



26 November 2019

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Australian Securities & Investments Commission

Dear Ms Grey

Supplementary submission to ASIC Consultation Paper 209: Update to RG 209 Credit Licensing: Responsible lending conduct

The Australian Banking Association (**ABA**) welcomes the opportunity to provide this supplementary submission to the Australian Securities & Investments Commission (**ASIC**) Consultation Paper 309 on the proposed update of Regulatory Guide 209 Credit licensing: Responsible lending conduct (**RG 209**).

As outlined in our initial submission, the ABA and our member banks welcome this review and update of RG 209. At a time when the financial services sector is undergoing significant and rapid technological change, it is vital that the responsible lending framework remains fit for purpose and is meeting the evolving needs of customers.

The ABA supports ASIC finalising this review and releasing updated regulatory guidance as soon as possible to provide clarity and assist credit licensees comply with their responsible lending obligations. This will help ensure that our member banks can continue to provide access to timely and appropriate credit for customers.

1. Key issues in RG 209

1.1 Maintaining a principles-based approach

The ABA strongly supports the retention of a principles-based approach to responsible lending through the legislative provisions contained in the NCCP Act, as well as in relation to relevant regulatory guidance, including in ASIC's RG 209 and APRA's APG 223 and APS 220.

We submit that this approach should remain the underlying basis of ASIC's guidance as this is in line with the principles-based nature of the responsible lending provisions in Chapter 3 of the NCCP Act. This enables credit licensees to take a scalable approach to determining what inquiries and verification steps are required in making a suitability assessment under the NCCP Act. This means that what a licensee needs to do to meet these obligations in relation to a particular customer will vary depending on the circumstances and risks presented in each credit application.

As we near the conclusion of this consultation process the ABA remains firmly of the view that it would not be in the interests of customers for ASIC to move away from a principles-based approach to take a prescriptive approach to setting minimum standards. This is based on a number of grounds:

- **No "one size fits all" approach:** the NCCP Act requires credit licensees to make "reasonable inquiries" into and take "reasonable steps" to verify a customer's financial situation but what is 'reasonable' will depend on the circumstances of each applicant, which includes factors specific to the consumer and to the kind of credit contract involved. It would be impossible for ASIC to prescribe an effective and efficient set of minimum standards to cover all types of consumers and/or products
- **'Check list' compliance:** we remain concerned that prescription of minimum obligations in all circumstances could risk reducing compliance to a "check list" exercise rather than the current



practice of licensees being required to consider the financial position of the customer as a whole in deciding whether to extend credit or not

- **Customer experience:** a prescriptive approach will reduce the flexibility of licensees to adopt a risk-based approach and this will negatively impact a customer's experience in seeking and being extended appropriate credit. This includes increasing the cost of credit origination, delays in the processing of credit applications and discouraging customers from switching between credit providers.

While the ABA and our member banks are committed to ensuring that customers are only able to access appropriate levels of credit that is deemed 'not unsuitable' and meets their requirements and objectives, we suggest that the regulatory approach needs to consider that the vast proportion of customers are meeting their debt obligations. Further, the evidence shows that when customers experience difficulty making repayments on their debt, it is primarily driven by factors outside of the control of credit licensees or often the customers, such as illness, divorce, loss of employment or death.

1.2 Risk-based approach to variable/discretionary expenses

A key issue that has emerged as part of the review of RG 209 has been the inquiry into and verification of a customer's variable/discretionary living expenses. As outlined in our original submission, we believe ASIC's regulatory guidance needs to differentiate significantly between fixed/essential and variable/discretionary expenses, particularly in relation to requirements for how the level of verification should differ between the categories.

The ABA believes that in most applications there is limited value in verifying past variable/discretionary expenses such as entertainment and hospitality expenses. Given the fluctuating nature of these types of expenses, positive verification is not possible and it is only possible to test the plausibility of these expenses by reference to historical data, such as transactional information. Additionally, by their nature these expenses can be more easily reduced by a customer in the future when taking on new credit and are less likely to materially impact the customer's ability to repay without substantial hardship. Mandating some form of verification of these expenses, which can and often are varied by customers when taking on debt, may not only be practically impossible but may also significantly impact credit assessments.

The preferred approach is for the required level of verification of a customer's variable/discretionary expenses being determined on an assessment of the customer's financial situation and the level of risk presented. There may be circumstances requiring a higher level of due diligence by a credit licensee such as where a customer's self-declared expenses falls below expected ranges based on their personal situation. However, at a minimum, customers should have the opportunity to demonstrate if they have plans in place to reduce discretionary living expenses and a credit licensee should be able to take this into account in assessing a credit application.

The regulatory guidance should require credit licensees to inquire into an applicant's variable/discretionary expenses (e.g., through a customer's self-declared breakdown of spending on these categories) and to conduct follow up and verification if a risk factor is identified. This will balance the need to conduct an appropriate level of assessment of a customer's financial situation and the practical limitations of assessing a customer's future expenses.

1.3 Retaining use of benchmarks and statistical measures

The development and use of expense benchmarks, most notably the Household Expenditure Measurement (**HEM**), was subject to significant scrutiny in ASIC's public hearings. The ABA remains firmly of the view that appropriately designed and quality benchmarks and statistical measures can be used as an element of making reasonable inquiries into and verification of a customer's financial situation.

While ASIC accepts that these benchmarks can be used by a licensee to determine the plausibility of a customer's self-declared information, the ABA submits that they can play a wider role in taking reasonable steps to verify a customer's financial situation. This is particularly important given industry



expectations that new and more comprehensive benchmarks and statistical measures will be developed over time.

Any changes to the regulatory guidance that would limit the use of benchmarks and statistical measures in responsible lending assessments would not be in the interests of customers, particularly if stronger requirements are imposed both on consumers to accurately declare their financial situation and credit providers to take responsibility for the appropriate use, quality and accuracy of such measures.

1.4 Improvements in technology

A key issue identified in ASIC's consultation paper and raised through the public hearings was the potential for technological developments to enhance the capacity of the credit industry to meet their responsible lending obligations. This includes the development of open banking, comprehensive credit reporting (CCR) and data aggregation services.

While the ABA acknowledges the potential of these developments to improve industry practices and access to customer data, we continue to caution that there is much to be done to implement these into the credit system and it will require significant consumer, industry and government support to bring the benefits to fruition. Therefore, in finalising RG 209, we submit that ASIC should not consider any of these as a "silver bullet" in resolving the complex issues that can often make it difficult to access reliable and detailed data for responsible lending assessments.

There is still inherent uncertainty and limitations for each of these developments, including:

- **Open Banking:** we are concerned that ASIC's approach is assuming that open banking will be a key part of a licensee's ability to fulfil its responsible lending obligations. As we have previously noted, this is something that will require significant buy in from consumers as they need to consent to the sharing of their data. We note that the open banking regime in the UK has reflected limited uptake as customers have been concerned by data security and privacy risks.

The ABA notes that the very basis of the Consumer Data Right (**CDR**) is for consumers to have the ability to choose to safely share their data and it is not a right for businesses to share consumers' data without their consent. Regulatory guidance should not set obligations that a licensee can only meet through accessing open banking data. In that circumstance, the open banking regime may act to limit the ability of licensees to provide appropriate credit to customers unless they consent to the sharing of their data for responsible lending purposes. This would not be in line with the original intention of the Government in legislating for open banking or in accordance with the CDR.

- **CCR:** similar to open banking, we are concerned there is much to be done before the benefits of CCR in providing a much broader insight into the financial situation of many customers can be realised. While some banks are participating in credit reporting and sharing positive data with credit bureaus, the legislation before the parliament only mandates it for the major banks and it will take time for other entities to participate and for the full picture of customer liability to be consistent and reliable.

We therefore suggest that RG 209 guidance on the interaction between CCR and responsible lending obligations be principles-based to enable future development and changes in industry practice.

- **Data aggregation:** the ABA is concerned that in the considerable discussion of data aggregation and other similar tools during the public hearings, there was not much of a focus on some of the significant concerns that remain over the use of these services including:
 - **Data security:** these services often require a customer to provide their banking log in details, including passwords, which raises significant data security concerns and potential losses for customers



- Data quality: there are concerns around the reliability of information due to aggregator services having different approaches to categorising data from a transaction feed and licensees should be cautious in using them for responsible lending assessments, and
- Customer liability: in using these services, customers may be breaching the terms and conditions of their accounts and invalidate their protections under the ePayments Code.

1.5 Design and distribution obligations

The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers)* amended the *Corporations Act 2001* to establish a design and distribution obligation regime for financial services firms to take effect from 6 April 2021. These obligations extend to any *Australian Securities and Investments Commission Act 2001* financial products issued to retail clients, which includes most credit products.

Under the regime, issuers and distributors will be required to design, market and distribute financial and credit products that meet consumer needs. Further, issuers will be required to identify in advance the consumers for whom their products are appropriate, and direct distribution to that target market.

Nonetheless, some financial products requiring a PDS are not subject to the new design and distribution regime: MySuper products and margin lending facilities.¹ These products are currently subject to product-specific regulations that are also aimed at ensuring that firms provide appropriate products to consumers.

Now that the regime applies to (non-business) credit, it would be useful if the guidance provided insight on ASIC's view of the interaction between:

- the design and distribution obligation for credit and the responsible lending requirements under the National Consumer Credit Protection Act 2009, which revolve around products being deemed 'not unsuitable' for a consumer, and
- the new 'best interests' duty for brokers.

2. Small business lending

2.1 Small business and responsible lending

As noted in our initial submission, the ABA supports the intention of the NCCP Act that lending to small business is not captured by the responsible lending obligations set out to primarily apply to customers. However, we are concerned that issues in relation to the interpretation and application of the NCCP Act and associated regulatory frameworks are impacting on the provision of credit to small business. There are a number of key aspects to this impact including:

- in many small business lending applications instances, homes or other personal assets are being used as security over business lending
- small business customers frequently comingle their business and personal cashflows and often do not distinguish between their personal and business borrowings – this often means their requirements and objectives across these, and their capacity to repay loans are intrinsically linked
- where the funds required for business purposes are less than 50% of the total customer lending requirement, the National Credit Code (NCC) applies, and
- customer documentation and verification requirements are often more complex for a small business customer than for a standard PAYG customer.

As noted in the consultation process, while the law under the NCCP Act may appear to be clear in not applying to business lending, the complicated financial situation of small business customers is often

¹ Margin lending facility is defined in section 761EA of the Corporations Act.



unclear. This has led to some lenders adopting a more conservative approach to applying the NCCP Act to loans applied for by small business owners.

2.2 Further clarity will assist industry

The ABA welcomes ASIC's intention to provide clarity in the updated RG 209 to assist industry in interpreting its responsible lending obligations, particularly in relation to small business lending.

We note the comments made by ASIC Commissioner Sean Hughes in his speech delivered at the ASF Conference on 18 November 2019², which confirmed ASIC's view that responsible lending rules do not apply to small business and no lender "should refuse a small business loan solely based on perceived constraints imposed by the National Consumer Credit Act".

We therefore suggest that ASIC consider inserting some of the key principles as outlined by Commissioner Hughes into RG 209 with some supporting examples, including:

- responsible lending obligations administered by ASIC only apply to credit provided to individuals for personal, domestic and household purposes; and residential investment purposes (with the minor exceptions of loans to strata corporations for the same purposes)
- credit provided to a company (including small proprietary companies) for any purpose is not subject to responsible lending obligations
- whether a loan to an individual is subject to responsible lending obligations is determined by the purpose of obtaining the credit and neither the security nor the source of funds for repayment affect this test (e.g., a loan to an individual predominantly for a business purpose is not subject to responsible lending obligations)
- a loan to an individual for business purposes secured over a borrower's home is not subject to the responsible lending obligations.

Please contact me on 0400 681 407 or at justin.mining@ausbanking.org.au if you require anything further.

Yours sincerely

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² <https://asic.gov.au/about-asic/news-centre/speeches/interpreting-responsible-lending/>