

The background of the cover features a blurred image of a person's face in the upper left. Overlaid on this are several stacks of coins: a small stack of silver coins, a medium stack of silver coins, and a tall stack of gold coins. A large, teal-colored geometric shape, resembling a stylized 'V' or a large arrow pointing downwards, is positioned on the right side of the cover. The overall design is modern and professional, with a focus on financial themes.

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RESPONSIBLE LENDING – UPDATED GUIDANCE AND PRACTICAL CONSIDERATIONS

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I. Introduction

Lenders' responsible lending obligations have been a fluid topic in the wake of the Hayne Royal Commission's final report in February 2019. In that report, Commissioner Hayne said that he was ultimately not persuaded that the *National Consumer Credit Protection Act 2009* (Cth) (**NCCP**) needed to change in that aspect. His view was that the responsible lending issues uncovered by the Commission would be resolved by the banks *"...applying the law as it stands"*.¹

Therein lies the problem though. Different views have been taken as to what the law requires, including recently between ASIC and the Federal Court. ASIC has stated that the responsible lending decision in

*ASIC v. Westpac*² in August 2019 (currently on appeal) *"...creates uncertainty as to what is required for a lender to comply with its assessment obligation..."*.³ Notwithstanding, ASIC released updated guidance RG 209 pertaining to responsible lending in December 2019, in part based on unusual public hearings it conducted with banks, consumer groups and others in August 2019.

Against the backdrop of this moving feast, considering the updated RG 209 and the surrounding context provides some practical insights for Australian credit licensees moving forward.

II. The background to the updated RG 209

Credit licensees are obligated to ensure that their lending is *"not unsuitable"* for consumers, which it will be if certain conditions are met, e.g. if it will cause substantial hardship.⁴ Before doing so, the licensee must make reasonable inquiries about the consumer's requirements and objectives in relation to the lending⁵, reasonable inquiries about their financial situation⁶ and take reasonable steps to verify the consumer's financial situation.⁷ ASIC's previous guidance in RG 209 released in 2014 provided that these separate obligations were *"scalable"* and that *"...what you need to do to meet these obligations will vary according to the circumstances"*.⁸ Whether the consumer is new or existing, the potential impact on the consumer if they enter an unsuitable loan, the complexity of the loan and the consumer's ability to understand it are all factors to be taken into account here.

In September 2018, Commissioner Hayne identified in his interim report that the major banks *"took some steps"* to identify the income of applicants, but *"much more often than not"* none of them took steps

to verify outgoings.⁹ Instead banks relied on the Household Expenditure Measure (**HEM**), being a benchmark used to estimate people's living expenses. In commenting on the effectiveness of the HEM, which does not consider unusual outgoings, e.g. caring for aged relatives, Commissioner Hayne noted that its use does not by itself constitute any verification of the borrower's expenditure.

In February 2019, in the same month as Commissioner Hayne released his final report, ASIC released a consultation paper to facilitate it updating its responsible lending guidance (CP 309). To assist its consultation, ASIC unusually held two days of public hearings in August 2019. ASIC opened those hearings by telling lenders its *"factually and fundamentally"* did not accept some of the matters set out in the 72 submissions it received in relation to CP 309¹⁰. Many of those submissions, and the subsequent hearings, were concerned with the balance between principles-based versus prescriptive rules in complying with responsible lending obligations.

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report dated 4 February 2019, page 117.

² Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial) [2019] FCA 1244

³ Media release, 19-246MR ASIC to appeal Westpac responsible lending Federal Court decision, 10 September 2019

⁴ s.131(1) NCCP Act

⁵ s. 130(1)(a) NCCP Act.

⁶ s. 130(1)(b) NCCP Act.

⁷ s. 130(1)(c) NCCP Act.

⁸ ASIC, Regulatory Guide 209: Credit Licensing: Responsible Lending Conduct, November 2014, reg 209.19.

⁹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report dated 28 September 2018, page 25.

¹⁰ Public Hearing on Responsible Lending Guidance, Transcript of Public Hearing Sydney 12 August 2019 at T:15:7.

One large bank took the approach of conducting expense validation on bank statements for every mortgage loan application;¹¹ most others said this was too far.¹² Borrowers who use a lot of Uber Eats, Afterpay and Netflix probably agree.

In August 2019, right in the middle of ASIC's responsible lending hearings, Perram J delivered judgment in *ASIC v. Westpac* in favour of Westpac. Commenced on 1 March 2017, the case concerned ASIC's allegations that Westpac had breached the responsible lending laws by failing to have regard to consumers' disclosed living expenses (instead relying on the HEM, among other benchmarks) and by treating interest-only loans as being amortised over the life of the loan.

Perram J found at [82] of his judgment that “A credit provider may do what it wants in the assessment process, so far as I can see; what it cannot do is make unsuitable loans. ASIC's argument creates a whole new range of implied rules which appear altogether unnecessary...”. While the NCCP Act requires lenders to ask borrowers about their financial situation, his Honour did not accept that this had the “consequence that the credit provider must use the consumer's declared living expenses in doing so”. ASIC disagrees and regards the decision as inconsistent with the legislative intention of the responsible lending regime.¹³ It appealed the decision in September 2019, and the appeal hearing is currently set down 25 and 26 February 2020. You can read more about the decision and the appeal in our previous briefing [here](#).

III. The updated RG 209 – key changes

Against the backdrop of this tumult, and notwithstanding the unknown outcome of its appeal in *ASIC v. Westpac*, ASIC released the updated RG 209 on 9 December 2019. It contains many important changes which reflect broader shifts in the economy but also the context in which the updated guidance came into existence. The main changes are set out below:

- **General principles:** it unveils four principles that ASIC will be guided by in determining whether licensees are complying with their duties (in addition to other obligations, such as the consumer protection provisions in the *ASIC Act 2001* (Cth)).

ASIC's new four principles are as follows:

- you should have regard to what the obligation is intended to achieve and what consumer harm it is intended to address;
- you should have regard to the circumstances of the individual consumer you are dealing with;
- you should have regard to whether the credit product involves a higher risk of harm to the individual consumer if it is unsuitable; and

- the obligations are not static—what is ‘reasonable’ will be affected by the broader professional and regulatory environment in which you operate.

- **Inquiries:** additional information is set out in the new RG 209 regarding the inquiries necessary for a licensee to take to understand the consumer's requirements, objectives and financial situation: RG 209.43 – RG 209.50 and RG 209.58 – RG 209.78. As one example, in relation to income it is not sufficient to inquire how much income the consumer has received in the last pay period – whether the income is consistent and likely to remain at that level for the duration of the loan also needs to be considered. Casual or seasonal employees are likely to be affected here.

Another example is outgoings, as licensees “are likely to need enough information to determine how much of the consumer's income is, and will continue to be, needed for outgoings the consumer is unable or unwilling to forego” (RG.209.66). ASIC provides examples of the types of expenses a consumer is less likely to be able reduce in order to meet their credit obligations e.g. special medical needs.

¹¹ Ibid, at T:21:38

¹² As an interesting aside, these considerations took place against a broader trend of principles-based laws – which provide more flexibility – being introduced for regulators to perform their enforcement mandates e.g. the Banking Executive Accountability Regime.

¹³ See 3 above.

- **Verification:** licensees need to ensure that the information that they are receiving is reliable: RG 209.47 – RG 209.50 and RG 209.113 – RG 209.114. The updated guidance provides that if other circumstances or information raise doubt about the information provided e.g. there is an overstatement of income or understatement of expenses, it is reasonable to take steps to verify the true situation. This potentially creates an additional burden on licensees, for e.g. reconciling information held on existing consumers with new lending applications.
- **“Reasonable”:** The new guidance retains the scalability element of the previous guidance; what will constitute “reasonable” inquiries or verification steps in inquiring about a consumer and verifying their financial position (based on reliable information as set out above) will depend on the circumstances: RG 209.79 – RG 209.83.

The guidance then provides a new and helpful broader range of circumstances where more or less information may be required: RG 209.84 – RG 209.114. There is a lot of value in the updated guidance here, which considers credit risk, guidance on hardship indicators and how licensees can use credit history information to assist in making assessments. This will be particularly important with the roll out of open banking later this year.

As but one example, less information may be required where the licensee has previously had dealings with the consumer and reasonably considers they have an appropriate level of experience or understanding in relation to financial matters.

- **Benchmarks:** the new guidance does not contain any prohibitions on using benchmarks, such as the HEM: RG 209.133 – RG 209.145. It does contain a lot of cautions in relation to the use of these benchmarks though, for e.g. the types of expenses that the HEM does not take into account, and notes that such benchmarks do not satisfy the verification obligations in and of themselves. This was Commissioner Hayne’s point in his interim report.

Interestingly, the updated guidance does not state that the use of benchmarks is not a replacement for making reasonable inquiries about income and

expenses which the previous version did. Whether that position will change after ASIC’s appeal in the *ASIC v. Westpac* case remains to be seen.

- **“Not unsuitable”:** additional guidance has been provided to assist licensees in determining whether the proposed product is “not unsuitable” for the consumer once the above-mentioned inquiries and verification have been undertaken: RG 209.171 - RG 209.252. A credit product will be unsuitable where:
 - the consumer *will be* unable (and here it is worth noting the tension of assessing a future state of affairs) to comply with their financial obligations under the product, or
 - the consumer will only be able to comply with their financial obligations under the product with substantial hardship: or
 - the product will not meet the consumer’s requirements or objectives.

ASIC has directed licensees to consider:

- foreseeable changes to consumer’s circumstances: RG 209.175- RG 209.180;
- whether the consumer can meet all the repayments, fees, charges and transaction costs of complying with the proposed credit contract where there is a refinance e.g. discharge or break fees: RG 209.184 – RG 209.186;
- set out the meaning to be given to “*substantial hardship*” - it is something different to and less than being unable to meet the required financial obligations, such as selling the family home: RG 209.189 – RG 209.193;
- stated the need for *all* reasonable inquiries and verification to be completed prior to an assessment: RG 209.204 – RG 209.206; and
- said that refinancing requires additional matters to be considered: RG 209.240.

- **Reviews:** ASIC has instructed credit licensees to periodically review their portfolios to consider whether the assessments they make are effectively identifying individual circumstances in which credit products are unsuitable or “*not unsuitable*” for the consumers: RG 209.249-252. The guidance states that “*A higher incidence of complaints received through your dispute resolution processes, and early default or arrears, hardship or switching events, may indicate that the assessments you are making are not achieving their objective.*”
- **Record keeping:** the new guidance stresses that licensees need to keep appropriate records of inquiries made and verification steps taken, otherwise they may be unable to demonstrate they have complied with their obligation: RG 209.263 – RG 209.266. The guidance advocates the use of application forms, “*fact find*” and “*needs analysis*” documents and ensuring that all questions are answered including by indicating “*nil response*”: RG 209.266. Brokers need to be careful to connect a product recommendation to the consumer’s requirements and objectives, as this shortcoming has previously been highlighted by ASIC.¹⁴
- **Application:** finally, the updated RG 209 has a section which sets out circumstances where the responsible lending obligations do not apply. This includes intermediaries who are not acting as credit assistance providers (who are most often brokers) and credit-to-purchase investments other than residential property.

IV. Practical considerations for credit licensees

In releasing the updated RG 209, ASIC announced that the changes embodied a “...*stronger focus on the legislative purpose of the obligations... to ensure licensees obtain sufficient reliable and up-to-date information about the consumer’s financial situation, requirements and objectives*”.¹⁵ In our view, the new RG 209 is an improvement on the previous version given the depth of the guidance provided whilst retaining a principles-based approach to compliance.

Credit licensees should now take two steps.

First, they should re-evaluate their internal approaches to responsible lending. Do their systems and processes allow them to factor in reasonably foreseeable changes to consumers’ income in the future? Do they rely on the HEM or another benchmark alone for outgoings, without any verification? Is additional criteria being considered where consumers are refinancing? How is the data captured by the internal dispute resolution and credit risk functions e.g. high level of defaults for certain consumers being utilised to inform the licensees’ responsible lending approach?

Risk and compliance functions should take the time to reconsider their existing policies and procedures in light of the updated guidance in the updated RG 209.

Not doing so runs the risk of increased regulatory scrutiny from a now hawkish regulator seized of a “*why not litigate?*” approach to enforcement. Responsible lending is at the top of its agenda. Of course, there are others risks such as AFCA claims and professional claims i.e. class actions and reputational damage.

Second, credit licensees should keep a watching brief on this area. Some confusion will remain given the principles-based approach that ASIC has retained, the pending outcome of ASIC’s appeal in the *ASIC v. Westpac* case and with the advent of new technologies and open banking in 2020. Further direction from ASIC will also no doubt be forthcoming, as ASIC Commissioner Sean Hughes stated late last year “...*there is little doubt that [ASIC] will continue to be engaged in conversation with industry about responsible lending.*”

Please reach out to us if you wish to discuss the changes to the responsible lending laws. We have deep experience in this area and would be delighted to assist you.

¹⁴ ASIC Report 493, Review of interest-only home loans: Mortgage brokers’ inquiries into consumers’ requirements and objectives, September 2016

¹⁵ ASIC 19-342MR ASIC updates responsible lending guidance, 9 December 2019

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