

ASIC Consultation Paper 115

Responsible Lending

**Submission authored by Consumer Action Law Centre
October 2009**

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1. Background

1.1 About this submission

This submission has been prepared by the Consumer Action Law Centre following broad consultation with a range of consumer advocates, mainly in the community legal sector.

This submission has been endorsed by the following organisations:

- Consumer Action Law Centre (CALC)
- Consumer Credit Legal Centre NSW (CCLC)
- National Legal Aid (NLA)
- Consumer Law Centre (ACT) (CLC)
- Legal Aid Queensland
- Legal Aid NSW
- Illawarra Legal Centre Inc.
- Australian Financial Counselling and Credit Reform Association (AFCCRA)
- Brotherhood of St Laurence (BSL)

Details of the consultation process are set out below.

1.2 Consultation with consumer advocates

This submission has prepared following consultation with consumer advocates.

This consultation included:

- A teleconference co-ordinated by Fiona Guthrie on 8 October 2009, with the following attendees:
 - John Moratelli, Legal Aid NSW
 - Catherine Uhr and Paul Holmes, Legal Aid Queensland
 - Katherine Lane, CCLC
 - Fiona Guthrie, AFFCRA
 - Gerard Brody, BSL
 - Agata Pukiewicz, CLC
 - Jane Hutchison, Hobart Community Legal Centre
 - Carolyn Bond, Consumer Action
 - Zac Gillam, Consumer Action

1.3 Nature of this submission

In the interests of providing feedback directly related to the proposed ASIC guidelines, this paper does not discuss the broader issues of responsible lending at length but instead seeks to concisely address each question raised by ASIC in Consultation Paper 115, in the order in which they are raised.

2. Consumer Action Response

2.1 Broad Summary

Consumer Action is broadly supportive of the guidelines proposed by ASIC and believes that in most cases an open ended, non-prescriptive approach is necessary to allow for broad interpretation of the National Credit Bill, and therefore give full scope the Bill's legislative intent.

An overly prescriptive approach often leads to business practices that successfully meet narrow guidance criteria, but fail to meet the spirit of the legislation. It is important that lenders take a principles based approach to responsible lending, rather than seeking to discharge their obligations through a convenient "tick a box" approach.

If there is any major criticism of the guidelines, it is that there is insufficient emphasis on the notion of harm, and on the lender's obligation to ensure that the product being sold to the consumer will not induce financial hardship.

Consumer Action's primary interest in responsible lending matters is in protecting consumers from harmful business practices, and thereby preventing the hardship that can result from those practices. There is a risk with any responsible lending legislation and associated guidelines that the notion of "responsible" lending, over time, becomes divorced from the notion of harm and is instead determined strictly by other criteria (such as income, credit report data, variable expenses, etc). There is a risk that criteria which are chosen for their utility as a means to preventing harm, become seen as an end in themselves.

Consumer Action would recommend that the guidelines make more explicit the intent of the legislation to prevent harmful lending practices, and that the potential to cause harm should be considered central to assessing whether or not a credit contract is unsuitable. On that basis, the capacity of the consumer to repay is not a sufficient measure in itself, but should be extended to include the capacity of the consumer to repay *without substantial hardship*.

Explicitly introducing the concept of harm prevention into the guidelines does result in a reframing of some of the proposals. This is discussed further below.

2.2 B - Proposed guidance about reasonable inquiries

2.2.1 - Proposal B1 - Scalability

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| ASIC Proposal B1 | <i>Guidance to be provided that the obligation to make reasonable inquiries is scalable - that is, what a credit licensee needs to do to meet the obligation will vary depending on the circumstances.</i> |
| Question B1Q1 | <i>Do you agree with our proposed approach to guidance about the</i> |

reasonable inquiries obligation being scalable?

RESPONSE

Consumer Action acknowledges the practical necessity for some notion of scalability, and that in principle a small loan should not require the same degree of inquiry than a large loan for the purchase of a house or other major asset.

However, this distinction should always be based on the potential harm or negative impact that the consumer is likely to encounter if the product is unsuitable - which is not always determined by the size or complexity of the product being sold, and has much more to do with the consumer's personal circumstances.

Although the guidelines outline "potential impact" as the primary criteria of scalability, Consumer Action is concerned that the concept of scalability could easily be simplified to relate simply to the size and complexity of the credit contract being sold. The guidelines themselves indicate how this could easily occur. Example 1, provided in the guidelines, suggests an approach of scalability based primarily on the nature of the product.

In Consumer Action's experience, harmful lending practices often occur in the fringe credit market, which generally trades in small amount, and relatively straightforward credit products. Nonetheless, many fringe credit products have a profoundly negative impact on consumers, and are often sold with very little inquiry into the consumer's circumstances, capacity to repay, and the likelihood that the product will cause hardship. Further, Consumer Action is concerned about certain categories of credit referrals, whereby vendors using high pressure selling in the home, refer consumers through to credit providers for credit products that are often unsuitable, in part, because the borrower has signed under pressure. Although these amounts may not be considered significant when compared with a home loan, the negative impact on consumers can be profound. In most cases, the vendor makes very little effort to ascertain the consumer's capacity to pay, or the potential harm that may result from the credit product.

It would be a significant failure of the responsible lending provisions of the National Credit Bill if harmful fringe lending practices were to continue unabated on the basis that scalability rendered the reasonable inquiries obligation lower for those products than for other products, because they are generally for smaller amounts, or less complex in their construction.

On that basis, Consumer Action would recommend that although the reasonable inquiry obligation should be scalable, there should be a minimum reasonable inquiry obligation that applies to all credit contracts, regardless of their scale and complexity.

Further, we believe that rather than the term scalability, that the policy use the term "proportionality". In addition to the amount of credit, the level of enquiry required should be proportional, based on a range of factors that could indicate the likelihood of risk that information provided to the lender may not be accurate or risk of detriment to the borrower. Examples of where a lender may be on notice that the information provided may not be

accurate might be where a borrower has responded to advertising by the lender (or an intermediary) that there are "no credit checks" or that credit is provided to those with poor histories, where the borrower is referred by property investment promoters or other vendors who may use high pressure selling, and may convince the borrower that he or she requires a particular type of loan. Additional enquiries would be expected where the borrower is referred by someone offering debt reduction schemes, or where there is some belief that someone other than the borrower is the beneficiary of the credit.

Question B1Q2

Is there any further guidance we should give?

RESPONSE

Although the concept of scalability is broadly supported, Consumer Action would suggest that guidance should be given that the reasonable inquiry obligation carries a minimum requirement of protection that applies to all credit products, regardless of the nature of the product or the circumstances of the borrower.

That minimum should include a requirement to assess the potential of the product being sold to:

- (a) cause the consumer ongoing hardship, or;
- (b) lead to further and unsustainable borrowing.

In the case of most fringe lenders, this will require substantially more lender inquiry than is currently undertaken.

For example, an unemployed Centrelink recipient who receives a Newstart payment of approximately \$450 per fortnight is unlikely to benefit from borrowing \$300 from a payday lender, and being required to repay \$405 four weeks later.

In this circumstance, the likelihood that the borrower will fail to meet basic living expenses and will either borrow again or pay a fee to extend the initial loan, (potentially repeatedly, over many months), is reasonably high. This in turn would lead to a serious negative impact on that consumer - despite the relatively small amount borrowed, on reasonably straightforward terms.

2.2.2 - Proposal B2 - Degree of guidance regarding reasonable inquiries

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| ASIC | <i>Guidance to be provided that licensees will be expected to determine the degree of inquiry required to meet the reasonable</i> |
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| Proposal B2 | <i>inquiries obligation, with ASIC providing criteria to assist licensees in making that determination.</i> |
| Question B2Q1 | <i>Do you agree with our proposed approach to guidance about making reasonable inquiries?</i> |
| <p style="text-align: center;">RESPONSE</p> <p>To an extent, Consumer Action agrees with ASIC's open ended approach of providing a non-exhaustive list of criteria by which lenders may make a determination as to what constitutes a reasonable inquiry in any given circumstance.</p> <p>That being said, Consumer Action believes that some minimum basic criteria should apply in all cases, and that guidance should be issued to that effect. This is necessary to provide a minimum level of consumer protection in every consumer credit scenario.</p> <p>Consumer Action believes this is necessary to provide the minimum level of reasonable inquiry as discussed in B1 above.</p> <p>Consumer Action believes that the minimum level of inquiry in all cases should include:</p> <p>(a) The consumer's income; (b) The consumer's expenses; (c)</p> | |
| Question B2Q2 | <i>In your view, are the obligations about making reasonable inquiries consistent with current good business practice?</i> |
| <p style="text-align: center;">RESPONSE</p> <p>The obligation to make reasonable inquiries is an essential feature of any responsible lending regime, and it is important that credit licensees are not permitted to shirk that requirement in the name of efficiency or convenience.</p> <p>Credit licensees do generally make reasonable inquiries to cover their own risk, but this does not apply in all cases - and covering the lender's risk is not always the same as ensuring the borrower doesn't experience hardship.</p> <p>In small amount fringe lending transactions, repayments are often pre-arranged by way of a direct debit timed for withdrawal on the borrower's next income date. Accordingly, the loan presents very little risk for the lender, and therefore there is little impetus to make reasonable inquiries on the basis of risk. Lenders in those</p> | |

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| <p>circumstances will only make reasonable inquiries for the purposes of consumer protection if they are required to by law, and are prompted to by regulatory guidelines.</p> | |
| <p>Question B2Q3</p> | <p><i>Is there any further guidance we should give?</i></p> |
| <p>RESPONSE</p> | |
| <p>See above.</p> | |

2.2.3 Proposal B3 - Licensee processes

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| <p>ASIC Proposal B3</p> | <p><i>Guidance to be issued outlining an expectation that licensees will have processes in place to ensure reasonable inquiries are made in each transaction.</i></p> |
| <p>Question B3Q1</p> | <p><i>Do you agree with the proposed approach?</i></p> |
| <p>RESPONSE</p> | |
| <p>Consumer Action supports this proposal as a logical means of ensuring compliance on the part of credit licensees. It is difficult to envisage how a credit licensee could establish that they were making reasonable inquiries in all circumstances, without having clear processes in place to prove it.</p> | |
| <p>Question B3Q2</p> | <p><i>To what degree do you anticipate that you will need to implement new processes?</i></p> |
| <p>RESPONSE</p> | |
| <p>N/A</p> | |
| <p>Question B3Q3</p> | <p><i>Is there any further guidance we should give?</i></p> |
| <p>RESPONSE</p> | |

N/A

2.2.4 Proposal B4 - Verification requirements

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| ASIC Proposal B4 | <i>Guidance to be issued that the obligation to take reasonable steps to verify the consumer's financial situation will require the licensee to take some positive steps to verify the information provided by the consumer.</i> |
| Question B4Q1 | <i>Do you agree with the guidance ASIC is proposing to give?</i> |
| RESPONSE | |
| <p>Credit licensees must be required to take some pro-active steps to verify information provided by prospective borrowers in response to reasonable inquiries, in order to gain as complete a picture as possible of the consumer's financial circumstances. However, we believe that this can be proportional, based on the types of factors mentioned above.</p> <p>In the absence of such a requirement, some credit licensees will seek to rely on information provided by consumers who are desperate for credit even where the licensee does not believe the information to be true.. Credit licensees are well aware of this dynamic, but can find it convenient to rely on the data provided by consumers to facilitate the transaction, particularly where the credit is secured against property, or in the fringe credit market where payments are secured by direct debit.</p> <p>The requirement to positively verify a consumer's financial circumstances is a necessary requirement of any responsible lending regime, and it would be a significant failure of the National Credit Bill if credit licensees were not held to this requirement.</p> | |
| Question B4Q2 | <i>How consistent are the obligations about verification of information with current good business practice?</i> |
| RESPONSE | |
| <p>Again, any responsible lender should already have processes in place to verify information provided by consumers. In most cases, the motivation for such processes will be to minimise the lender's risk. In relation to some products however, the lender's risk is already minimal, and there is less impetus to verify data and processes are therefore less thorough.</p> | |

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| Question B4Q3 | <i>What changes will you need to make to your business?</i> |
| RESPONSE | |
| N/A | |
| Question B4Q4 | <i>Is there any other guidance we should give?</i> |
| RESPONSE | |
| No - the verification methods outlined by ASIC in the consultation paper are appropriate. | |

2.2.5 Proposal B5 - Intermediary assessment

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| ASIC Proposal B5 | <i>Guidance to be issued about licensee's obligation to ensure reliability of information collected by third parties.</i> |
| Question B5Q1 | <i>Do you agree with the guidance we are proposing to give in relation to relying on information provided in an intermediary's preliminary assessment?</i> |
| RESPONSE | |
| <p>Consumer Action is particularly concerned about the potential for credit licensees to shirk their responsible lending obligations by relying on the preliminary assessments of intermediary's who are likely to endorse as many credit applications as possible, in the interests of their own profitability.</p> <p>In order to counter this, it is necessary that credit licensees be given guidance that relying on preliminary assessment is not sufficient to meet responsible lending requirements, and that re-verification should be undertaken on a regular basis as a means of ensuring that preliminary assessment's are consistent with responsible lending.</p> <p>It should be clear that lenders should undertake additional verification in certain circumstances, based on past experience with the intermediary, the type of customers targeted by the intermediary, the types of businesses that refer business to the intermediary</p> | |

and the purpose of the credit - see next question.

Question B5Q2

Is there any other guidance we should give?

RESPONSE

Based on our own experience of the consumer credit market, Consumer Action recommends that certain types of intermediary referrals should automatically trigger a requirement to re-verify consumer information, before credit is extended. This is due to both the target customers for certain products, and the high pressure sales tactics commonly employed in certain industries.

If a credit licensee receives a referral from any of the below business types, then they should be given guidance to re-verify every application received from:

- web -based businesses offering credit with "no credit checks", or similar;
- businesses selling property investment seminars;
- businesses selling products through direct door to door selling practices, which often employ high pressure sales tactics, and
- businesses that promote "debt reduction strategies."

2.3 C- Assessment of unsuitability

2.3.1 - Proposal C1 - 'Not unsuitable'

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| ASIC Proposal C1 | <i>Guidance to be issued that a credit licensee must form a view that a credit contract is 'not unsuitable' before entering into a contract with a consumer.</i> |
| Question C1Q1 | <i>Do you agree with our proposed approach?</i> |
| RESPONSE | |
| <p>This important component of the responsible lending regime puts the onus on the lender to make a positive assessment that the credit contract will not cause harm to the consumer.</p> <p>Consumer Action endorses ASIC's proposed guidance that a credit licensee must form a view that the credit product is not unsuitable for the consumer, and that this assessment must be based on reasonable inquiries. Further, it is positive that the assessment will be required to be recorded in writing.</p> | |

Consumer Action further believes that this written assessment should always be provided to the consumer, and not only on request. This has the double benefit of encouraging compliance with the requirement, and also in educating consumers about responsible lending principles, whilst at the same time improving the transparency of the credit application and assessment process.

Question C1Q2

What changes will you need to make in your business?

RESPONSE

N/A

Question C1Q3

Is there any further guidance we should give?

RESPONSE

The required written assessment determining that the product is not unsuitable should be provided to the consumer in every instance, and not just on request.

2.3.2 - Proposal C2 - Capacity to repay

**ASIC
Proposal C2**

Issue guidance about determining the consumer's financial situation and capacity to repay, including:

(a) licensees should take into account all costs associated with the credit contract when determining capacity to repay;

(b) licensees should have appropriate processes in place for assessing whether a consumer will be able to repay a credit contract without substantial hardship; and

(c) generally, consumers should be able to meet the credit contract's obligations from income rather than equity in an asset.

Question C2Q1

Do you agree with our proposed approach?

RESPONSE

Consumer Action supports the above proposal, particularly the requirement that the consumer must be able to repay the credit contract without incurring substantial hardship - as this goes to the core of consumer protection in lending. This is a fundamental and necessary requirement of any genuine responsible lending regime.

Question C2Q2

Are the obligations about capacity to repay consistent with current good business practice?

RESPONSE

The majority of inquiry measures currently undertaken by lenders are designed exclusively to protect the lender from the risk of borrower default and do not specifically take into account the need to prevent harm to the consumer.

Accordingly, products are sometimes sold which are profitable to the lender, yet have the capacity to cause harm to the borrower. However, we believe that obligations to assess capacity to repay are consistent with good business practice, and evidence can be found in a number of industry Codes including the Banking Code of Practice, the Mutual Banking Code of Practice, and the Mortgage and Finance Association of Australia Code of Practice.

While we believe this is accepted to be good business practice, it is clear that many lenders don't currently apply this in practice.

Question C2Q3

What changes will you need to make in your business?

RESPONSE

N/A.

Question C2Q4

Is there any further guidance we should give?

RESPONSE

No - the factors outlined in paragraphs 46 to 50 are sufficient.

2.3.3 - Proposal C3 - 'Substantial hardship'

ASIC

Guidance to be issued about factors ASIC will take into account when considering whether a particular situation

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| Proposal C3 | involves substantial hardship. |
| Question C3Q1 | <i>Do you agree with the proposed guidance?</i> |
| RESPONSE | |
| <p>Consumer Action supports the approach of not providing a strict definition of substantial hardship, but of allowing the concept to develop over time. However, Consumer Action does endorse the criteria listed as paragraph 56, as a useful guideline for lenders as measures of substantial hardship.</p> <p>Ultimately, lenders need to shift the concept of "affordable" credit away from what they can reasonably expect to secure from the borrower without incurring undue risk, towards what the consumer can reasonably afford to pay, without incurring undue hardship. It is expected that some contracts considered to be affordable on the first measure, will not be considered affordable on the second.</p> | |
| Question C3Q2 | <i>Is the proposed guidance consistent with current good business practice?</i> |
| RESPONSE | |
| See response to C2Q2. | |
| Question C3Q3 | <i>What changes will you need to make in your business?</i> |
| RESPONSE | |
| N/A | |
| Question C3Q4 | <i>Is there any further guidance we should give?</i> |
| RESPONSE | |
| No. As stated, the concept of substantial hardship will develop over time as it is tested through the courts. | |

2.3.4 - Proposal C4 - Requirements and objectives of consumer

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| <p style="text-align: center;">ASIC Proposal C4</p> | <p style="text-align: center;">Guidance to be issued about determining the requirements and objectives of the consumer in relation to the credit contract.</p> |
| <p>Question C4Q1</p> | <p><i>Do you agree with the proposed approach?</i></p> |
| <p style="text-align: center;">RESPONSE</p> <p>Consumer Action strongly supports this proposal as means of ensuring that consumers are not sold inappropriate credit products, or given excessive credit for their needs. We see borrowers with unsuitable products, such as in-store credit at levels above that required for the purchase of the good for which the contract is formed, and many fringe lenders offer an ongoing credit facility to their clients, significantly over and above the value of the original loan sought. For example, an application for a \$200 loan with a prominent web-based payday lender entitles the borrower to access to \$8,100 credit over a twelve month period, obtainable in \$600 multiples through the use of a card which can be used 24 hours a day, seven days a week. This is provided on the basis of only the barest financial data provided by the consumer. Clearly, such products and practices represent irresponsible lending practices that have the capacity to cause serious harm to the consumer, by encouraging unsustainable levels of personal debt.</p> <p>Again, the major benefit of proposal C4 is that it requires the lender to consider the impact of the proposed product from the perspective of the consumer;s needs and circumstances.</p> <p>It should be clear that in some circumstances a lender or intermediary would be expected to seek more information about the consumer's requirements and objectives than the actual request made by the consumer. The content of an advertising campaign to which a consumer is responding, or the type of business referring the consumer to the licensee may indicate that further inquiries need to be made of the consumer about the requirement for a particular credit product. For example, a consumer may seek a line of credit loan because a debt reduction company has referred the consumer after telling the consumer that this can cut 10 years off his or her mortgage.</p> | |
| <p>Question C4Q2</p> | <p><i>Is the obligation consistent with current good business practice?</i></p> |
| <p style="text-align: center;">RESPONSE</p> <p>We believe that this obligation is consistent with current good business practice.</p> | |
| <p>Question C4Q3</p> | <p><i>What changes will you need to make in your business?</i></p> |

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| RESPONSE | |
| N/A. | |
| Question C4Q4 | <i>Is there any further guidance we should give?</i> |
| RESPONSE | |
| No - the guidance is direct and thorough, and the examples provided are useful. | |

2.3.5 Proposal C5 - "Fit for purpose"

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| ASIC Proposal C5 | <i>Guidance to be issued about the factors ASIC will take into account when considering if a transaction is fit for purpose.</i> |
| Question C5Q1 | <i>Do you agree with our proposed approach?</i> |
| RESPONSE | |
| Yes - this is closely related to proposal C4 above. See above response (C4Q1). | |
| Question C5Q2 | <i>Is our proposed guidance consistent with current good business practice?</i> |
| RESPONSE | |
| See response to C2Q2. | |
| Question C5Q3 | <i>Is there any further guidance we should give?</i> |
| RESPONSE | |
| No - the guidance is direct and thorough, and the examples provided are useful. | |

2.3.6 Proposal C6 - Switching and refinancing

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| ASIC Proposal C6 | <i>Guidance to be issued that a new credit contract will not be considered to meet the consumer's requirements if the benefits are less than existed under the previous contract.</i> |
| Question C6 | <i>Do you agree with the proposed guidance?</i> |
| RESPONSE | |
| <p>Yes. This is an important measure which will have a positive impact of reducing the incidence of misleading "debt reduction" products, and exploitative debt consolidations, which currently operate in a predatory manner and often put the consumer in a worse situation than they were before.</p> | |

2.4 D - Guidance about written assessment

2.4.1 Proposal D1 - Written assessments

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| ASIC Proposal D1 | <i>Guidance to be issued about ASIC's expectations for the form and content of both the preliminary and final written assessment that a credit contract is not unsuitable.</i> |
| Question D1Q1 | <i>Do you agree that this type of information should be included in a written assessment?</i> |
| RESPONSE | |
| <p>Yes. Consumer Action believes this is an important requirement that will help to ensure compliance with responsible lending principles. Consumer Action also believes that written assessments should always be provided to successful credit applicants, and not only on request. See C1Q1 and C1Q3 above.</p> <p>Further, Consumer Action is of the view that the third criteria should state:</p> <p><i>" (c) a statement that the licensee has assessed a particular credit contract as not unsuitable for the consumer, and will not cause the consumer substantial hardship".</i></p> | |

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| Question D1Q2 | <i>What changes will you need to make in your business?</i> |
| RESPONSE | |
| N/A. | |
| Question D1Q3 | <i>Do you think any additional information should be included in the written assessment?</i> |
| RESPONSE | |
| No - the information currently required is appropriate, with the additional suggested in our response to D1Q1 above. | |