was not apparent from a general review of the bank statements. Again, this highlights the importance of reviewing bank statements, if obtained on file as part of the application.

New credit product examples

ASIC provides several new examples displaying the treatment of different credit products, including a new example[25] where a consumer applied for a personal loan that took the consumer to "tipping point", even though the consumer had a reasonably high income and appeared to be managing repayments. As the consumer's credit history showed it also had two credit cards, one of which has been obtained recently, a red flag was triggered for the lender indicating potential harm and further inquiries needed. This included obtaining home loan statements which showed the consumer had been meeting home loan repayments using its credit cards. This illustration demonstrates the importance of ACL holders of taking into account red flags in credit reports which should trigger further inquiries and documentation requests. The lender in this example ultimately declined the personal loan as the likelihood that it was unsuitable was high.

ASIC also provides an example of a high-cost lease product used to buy multiple goods in a remote area which, on their own, may not appear expensive, but together would be a significant proportion of the consumer's income.[26] The lender explains to the consumer in this example that it will be paying around twice the value of the goods and will not own the goods at the end of the loan payments. During this discussion, there is an indication that the consumer may also be close to the limits of its income and the lender, therefore, asks for bank statements to determine if the consumer can afford the loan. In this example, the lender decides the consumer can afford one of the leases, but not leases for the other products.

In the revised RG 209, ASIC also describes how a lender's credit risk policy may not necessarily meet the responsible lending standards which are focused on the individual consumer,[27] and provides a new example[28] to illustrate this point. A consumer with a good credit score and credit history applying for a secured car loan has recently used several "buy now, pay later" products. The consumer also holds three credit cards, two of which are near their maximum balance, paying only minimum required payments. As this indicates there is a higher risk that the consumer is operating at the margins of its available income, ASIC describes that this lender will still need to obtain more information to determine whether the consumer can afford the repayments.

In another new example,[29] ASIC describes how a lender cannot simply rely on the reduced credit risk of a guarantee being in place to secure a loan, and still needs to obtain information to determine the consumer can meet the repayments. In this example, a consumer applies for a small loan, secured by its partner as guarantor, to help meet expenses the consumer is struggling to pay. The lender reviews both the consumer and guarantor's account statements over a 90-day period and income details declared in an online application. After the lender makes inquiries by phone about the consumer's spending patterns, the lender is concerned the consumer withdraws its pay when it hits its account and its account is often overdrawn. While the partner will step in if the borrower cannot pay, the lender still needs to ensure the borrower can service the loan. This demonstrates that while lender credit risk policies are important, they need to be overlaid with responsible lending obligations which focus on individual circumstances.

Hardship indicators and negative repayment history information

Hardship assistance is an important mechanism at the moment given the current COVID-19 challenges consumers and ACL holders face in Australia. ASIC provides a new illustration of how a lender may take into account past repayment difficulties on a personal loan application where a consumer has temporary unemployment,[30] which may assist with current policies. In this example, the applicant already has had a hardship arrangement with the lender to make reduced repayments for about 6 months as a result of redundancy. ASIC describes how the lender may be satisfied to approve the new loan given the consumer is back in employment, completed its hardship arrangement and is back on track with its home loan. It is important that lenders keep detailed records of the explanations provided by the consumer when considering the new loan.

Different consumer circumstances

To accentuate the importance of ACL holders considering the individual circumstances of consumers, ASIC provides guidance in new examples covering some different consumer circumstances an ACL holder may face. The first new example[31] describes a fisherman with seasonal income. Through this example, ASIC explains that ACL holders cannot simply rely on income the customer has received in the last pay cycle and must determine that it is consistent and likely to remain at that level for the loan term.[32] ASIC believes it would be reasonable to make inquiries to establish the usual patterns of income, and determine the amounts the consumer puts aside to cover outgoings in lieu of periodic income. The ACL holder could then have regard to the lower notional amounts to determine available income across the period for which credit is sought.

In another example,[33] ASIC addresses the "gig economy" which is quickly becoming a popular way to work in Australia. A consumer applying for a credit card receives income from a food delivery business with highly variable hours of work and income. To form a view on the consumer's income in this situation, ASIC describes the lender having regard to the pattern of income shown in account statements, which varies significantly from week to week, with an average amount earned per fortnight over a period of several months being the best indication of the consumer's likely income.

In another example,[34] a consumer applying for a car loan with a 5-year term is on 3 months' probation with a new job, having only received two fortnightly pays. Even where the amount of income the consumer is receiving would be sufficient to meet the repayments under the loan, ASIC says the probation period shows the probation review is a reasonably foreseeable event that could affect the consumer's continued income. ASIC suggests obtaining certainty from the employer or making inquiries about the consumer's previous employment history to demonstrate it has held a position beyond probation in the past.

Finally, for consumers who receive income derived from small businesses, ASIC provides an example[35] of a home loan applicant with irregular income from the business that has no clear pattern evident in its account statements. ASIC describes the lender considering whether different sources of information can adequately demonstrate the consumer's likely future available income, including business bank account showing available funds, written advice from an accountant confirming profit and loss position and personal income, income tax assessment notices and returns, and business activity statements that show amounts generally available to the consumer.

It is clear that lenders and brokers should adjust their responsible lending policies to ensure that the consumers' individual circumstances and income types are considered when determining the level of inquiries and verification to make, and in assessing applications.

Foreseeable changes assessment

ASIC also develops in its guidance that while an ACL holder's assessment is made at a point in time, it must also consider what is likely to be the case in the future and any foreseeable changes to a consumer's financial situation,[36] including such changes to income[37] and outgoings.[38] Brokers and lenders need to understand what is *likely* to be the case if the consumer enters into the credit product, the given information currently available to them about the consumer, foreseeable changes to its circumstances that may affect its income or outgoings, and the known obligations under the credit product.[39]

For it to be *likely* (ie, probably, apparently or destined to happen[40]) that the consumer will be able to comply with its financial obligations under the contract, lenders and brokers need to take a future view about whether that compliance is reasonably foreseeable given they occur into the future.[41] This can be difficult for lenders and brokers given their assessment generally focuses on the consumer's past conduct and documentation, and the uncertainty of future events occurring. To this point, ASIC is clear in its guidance that ACL holders are not expected to consider every future possibility, but instead what is reasonably foreseeable (ie, known, planned or expected).[42]

There are challenges for brokers and lenders while the COVID-19 pandemic sees the lockdown of many Australian businesses and loss of jobs, and where applicants are uncertain about whether or not their jobs are secure. This uncertainty may not be because they have been told by their employers that they will lose their job, but because generally the population was uncertain about job security. ACL holders have had to adapt to ensure their inquiries relate to matters the consumers know, or should reasonably know (for example, they are aware that they are going to be made redundant, or they are aware that their company is no longer trading or is about to stop trading, or they have been told their hours will be cut from next week, or it is reasonable that they should have been aware of those things). It is useful in this current climate for ACL holders to list for consumers the possible types of foreseeable changes they expect the consumers to disclose.

Where a consumer responds that it foresees future foreseeable changes to their financial situation, ASIC guides ACL holders to then consider all the information obtained from the consumer, consider whether changes are foreseeable, and make appropriate adjustments to reflect those changes. Where appropriate, licensees should discuss with the consumer whether the future changes it anticipates are realistic.[43] In light of the current uncertainties of COVID-19, ACL holders should also query whether any steps are being taken by the consumer to mitigate future negative financial situation changes, including government benefits that may be available.

Thankfully, ASIC recognises that brokers and lenders cannot verify many of the future matters that may arise in a consumer's circumstances, and that judgment will need to be made before accepting those statements based on whether or not they are realistic or achievable given the consumer's circumstances.[44] ACL holders should take detailed file notes of all such discussions, and their assessment decision.

Conclusion

While ASIC has chosen to utilise many more examples in the updated RG 209 to provide helpful clarification about the steps it believes ACL holders can take to minimise the risk of non-compliance with their responsible lending obligations, the examples are not intended to cover all scenarios and are not prescriptive in nature. ASIC also provides clearer guidance on how ACL holders should consider future foreseeable changes in their inquiries and assessment, but again, judgment by the licensee in the individual circumstances is needed.

While this article covers some of the key new examples covering business purpose declarations, requirements and objectives and financial situation considerations, different credit products, hardship indicators and different consumer circumstances, and provides commentary on foreseeable changes particularly in light of the current COVID-19 situation, it is clear that ASIC expects lenders and brokers to ensure responsible lending policies can be applied broadly and flexibly enough to adapt to various consumers, products, risks and other circumstances during their application and assessment processes.

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

Footnotes

1. Australian Securities and Investments Commission (ASIC) "ASIC updates responsible lending guidance" media release 19-342MR (9 December 2019) https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-342mr-asic-updates-responsible-lending-guidance/.
2. 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.

3. ASIC *Credit Licensing: Responsible Lending Conduct* Regulatory Guide 209 (2019) Example 1.
4. National Consumer Credit Protection Act 2009 (Cth), Sch 1 (*National Credit Code*).
5. Above n 3, para 209.39.
6. *National Credit Code*, above n 4, s 5.
7. Above n 3, para 209.38.
8. Above n 3, Example 1.
9. Above n 3, Example 2.
10. Above n 2, at 176.
11. Above n 3, Example 13.
12. Above n 3, para 209.85(c).
13. Australian Banking Association Banking Code of Practice (1 July 2019 release).
14. Above n 3, Example 14.
15. Above n 3, Example 34.
16. Above n 3, Example 35.
17. Above n 3, Example 36.
18. Above n 3, Example 37.
19. Above n 3, Example 38.
20. Above n 3, Example 15.
21. Above n 3, Example 16.
22. Above n 3, Example 28.
23. Above n 3, Example 33.
24. Above n 3, Example 27.
25. Above n 3, Example 17.
26. Above n 3, Example 18.
27. Above n 3, para 209.101.
28. Above n 3, Example 19.
29. Above n 3, Example 20.
30. Above n 3, Example 21.
31. Above n 3, Example 5.
32. Above n 3, para 209.62.
33. Above n 3, Example 6.
34. Above n 3, Example 7.
35. Above n 3, Example 8.
36. Above n 3, para 209.75.
37. Above n 3, paras 209.61 and 209.64.
38. Above n 3, para 209.65.
39. Above n 3, para 209.175.
40. Above n 3, para 209.177.
41. Above n 3, para 209.176.
42. Above n 3, para 209.178.
43. Above n 3, para 209.179.
44. Above n 3, para 209.180.