

Response to CP 309: Update to RG 209: Credit licensing: Responsible lending conduct

Submission to Australian
Securities & Investment
Commission

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ABOUT US

Consumer Action Law Centre is an independent, not-for-profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

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PART 1 – INTRODUCTION AND GENERAL COMMENTS

1. Consumer Action Law Centre (Consumer Action) welcomes the opportunity to respond to the review of the Australian Securities and Investments Commission (ASIC) guidance *RG 209 Credit Licensing: Responsible lending conduct* ('RG 209'). The review is timely, with the 2018 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the 'Royal Commission'), demonstrating the systemic failings of banks and other lenders to comply with their responsible lending obligations set out in the *National Consumer Credit Protection Act 2009* (Cth) (the 'NCCP Act') and the significant consumer harm derived from these breaches. The Royal Commission exposed bank and lender reluctance at moving away from practices that cause consumer harm for fear of losing market share or profits.¹
2. We advocate that all updates to RG 209 are drafted with this recent evidence in mind, rather than with an assumption that credit lending practises and cultures have improved. It is important to recognise that there are many more licensees beyond those large entities examined by the Royal Commission, and in many respects small and medium licensees often have far more harmful lending practices than the big banks.
3. Since 2015, Consumer Action has provided legal assistance in over 1,300 matters in which irresponsible lending was identified as likely to have occurred. Consumer Action provided legal representation to consumers in more than 120 of those matters—nearly half of these matters were conducted since the beginning of the Royal Commission. These matters have included action against major banks, consumer lease licensees, payday lenders, credit card providers, medium to small-sized lenders, brokers and other intermediaries.
4. This reflects the significant and persistent power imbalance between financial services entities and the customers whose interests they claim to serve. A revised RG 209, that adequately reflects community expectations and sets out ASIC's expectations for banks and creditors' responsible lending, is crucial to address the customer needs that the responsible lending provisions were introduced to protect.

RECOMMENDATION 1. Any updates to RG 209 must consider consumer harm due to irresponsible lending exposed during the Royal Commission.

¹ For example, during the Royal Commission, CBA was still paying mortgage broker commissions despite Mr Narev admitting it can lead to poor customer outcomes: Transcript of Proceedings (Day 4, 15 March 2018) 240–3, and Westpac was still paying flex commissions until outlawed despite admitting it is a huge conflict of interest: Transcript of Proceedings (Day 8, 21 March 2018) 752–4.

Outcomes-based approach

5. Responsible lending in the NCCP Act takes a principles-based approach, and RG 209 does not currently prescribe detailed rules to comply with responsible lending. Consumer Action is generally supportive of principles-based regulation where it is focused on customer outcomes. However, it must be admitted that this approach has not delivered high levels of compliance. Despite the outcomes being loan suitability and avoidance of hardship, this is consistently not delivered by the current regulatory settings. Given this, we advocate that greater prescription is required in certain aspects of the regulatory guidance.
6. An effective outcomes-based approach would require and encourage credit licensees to buy into their responsible lending obligations. Licensees would need to have an incentive that they are achieving good outcomes and that loans provided are not unsuitable for the customer. To achieve this, the onus should be on licensees to prove that a loan was not unsuitable, instead of current frameworks which provide that the customer bears this burden of proof. Further regulatory effort would also need to be given to identifying and imposing incentives for licensees to comply. Such an approach is more aligned with the social purpose of banking and finance and the spirit of the NCCP Act. This would, however, require legislative change.

RECOMMENDATION 2. Where a principles-based approach has not delivered compliance, provide more detailed prescription as to how licensees can comply with responsible lending obligations.

Plain language and audience

7. RG 209 is of vital significance to credit licensees and advocates in understanding responsible lending expectations and obligations. Accordingly, the document as a whole must be clear and practical in its language and structure.
8. RG 209 sets out a number of detailed expectations for licensees providing certain types of credit contracts. For example, for licensees providing small amount credit contracts, RG 209 sets out guidance in relation to inquiries and verifications. Within this, it offers specific guidance that is helpful for not only small amount credit contracts, but for other types of credit contracts. This, in turn, means that important guidance becomes hidden or lost.
9. For example, paragraph 209.69 sets out guidance about what to look for when reviewing account statements that must be collected for small amount credit contract responsible lending assessments, including how statements may show payments towards other credit contracts that have not been disclosed in a loan application or that the account is regularly overdrawn. It then encourages further inquiries to be made. This sort of guidance is very relevant beyond small amount credit contracts but will not be necessarily read or considered by licensees that offer other kinds of credit.
10. Consumer Action urges ASIC to undertake a review of the overall readability of RG209. ASIC should review the draft from the perspective of a new licensee. This will help to ensure important points are emphasised rather than hidden and will also help to reduce unnecessary replication. A new, more accessible RG 209 may go to improving compliance.

RECOMMENDATION 3. Ensure overall readability and clarity of RG 209, including emphasis on the main expectations of credit licensees.

Benefits, risks and costs

11. Rather than responding to each question in CP 309 on benefits, risks and costs to consumers and lenders, we provide the following response.
12. The responsible lending provisions of the NCCP Act were implemented in response to an identified need to protect consumers when accessing credit.² Flagrant breaches and practices that skirted these requirements for years contributed to the establishment of the Royal Commission, which exposed the risks and costs to consumers and the banking and finance industry when responsible lending obligations are ignored or undermined.
13. There has been a stark decrease in trust of the banking and finance sector.³ The case studies included in this submission show that the provision of irresponsible loans cost consumers severe financial and non-financial hardship, including the inability to pay for food, housing and other basic living expenses, declining mental health and a lack of dignity.
14. Arguably, the most significant costs occur at an individual and household level. The greatest impact of irresponsible lending is felt by marginalised borrowers whose inadequate income is further reduced by servicing debt. People struggling with debt often prioritise loan repayments over other essentials due to fear of bankruptcy or having assets repossessed. Studies have found links between high levels of personal debt and lower standards of living, with reduced spending on food and other household essentials.⁴ Highly indebted individuals can be financially excluded and struggle to access mainstream credit, pushing them to high cost predatory lenders like payday lenders.⁵
15. Over-indebtedness can also have significant longer-term impacts and costs to consumers, potentially affecting a person's capacity to provide for housing, health, education and retirement. Problem debt can have a harmful effect on physical and mental health and personal relationships,

² Revised Explanatory Memorandum, *National Consumer Credit Protection Bill 2009 (Cth)* p 82 - 84, <https://www.legislation.gov.au/Details/C2009B00148/Download>.

³ James Evers, "Royal commission erodes trust in banks: new poll", *Financial Review* (28 October 2018) <https://www.afr.com/business/banking-and-finance/royal-commission-erodes-trust-in-banks-new-poll-20181025-h172v9>.

⁴ Citizens Advice, *A Debt Effect? How is unmanageable debt relate dot other problems in people's lives?* (July 2016) p. 11, Available at: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/The%20Debt%20Effect.pdf>.

⁵ Consumer Action, *Submission to Small Amount Credit Contract Review* (October 2015), p. 11. Available at: <https://consumeraction.org.au/review-of-the-small-amount-credit-contract-laws-submission/>

and can contribute to family breakdown.⁶ Debt worries also impact on people's ability to work, by affecting their attendance or concentration.⁷ Personal financial issues have been found to be the leading cause of stress by the Australian Psychological Society, while other studies have found that individuals with unmet loan payments have experienced suicidal ideation and suffered from depression more often than those without such financial problems.⁸ Studies have also likened unpaid financial obligations with poorer subjective health assessments and health-related behaviour.⁹ The cost of non-compliant practices that do not adhere to the spirit of responsible lending laws is demonstrably high.

16. While credit licensees' monetary costs may rise as a result of undertaking reasonable inquiries and verifications into the financial position and requirements and objectives of a consumer, these costs were anticipated when the responsible lending obligations were introduced and should not be considered 'new' costs imposed on industry.¹⁰ In any event, the positive societal benefits and savings to consumers would far outweigh those costs.
17. Moreover, industry has borne significant costs as a result of non-compliance with community expectations with respect to responsible lending. This was a significant contributor to the establishment of the Royal Commission which has cost the industry heavily, both in direct costs such as remediation but perhaps more importantly in the loss of reputation and confidence in the finance sector. Stricter requirements to prevent irresponsible lending are clearly justifiable in the context of the costs incurred by industry.
18. Additionally, open banking, which will allow licensees access to banking transaction data from other institutions with the informed consent of customers, will enable verification to be accomplished at a granular level and with greater ease, resulting in cost and time savings. Similarly, improvements in credit reporting practices, through the sharing of liability information, will assist licensees in understanding other forms of credit the consumer holds or has access to.

⁶ Step Change, *Statistics Yearbook Personal Debt* (2014) p 24, available at:

<https://www.stepchange.org/Portals/0/documents/media/reports/statisticsyearbooks/StepChangeDebtCharityStatisticsYearbook2014.pdf>.

⁷ Step Change, *Life on the Edge* (2014) p 3, available at:

<https://www.stepchange.org/Portals/0/StepChangeLifeontheEdgereport.pdf>.

⁸ Australian Psychological Society, *Stress and wellbeing survey* (2015) p 27, available at:

<http://www.psychology.org.au/Assets/Files/PW15-SR.pdf>; Turunen and Hiilamo, *Health effects of indebtedness: a systematic review*, BMC Public Health (2014) available at: <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4060868/#B31>.

⁹ Turunen and Hiilamo, *Health effects of indebtedness: a systematic review*, BMC Public Health (2014) available at:

<https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4060868/#B31>.

¹⁰ Revised Explanatory Memorandum, *National Consumer Credit Protection Bill 2009 (Cth)* Ch 9.

RECOMMENDATION 4. Recognise the substantial costs of non-compliance with responsible lending obligations to both consumers and industry in the relevant regulatory impact statement.

PART 2 – INQUIRIES AND VERIFICATION OF FINANCIAL SITUATION

Proposal B1:

We are considering whether to identify particular inquiries and verification steps in RG 209 that we think would generally be reasonable to provide greater certainty to licensees about complying with their obligations.

B1Q1: Would it be useful for licensees if ASIC were to identify the inquiries and verification steps that we consider should be taken? Why or why not?

19. Yes, we think it would be simpler for licensees to comply with their responsible lending obligations if ASIC were to identify the inquiries and verification steps that it considers should be taken. The Royal Commission highlighted a lack of inquiry and verification, particularly in relation to a person's expenses and liabilities, that has caused real harm. Further guidance on the steps to be taken will help to clarify the responsible lending obligations and, hopefully, lead to a decrease in lending without proper assessment of affordability or loan suitability.

B1Q2: If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.

Verification of expenses

20. Starting with the positive, Commissioner Hayne noted in the Royal Commission Final Report that banks have taken steps in 2018 to improve processes to verify a person's financial position.¹¹ It was reported that CBA, ANZ and Westpac have all enhanced their individual processes to better identify expenses and to more accurately verify expenses and commitments through improved digital calculators and other verification tools.¹² Consumer Action welcomes this trend as these improvements align with expectations from the community, as revealed over the course of the Royal Commission hearings. ASIC should align its guidance with these improvements, but also expect greater improvements over time.

¹¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (February 2019) vol 1 p 55.

¹² Royal Commission, *Final Report* (February 2019) vol 1 p 55 citing Exhibit 7.2, Witness statement of Matthew Comyn, 14 November 2018, 59–60 [216]–[217] and 61–3 [221]; Exhibit 7.121, Witness statement of Shayne Elliott, 16 November 2018, 8 [41]–[47]; FSRC, Interim Report, vol 1, 26.

Use of automated systems:

21. Consumer Action considers that the use of automated systems alone, including account scraping technology, is not sufficient to fulfil responsible lending obligations. Our observations are that automated systems are currently built to manage a licensee's credit risk rather than to lend responsibly. We submitted to the Royal Commission that banks have adopted policies that indicate a preference for automation or administrative convenience over compliance with responsible lending laws.
22. Automated systems will not necessarily pick up on factors relating to fraud and cannot provide insight to a consumer's overall objectives, unlike a person inquiring, reviewing and verifying the information provided, and making an assessment on suitability. Depending on their nature, automated systems can falsely inflate income and disregard expenses and liabilities.
23. For example, CBA gave evidence at the Royal Commission that it automatically assessed customers as eligible for credit limit increases simply by reference to whether a person's monthly average repayments over the last 6 months were equal to or greater than 2 percent of the proposed new limit.¹³ Further, CBA gave evidence that no inquiries or verification of expenses were conducted as part of the credit limit increase offer processes, as it considered its obligations were scalable. In another example, Westpac's evidence at the Royal Commission showed it had approved 183 credit limit increases using automated systems, even though it did not inquire about those customers' employment, income or non-Westpac debts as part of this process.¹⁴
24. The Commission also received evidence about ASIC's concerns with highly automated processes. In its letter to banks, ASIC said 'the use of highly automated processes, while arguably efficient for industry, creates a potential tension with responsible lending obligations that require assessment of each individual consumer's needs, objectives and financial capacity'.¹⁵ While automated processes offer 'administrative convenience', they are unlikely to be compliant. In fact, they are simply allowing more mistakes to be made at a quicker pace. This is clearly demonstrated in Wanda's story (case study 1), below.
25. The use of automated systems to process and approve applications for unsecured credit is particularly problematic. The banking Code Compliance Monitoring Committee (CCMC) found that automated systems are used to process approximately 97 percent of applications for unsecured credit, with 65 percent of those applications ultimately being approved. There is a significant risk of lenders breaching responsible lending obligations if they rely solely on automated processes as they

¹³ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Transcript of Proceedings* (Day 9, 22 March 2018) 886.

¹⁴ Royal Commission, *Transcript of Proceedings* (Day 10, 23 March 2018), 919.

¹⁵ Royal Commission, *Transcript of Proceedings* (Day 10, 23 March 2018), 919.

are unlikely to provide a full and up-to-date picture of a person's financial circumstances. The CCMC states that: 'At this point in time banks have not demonstrated, to the CCMC's satisfaction, that the use of an automated system or statistical credit scoring model alone is sufficient to comply with the Code obligations...'.¹⁶

Case Study 1: Wanda

Wanda and Archie (names changed) were a de facto couple with care of four children under the age of 12. At the time of applying for credit, Wanda's sole income was Centrelink benefits and child support of approximately \$3,744 per month; Archie worked casually earning approximately \$4,229 after tax. Throughout their relationship, Wanda experienced family violence from Archie.

In November 2016 Archie decided to purchase a car. Wanda already had a car in her name. Archie and Wanda went looking at dealerships and were told they might struggle to get a car loan because their credit histories were bad. One dealership referred them to a broker.

The broker rushed Wanda and Archie through the process of explaining and signing of the loan documents, so Wanda did not really understand what was going on and felt pressured by the broker and Archie to enter into the car loan. She asked whether the loan could just be in Archie's name as she already had a car, but the broker said it should be in both their names given their credit histories. Wanda did not know she was applying for a loan with a separate finance company; she thought the broker was actually the lender.

Archie and Wanda then found a 2011 Ford Falcon, for a purchase price of \$15,000 to be financed by the loan. When they picked up the car, the dealer said the car had to be in Wanda's sole name because Archie did not have a licence at the time. The car was registered in Wanda's name even though the car has been solely used by Archie. In about April 2017, Archie and Wanda separated. Since then, Archie has been in possession of the car.

Wanda was not aware that the total amount payable under the loan was \$35,372.72, she thought it was \$15,000 being the car purchase price. The credit amount was actually approximately \$20,600, with additional fees and a fixed 28% interest rate. She was unaware that they had been sold gap insurance and a warranty totalling approximately \$2500, and that a brokerage fee of nearly \$1,000 was paid.

¹⁶ Code Monitoring Complaint Committee, *Own Motion Inquiry Provision of Credit* (January 2017) p5, available at: <http://www.ccmc.org.au/cms/wpcontent/uploads/2017/01/CCMC-Inquiry-Report-Provision-of-credit-January-2017.pdf>.

By March 2017, Archie and Wanda fell into arrears on the loan. To date, they have paid just approximately \$9,294 towards the loan, and the current loan arrears are over \$10,500. Wanda has made the lion's share of the loan repayments even though she has not used the car. The loan was not affordable for her and has caused her substantial hardship.

While the finance company appears to have roughly assessed Archie's and Wanda's incomes correctly, it appears to have used only a one-page account scraping document pertaining to an account in Archie's sole name, which was submitted in the loan application, to verify expenses. The finance company does not appear to have obtained copies of bank statements for Archie and Wanda's joint accounts and Wanda's sole accounts at the time, which would have shown whether the loan was unaffordable for Wanda and Archie.

Both the broker's loan application and finance company's assessment appear to significantly understate Wanda and Archie's living expenses, with the expenses listed on the lending assessment document totalling even less than that on the loan application. The finance company appears to have applied its own benchmark of \$3,650 living expenses per month, lower than both the Henderson Poverty Index (HPI) and Household Expenditure Measure (HEM) benchmarks for that quarter.

RECOMMENDATION 5. RG209 must make it clear that reliance solely on automated processes does not fulfil a licensee's responsible lending obligations as it does not enable a licensee to properly assess 'each individual customer's needs, objectives and financial capacity'.¹⁷

Scalability

26. Our detailed feedback and recommendations on the pervasive industry practice of scaling down reasonable inquiries and verifications are set out in our response to B1Q3.

Use of benchmarks to verify or determine expenses

27. Consumer Action strongly opposes the use of benchmarks (such as HEM, HPI or other 'do-it-yourself (DIY)' benchmarks) or any other calculations unrelated to actual expenses being used solely to verify or even determine a person's expenses. This is detailed in our response to C3Q1.

¹⁷ Royal Commission, *Transcript of Proceedings* (Day 10, 23 March 2018), 919.

B1Q3: Are there any kinds of credit products, consumers or circumstances for which you consider it may be reasonable to undertake fewer inquiries and verification steps? Please identify the kinds of products, consumers and circumstances and particular features you think are relevant.

Scalability

28. Consumer Action is extremely concerned about the effect of regulatory guidance that says responsible lending obligations are scalable. While we accept that what constitutes reasonable steps to inquire and verify will depend on the facts and circumstances of each case, in Consumer Action's experience, scalability is *only* used to reduce credit licensees' responsible lending obligations. Our case work indicates a significant, recurring problem of too few inquiry and verification steps being taken. This causes real, damaging financial and non-financial harm. Our key concern is that RG 209 encourages credit licensees to 'scale down' inquiries, facilitating problematic lending with too few inquiries and verifications under the guise that this is 'reasonable'.
29. Without set outcome measures or minimum requirements for inquiry and verification, Consumer Action considers that some credit licensees scale down their responsible lending obligations to little or no actual verification. Scaling down inquiries and verifications goes against the spirit of the NCCP Act, and, instead, enables or even encourages credit licensees to undertake the bare minimum of inquiries and verifications, or simply not comply with their responsible lending obligations. For example, CBA provided evidence in the Royal Commission that rather than taking steps to verify an applicant's expenses for an overdraft application (even if it held that information), it still complied with its responsible lending obligations 'taking into account scalability'.¹⁸
30. However, *ASIC v The Cash Store (in liquidation)*¹⁹ (the 'Cash Store decision') found that the law 'requires, *at the very least*, a sufficient understanding of the person's income and expenditure ... The extent to which *further* information and *additional* inquiries may be needed in order to assess the consumer's financial capacity to service and repay the proposed loan and determine loan suitability will be a matter of degree in each particular case.' This presupposes that there must be a minimum of inquiries and verifications required to avoid a breach of responsible lending.
31. Concerns over the effect of regulatory guidance that obligations can be 'scaled' are not new. The Financial Ombudsman Service (FOS) forecast concerns about this 'grey area' in a presentation in 2012.²⁰ Despite this, FOS's view was that licensees must undertake some base level inquiries and

¹⁸ Royal Commission, *Transcript of Proceedings* (Day 7, 20 March 2018) 595.

¹⁹ *ASIC v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 at [42].

²⁰ Bae Bastian, Teresa Willemsen, *Spotlight on responsible lending – an update*. Financial Ombudsman Service, p. 22. Available at: https://www.fos.org.au/custom/files/docs/conference_2012_spotlight_on_responsible_lending.pdf

verifications in order to be compliant with their responsible lending obligations. Specifically, 'reasonable inquiries and verifications' cannot be scaled down to none at all.²¹

32. Despite the above case law and guidance from FOS, we submit that licensees continue to 'scale down' and conduct too few inquiries and verifications. The potential for harm when scalability leads to decreased reasonable inquiries and verifications is extreme. Unaffordable lending leads to higher levels of household debt, exacerbates financial distress—and has a strongly negative impact on quality of life.
33. The *Cash Store* decision found that '[i]t is axiomatic that 'reasonable inquiries' about a consumer's financial situation must include inquiries about the consumer's current income and living expenses.'²² This is the minimum requirement and additional inquiries may be needed depending on the situation.²³ Consumer Action argues that a licensee should be required to verify a minimum of 90-day account statements, immediately preceding a loan application, in order to meet the community standard of compliance with responsible lending obligations. For home loans, 6 months' worth of bank statements should be considered.
34. Furthermore, we recommend that in most cases, core source documents should be used to verify income and expenses, for example, multiple PAYG statements, energy bills, etc. These will help to understand and evidence the broad financial position.
35. However, in many of the case studies in this submission (including case study 2, Robert Regan), inquiries and verifications were scaled down to the point of minimum review or involved reference to benchmarks only. The evidence presented at the Royal Commission indicated a reluctance from banks to improve responsible lending practices, where to do so would affect profitability.²⁴ We are concerned that statements in RG 209 referring to the ability of licensees to 'scale down' inquiries and verifications will encourage continued lack of compliance with responsible lending obligations.

Case study 2: Robert Regan

Robert was the first bank customer to provide evidence to the Royal Commission. Robert, a 72-year-old aged pensioner, worked 3 jobs for most of his working life. Before he retired in 2010, Robert had worked as a cleaner, school bus driver and gardener. Robert lives with an acquired brain injury after being the victim of an assault many years ago.

²¹ Bae Bastian, Teresa Willemsen, *Spotlight on responsible lending – an update*. Financial Ombudsman Service, p. 22. Available at: https://www.fos.org.au/custom/files/docs/conference_2012_spotlight_on_responsible_lending.pdf

²² *ASIC v Cash Store (in liquidation)* [2014] FCA 926 at [42] (Davies J)

²³ *Ibid.*

²⁴ E.g. as set out by Commissioner Hayne in Royal Commission, *Interim Report*, (September 2018) Vol 1 p 94.

Robert's wife passed away in April 2016. Sometime after his wife's passing, Robert was targeted by an online romance scam. Robert was convinced by the scammers to send money overseas. In February 2017, Robert had used up nearly all of his \$110,000 in savings. He was then signed up to a 30-year \$50,000 home loan with the ANZ through a broker, most of which ended up in the hands of the scammers. Shortly after the loan was approved, Robert went to his local ANZ branch and the bank manager assisted him to transfer over \$30,000 to the scammer's overseas bank account, despite the loan documentation suggesting the loan was for "renovations".

The broker completed the loan application for Robert. It contained incorrect records of Robert's expenditure. As a result, the application portrayed the proposed loan as being affordable, when in fact it appears to be unaffordable. For example, the loan application states that Mr Regan's food expenses were \$300 per month however Mr Regan considered that his food expenses were higher than that.

In addition to that error, the loan application prepared by the broker did not take into account the significant expenses being paid by Mr Regan at the time of the loan application due to the dating scam.

The ANZ gave evidence at the Royal Commission that the ANZ can rely on what is set out about a borrower's expenses in a Statement of Financial Position signed by both the broker and borrower. That is, subject to using the relevant HEM as a default measure of expenses when it is higher than declared expenses, ANZ's reliance on what was said about expenses in the Statement was said to be sufficient inquiry about, and verification of, this aspect of a borrower's financial position.

The ANZ's evidence was that verifying actual expenses was 'too hard', apparently on the basis that its obligations are 'scalable'. But as the Commissioner pointed out, ANZ had been provided with a bank statement that demonstrated that Mr Regan had been recently incurring expenditure which was much greater than the amount recorded in the Statement of Financial Position.²⁵

Prior to the Royal Commission Hearings, the ANZ made an offer to Mr Regan that offer was essentially: requiring full repayment of the capital amount of the debt, reducing periodical payments and allowing a moratorium on those reduced payments. Commissioner Hayne opined in the Interim Report that that this offer did not 'accord with what the community would expect' and 'if ANZ did breach its responsible lending obligations, the offer that it made was not adequate redress for that failure'.²⁶ Commissioner Hayne's findings suggests that the current guidance on responsible lending remedies is inconsistent with community expectations.

²⁵ Royal Commission, *Interim Report* (September 2018) Vol 1 p 48.

²⁶ Royal Commission, *Interim Report* (September 2018) Vol 1 p 51.

Scalability of obligations where loans facilitated by non-licensed introducers

36. We strongly recommend that RG 209 state that credit licensees must take additional steps to fulfil their responsible lending obligations when a consumer applies for credit through an unlicensed introducer, such as through a car dealer or retailer. The current point of sale exemption, which was criticised by Commissioner Hayne in the Final Report,²⁷ enables credit to be introduced by retailers or car yards without oversight from ASIC, based on the assumption that the credit will be assessed by the lender. However, the Royal Commission uncovered that this was often not the case.
37. For example, in respect of car loans, ‘Westpac accepted that in the “vast majority of cases”, it was “dependent on the accuracy of what the ... Business Manager” told Westpac as regards customer expenses²⁸ with similar processes undertaken for liabilities.²⁹ Westpac further acknowledged that “Westpac relied heavily on dealers in discharging its responsible lending obligations, including when making reasonable enquiries about customer needs”.³⁰ In addition to Nalini Thiruvangadam’s story in case study 3 (below), Allan’s story in case study 4 shows the harm that occurs without reasonable inquiries and verifications by an introducer. While these introducers are not obliged to adhere to responsible lending laws themselves, licensees that utilise them should be required to undertake enhanced steps of inquiry and verification.
38. The same should occur with respect to other forms of introducers, such as those engaged by NAB to facilitate home loan applications.³¹ Should the point of sale exemption be abolished, as recommended by the Royal Commission, we consider that more lenders may move to rely on a ‘mere referrer’ model to facilitate loan applications, and that regulatory guidance will be required to address similar risks to those described above.³²

Case study 3: Nalini Thiruvangadam

In March 2018, Nalini shared her story with the Royal Commission. Nalini is a single parent who needed to buy a new car in 2012 after her car suffered fire damage. At that time Nalini worked on a casual basis as a personal care assistant and needed a reliable car to get to work and take her children to school.

Nalini was rejected multiple times for finance from many of the mainstream lenders due to her bad credit rating and precarious financial situation. Despite this, one of the car dealers that Nalini contacted in July 2012 promised Nalini that if she visited his dealership she would go home with a car that evening.

²⁷ Royal Commission, *Final Report* (February 2019) Vol 1 p 84 – 88.

²⁸ Royal Commission, *Interim Report* (September 2018) Vol 2 p 84 quoting Transcript, Phillip George Godkin, 21 March 2018, 746.

²⁹ Ibid. citing Transcript, Phillip George Godkin, 21 March 2018, 767.

³⁰ Ibid. citing Transcript, Phillip George Godkin, 21 March 2018, 764.

³¹ Royal Commission, *Interim Report* (September 2018) Vol 2 p 1 – 15.

³² *National Consumer Credit Protection Regulations 2010* (Cth) reg 25(5).

Nalini told the car dealer that she had had trouble getting a loan. The car dealer told her to bring documents including her driver's license, payslips, Centrelink car and bank card to the dealership.

When Nalini attended the car dealership, the car dealer reviewed the documents she brought with her and asked how much she earned, what her expenses were, whether she had any other income and whether she owned any property. Nalini told the car dealer she was renting and paying approximately \$1,300 per month in rent, that her uncle sometimes gave her about \$300 per month and that she had a credit card debt of about \$1,500 that she was having trouble paying off.

Feeling under some pressure by the car dealer, Nalini purchased the car by signing documents that she understood entered her into an on-the-spot car loan with the Bank of Melbourne to repay approximately \$21,000 over 5 years. When she got home that evening, she read some of the documents that the car dealer gave her after signing and realised that she would not be able to afford the loan repayments. She rang the car dealer the next day to tell him this and tried unsuccessfully to cancel the loan and the contract of sale.

Over the years, Nalini had many issues with condition of the car and also struggled to meet the loan repayments, which were initially almost 30% of her total fortnightly income. Shortly after entering into the loan, Nalini had a fall at work and as a result was unable to continue working. Nalini repeatedly asked the bank for help, and despite one six-week moratorium on repayments when she suffered the workplace injury, was met with threats that the bank would come to repossess her car. These threats meant Nalini prioritised payment of her car loan above other daily living expenses including her rent—for which she was nearly evicted—and utility bills and meant that she had to borrow from family members and sell family jewellery she had inherited in order to survive.

It was later revealed that no verification of Nalini's expenses was conducted and the Bank relied upon a benchmark, the Henderson Poverty Index. Westpac acknowledged at the Royal Commission that its processes were deficient and that it had breached the obligations to take reasonable steps to verify Nalini's financial situation. It also acknowledged that the loan was unsuitable because it was unlikely for Nalini to be able to comply with repayments or could only do so with substantial hardship.

It was only after Consumer Action's lawyers became involved that Nalini was able to effectively negotiate with the Bank. She ultimately settled on the basis that she keep the car and receive compensation of \$20,000, having paid more than \$31,000 toward the loan.

Factors relevant to scalability

39. RG 209 includes Table 3: Factors relevant to the scalability of the reasonable inquiries and verification obligations. We provide the following specific feedback on this table.
40. Row 1: Consumer Action agrees that potential impact on consumers of the contract must be considered in determining reasonable inquiries and verification. Greater steps should be taken, for

example, where 'the size of the loan is large relative to the consumer's capacity to repay the loan'.³³ While the guidance then states that small loans can lead to financial difficulty for low income consumers, our observation is that too often lenders consider that small loans necessarily require less inquiries and verification. We urge ASIC to rephrase this guidance to give primacy to the fact that small loans are more likely to be targeted at consumers with less capacity to pay, and necessarily require enhanced inquiries and verification steps.

41. Row 2: Complexity of the credit contract or consumer lease. We consider guidance that encourages less extensive inquiries where a contract is 'simple' has the capacity to be mis-used or cited inappropriately. It is rare that a credit contract or consumer lease would have 'relatively simple terms that most consumers can easily understand'.³⁴ Contracts are, by nature, not understood easily. There is no guidance for how to assess the simplicity of the terms. Consumer Action's case work highlights basic problems with consumer understanding of credit contracts or leases, including, not knowing:
 - whether they are purchasing or renting goods;
 - when the amount will fall due; and
 - whether there are any additional charges, such as add-on insurance, hidden commissions or broker fees, or how interest may change over time (for example, Joe's story in case study 6).
42. Row 3: Capacity of the consumer to understand the credit contract or consumer lease. This is an important factor, but the 'Note' at the bottom of this row undermines a licensee's responsibility to make an active assessment of whether a loan will be suitable for a person. We consider that an evaluation of the capacity of consumers to understand the credit product to be necessary in order to understand whether it meets their requirements and objectives. This note should be removed.
43. Row 4: Whether a consumer is an existing customer or a new customer. Any scaling down of reasonable steps to verify information based on already 'hold[ing] information about the consumer' must be contingent on actually considering that information already held, as well as using it to verify the information provided in a loan application. The guidance is unclear on this point and currently facilitates scaling down on the basis of holding information alone.
44. Even in relation to long-term customers, licensees should be wary about scaling down their inquiries. It is difficult or currently impossible for licensees to know without making sufficient inquiries if customers hold all of their accounts with them, or if there are other transaction accounts or liabilities in the customer's name. While reforms such as more comprehensive credit reporting and Open Banking should alleviate this concern in the future, licensees must continue to make

³³ ASIC, *Regulatory Guide 209: Credit Licensing: Responsible lending conduct (RG 209)*, November 2014, p13 Table 3.

³⁴ ASIC, *RG 209*, November 2014, p. 13 Table 3 Row 2.

appropriate inquiries into a long-term customer's financial position and not make assumptions that they have all the information they need.

45. Similarly, licensees must make reasonable inquiries and verifications to check to see if a long-term customer's financial position has changed since previous assessments of suitability were made. This is particularly relevant in relation to credit limit increases. While licensees may be able to assess whether income has increased, remained stable, or decreased over time based on an assessment of their account transactions, they must also inquire into the customer's family situation, e.g. are they supporting dependents, or have they become fulltime carers? The requirement for reasonable inquiries and verifications will not be met simply by virtue of the applicant's status as a long-term customer.
46. Perhaps the only situation where lesser inquiries and verification steps could be permitted is where that customer is refinancing a mortgage, but they are not increasing the loan amount. We consider that a person should be able to refinance to a cheaper alternative where the result is reduced repayments that may improve their financial situation. Licensees should not use responsible lending obligations as a barrier to an outcome which alleviates hardship for a consumer. This will, however, require close consideration of individual circumstances to ensure such a refinance is appropriate.
47. The final note on Table 3 refers to scaling down the 'reasonable inquiries' threshold, which confirms that ASIC finds it to be an acceptable practice. We submit that scaling down reasonable inquiries and verifications results in unnecessary financial and non-financial harm to consumers by undermining the spirit and intent of the laws requiring credit licensees to lend responsibly.
48. We recommend RG 209 be updated to reflect more appropriate examples of scalability to help guide banks and other lenders in its use. This should focus on the factors that require licensees to 'scale up' inquiries and verification activities, that is, trigger further steps than the minimum required.
49. We are particularly concerned that an approach that adopts 'if not, why not' invites scaling down of inquiries and checks without the provision of any real substantial reason. We have detailed this concern in C2Q1.
50. The following table sets out concerns about scaling down inquiries and verification measures for an assortment of credit products.

Product	Comments
Credit cards and limit increases	<p>Amendments to the NCCP Act now require that a consumer be able to repay the full credit limit of a credit card in 3 years.³⁵ Credit card assessments will need to be more robust in order to determine that a consumer would be able to afford repayments, and enhanced steps to inquire and verify will be required. Unsolicited credit card increases are now also unlawful,³⁶ reflecting the known harm of extended credit when it is not kept in line with a consumer's requirements and objectives. Scaling down inquiries and verifications would flout the objectives of tightening the law to decrease the harm experienced when credit is extended.</p> <p>Licensees should not be permitted to scale down their inquiries into a customer's requirements and objectives for obtaining a credit card, including the customer's desired maximum credit limit. The practice of informing consumers of the maximum credit limit that they can obtain should be prohibited; instead, licensees should seek to understand the borrower's needs.</p>
Home loan	Loans secured on a family home should never be granted on the basis of fewer inquiries and verifications into income and expenses. Consumer Action recommends that any home loan be contingent on the review and consideration of a minimum of 6-month bank statements, credit reports and other consumer credit.
Car loan	Given that 90-day bank statements are considered mandatory for small amount credit contracts, we consider that similar obligations should also be required to verify a person's financial position prior to being approved for a car loan. Car loans are often provided with the help of an introducer exempted from responsible lending laws by the point of sale exemption. As set out above, this has proven to be problematic. Credit licensees should not scale down their inquiries and verifications even though the loan application has come through an introducer.
Refinance	<p>Any application to refinance should be met with sufficient inquiries into the applicant's requirements and objectives. Refinancing is usually sought due to either debt distress or as a means to access credit at a lower interest rate. The rationale would not be understood without appropriate inquiries.</p> <p>If a consumer is looking to refinance due to current debt unaffordability, care must be taken to ensure refinance is appropriate—this will require individual consideration. As noted above, a less prescriptive approach could be permitted</p>

³⁵ *National Consumer Credit Protection Act 2009* (Cth), paragraph 133(3AA)(b) et al.

³⁶ *National Consumer Credit Protection Act 2009* (Cth), Schedule 1 – National Credit Code, section 133BE.

Product	Comments
	where refinancing does not increase the loan amount. A person should be able to refinance where the result is reduced repayments that may improve their financial situation.
Payday loans	<p>Payday loans are often small amounts. The small amount credit contract amendments to the NCCP Act were implemented in recognition of the fact that multiple small loans can contribute to the risk of exacerbating a consumer's 'overall level of indebtedness' to the point where their 'standard of living is severely diminished'.³⁷ In particular, given the legal presumption that a third payday loan within a 90-day period would cause substantial hardship, it would never be appropriate to scale down inquiries and verifications for payday loan applications.</p> <p>Some licensees appear to consider that small amounts require little or no verification, yet as noted by the Commission even a small loan can cause financial difficulties for a consumer on a low income.³⁸</p>
Unsolicited offers generally	<p>As noted by the Final Report of the Royal Commission, "most unsolicited offers of credit to consumers will occur in circumstances in which the credit licensee would find it hard, if not impossible, to show compliance with those requirements, if only because it is not for the lender to impose its judgment of what the consumer requires or 'needs' and it is not for the lender to impose its judgment of what objectives the consumer could have (even should have) in taking up a proffered line of credit."</p> <p>RG 209 should, on the basis of the above, clearly state that unsolicited offers of credit will in most cases breach the responsible lending obligations and would require substantially enhanced inquiries and verification steps to be lawful. As noted above, this may well be impossible.</p>

RECOMMENDATION 6. Remove references encouraging 'scaling down' reasonable inquiries and verification steps, or include examples of very limited, specific circumstances in which it might be reasonable.

³⁷ Revised Explanatory Memorandum, *National Consumer Credit Protection Bill 2009 (Cth)* 54 para 4.7.

³⁸ Royal Commission, *Interim Report* (September 2018) Vol 1 p 29.

RECOMMENDATION 7. Update Table 3 so RG 209 better identifies factors which could lead to enhanced inquiry and verification obligations in relation to different credit products and practices.

B1Q4: In your view, what aspects of the consumer's financial situation would a licensee need to inquire about in all circumstances? If you think some aspects of the consumer's financial situation do not need to be inquired about, please explain why.

51. Consumer Action contends that a licensee must inquire about an applicant's income *and* expenditure in all situations in order to fulfil its responsible lending obligations. Responsible lending jurisprudence highlights the importance of reviewing both sides of the ledger.³⁹
52. While the current processes used by licensees to inquire into income generally meets the requirements of the NCCP Act, inquiries of expenses do not meet the requirements of the law or the standards of RG 209. At its simplest, in order to discharge this aspect of responsible lending obligations, a licensee should actually ask the borrower about their income and expenses,⁴⁰ and obtain information about the applicant's actual expenses,⁴¹ not their best guess or a benchmarked estimate. This is ordinarily done by way of a statement of financial position when a prospective borrower applies for a loan.⁴²
53. In relation to expenses, at a minimum, we would expect licensees to require applicants to disclose the categories of expenses which appear on the AFCA Statement of Financial Position form, which borrowers are required to complete where they seek financial hardship from a lender or seek to challenge an irresponsible loan.⁴³
54. We also think it is critical that lenders inquire about discretionary expenditure such as alcohol, entertainment and cigarettes. In our experience, consumers are poor historians when recalling expenses without being prompted to recall certain expenditure which is why a more detailed statement of financial position is required.

³⁹ *Australian Securities and Investments Commission v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926; *Australian Securities and Investment Commission v Chanic Pty Ltd (No 4)* [2016] FCA 1174.

⁴⁰ Revised Explanatory Memorandum, *National Consumer Credit Protection Bill 2009 (Cth)*, 108–9 [3.146].

⁴¹ Australian Securities and Investments Commission, RG 209 (5 November 2014), 15 [209.30].

⁴² Exhibit 1.86, Witness Statement of William Andrew Ranken, Australian and New Zealand Banking Group (4 March 2018) 7 [44]–[58]; Exhibit 1.87, KPMG, *Australian and New Zealand Banking Group Limited: ADI Targeted Review for 2016/17 Accuracy of data used in home loan underwriting* (28 April 2017), 6; Interim Report, Vol 1, 25–6.

⁴³ AFCA, Statement of Financial Position (2018) Available at: <https://www.afca.org.au/make-a-complaint/financial-difficulty/sofp/>. The AFCA statement of financial position includes expenses for housing (rent, rates and body corporate fees, insurance, utilities, communications (phone, internet, pay TV), repairs and maintenance, other housing expenses), Personal and family: food, groceries and takeaway; clothing; health, entertainment, personal care, personal insurance (eg. Life), pets, other (e.g. subscriptions, sports, hobbies). Transport: vehicle, public transport/taxis, other. Education and children: children education/childcare, self-education, other.

RECOMMENDATION 8. Credit licensees must inquire about both income and expenses. This should include the categories of expenses which appear on the AFCA Statement of Financial Position form as well as discretionary expenses.

B1Q5: In your view, what aspects of the consumer's financial situation would a licensee need to verify in all circumstances? If you think some aspects of the consumer's financial situation do not need to be verified, please explain why.

55. We consider that, licensees should be verifying the categories of expenditure which appear on the FOS Statement of Financial Position form and also using it to assist inquiries.
56. We note and agree with the advice provide to ANZ by KPMG that lenders and brokers should ask customers to provide documentary evidence of their major expenses which could include rent or board, insurance, child maintenance, school fees, travel expenses, childcare and TV subscriptions.⁴⁴ In addition, licensees should verify utility and telecommunication bills.
57. If the licensee intends to rely on the Household Expenditure Measure (HEM) to test the veracity of the borrower's expenses, the statement of financial position should also include categories for discretionary expenditure and licensees should separately verify these items. This is because those expenses are excluded from the HEM benchmark so there is no way to otherwise test the veracity of these expenses against HEM.
58. As stated earlier in this submission, licensees should also be required to review, at a minimum, bank statements (transaction accounts and credit cards) of the preceding 90 days as part of undertaking reasonable steps to verify the applicant's financial position, particularly their income and expenses. For home loans, a minimum of 6 months of statements should be reviewed.
59. Consumer Action welcomes ASIC's clarification that verification documents should be considered in relation to all relevant aspects of a consumer's financial position. For example, bank statements should be used to verify actual expenses as well as income.
60. See our response to question C1Q2 for further detail directly in relation to verification documents set out in Appendix 1.

RECOMMENDATION 9. Credit licensees must review at least 90-days' worth of account statements as part of verification, and review documentary evidence of expenses including

⁴⁴ KPMG, *Australian and New Zealand Banking Group Limited: ADI Targeted Review for 2016/17 Accuracy of data used in home loan underwriting* (28 April 2017), Exhibit 1.87, Royal Commission into Misconduct in the Banking, Superannuation and Finance Industry.

rent or board, insurance, child maintenance, school fees, travel expenses, childcare, utility bills, telecommunication, and TV subscriptions.

B1Q6: What would be the effect on consumers of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for consumers?

61. The case studies referred to throughout this submission are examples of the harm that could be avoided by ASIC requiring robust inquiry and verification of a consumer's income and expenses. The Royal Commission has shown that lenders do not conduct inquiries and verifications that meet community expectations and are even more unlikely to go above the requirements.⁴⁵ The conduct revealed in 2018 demonstrates the necessity of more extensive and stricter guidance on reasonable inquiries and verifications, with the opportunity for lenders to scale up (rather than scale down) their obligations to comply with responsible lending.

Proposal C1:

We propose to amend the current guidance in RG 209 on forms of verification to:

- (a) clarify our guidance on kinds of information that could be used for verification of the consumer's financial situation, and provide a list of forms of verification that we consider is readily available in common circumstances; and**
- (b) clearly state that views on what are 'reasonable steps' will change over time, as different forms or sources of verifying information become available. For example, developments in open banking and data aggregation services will assist licensees to efficiently confirm the financial situation of a consumer (including allowing simultaneous inquiry about and verification of some information).**

C1Q1: Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available forms of verification?

62. Please refer to our comments in answer to question B1Q5.
63. We reiterate that credit licensees should obtain and review account statements that cover at least the immediately preceding period of 90 days in order to meet the requirement of reasonable verification steps. Scalability⁴⁶ should not allow for less verification than this, which would align most lending such as credit cards and car loans with the minimum verification requirements performed by small amount credit contract licensees.⁴⁷ We consider the 'scaling down' of verifications that forgoes the need for a review of 90-day account statements to be non-compliant with responsible lending obligations. Even ANZ submitted to the Royal Commission that 'a single

⁴⁵ Royal Commission, *Final Report* (February 2019) Vol 1 p 50.

⁴⁶ Note Consumer Action's comments on scalability generally, and when the scaling down of necessary inquiries and verifications should actually be considered non-compliance with the requirement to undertake reasonable inquiries and verifications.

⁴⁷ *National Consumer Credit Protection Act 2009* (Cth) ss 117(1A), 130(1A).

month's bank statements do not provide a reliable account of a customer's recurrent or typical monthly expenses. Discretionary expenditures incurred in one month may not reflect a customer's average living expenses over a twelve month (or longer) period, and annual expenses may be paid, in full, in a single month.⁴⁸

64. Furthermore, in relation to home lending, we recommend that licensees obtain and review account statements covering the immediately preceding 6 months, at a minimum. This would help brokers and lenders to properly consider irregularities in income that can be masked by seasonal or casual work.
65. As noted in our introductory comments, RG 209.69 provides useful information about using information on transaction account statements for verification and should be accessible in relation to verification of all types of credit products, not just small amount credit contracts. RG 209 should also specify that transaction account and credit card statements are the few methods to verify buy-now-pay-later credit and recurrent withdrawals or transfers, which should both prompt further inquiries.
66. Account statements can also provide indications that an applicant may be operating at the margins of their income, for example, if the account shows Centrelink income or multiple buy-now-pay-later transactions. If an account balance is low and the stated reason for this is that the applicant's savings are in another account, bank statements from that savings account should also be verified.
67. Where borrowers hold a credit card, licensees should also obtain credit card statements that cover the preceding period of 90 days at a minimum.⁴⁹
68. Processes could be improved by requiring licensees to also verify borrowers' income summaries and tax returns for the previous two or three years (where available), and make further inquiries where there are any irregularities with declared income which can occur where borrowers work overtime sporadically in the three months' prior to applying for a loan. Case study 4 demonstrates a failure to consider irregularities in income can result in irresponsible lending.

⁴⁸ ANZ Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 'Submission on findings and questions arising from case studies involving ANZ' (13 July 2018) p 1 – 2. Available at:

<https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Australia-and-New-Zealand-Banking-Group-Limited.PDF> p 4 para 2.15.

⁴⁹ Royal Commission, Exhibit 1.87, KPMG, *Australian and New Zealand Banking Group Limited: ADI Targeted Review for 2016/17 Accuracy of data used in home loan underwriting* (28 April 2017).

Case Study 4: Allan

Allan (name changed) is an Aboriginal man who lives alone in rural Victoria. Allan came to the Victorian Aboriginal Legal Service (VALS) in mid-2018 after a concerned friend contacted VALS about the difficulties Allan was having making repayments on his car loan.

Allan purchased a car from a car yard in late 2012 for \$32,000. The car yard organised finance with the bank. The loan also included Consumer Credit Insurance (CCI) of \$1,995 and gap cover insurance of \$1,299. Along with other fees and charges the loan was for a total of \$36,200. At the time Allan got the loan he was working casually earning about \$2,200 a month and receiving government parenting payments of about \$1,050 per month and paying rent of \$800 per month. Allan was also a single father caring for his two young children. Allan only held his casual job for about a year after he was given the loan. After that time, he survived on Newstart as he was unable to find employment. Allan struggled for years to make the weekly car repayments of \$160, sometimes going without food to make the repayments. In early 2018 the car was voluntarily repossessed. Allan's friend helped him entered into a hardship agreement with the bank to repay the remainder of the loan at \$157 a week. Allan was unable to meet the repayments and the debt was transferred to a debt collector.

VALS obtained the loan documents and the suitability statement from the debt collector. Allan told VALS that he was never told about the CCI and gap insurance or the broker's fee. The documentation and Allan's instructions appeared to show that the bank had significantly overestimated his income and underestimated his expenses. The bank's suitability statement estimated Allan's income at \$7,781 and his rental expenses as \$770 per month. It appears the bank over-estimated Allan's income because they mistakenly included Centrelink payments that he wasn't receiving at that time. The expenses figure used by the bank only included an amount for rent and was well below the Henderson Poverty Index (HPI), which for someone's in Allan's position caring for two children was \$2,434.85 (without housing). The HPI does not include any allowance for other irregular common expenses that Allan was paying such as school fees, excursions and clothing.

VALS made an internal complaint to the debt collector requesting a waiver of the remainder of the debt and compensation of \$20,000 for alleged breaches of responsible lending laws. VALS also made a request to the insurance company seeking a refund of the premiums paid plus interest at the loan rate of 13.99%.

The debt collector initially offered to waive the debt, which Allan decided to reject. VALS then made a complaint to the Australian Financial Complaints Authority (AFCA). The debt company then transferred the matter back to the bank. On the day the response to AFCA was due, the bank offered to waive the debt and pay compensation of \$21,500, which was all the interest repayments Allan had paid and the fees and charges the bank had charged Allan over the course of the loan. The insurance company agreed to refund the premiums with interest at 13.99% to Allan which amounted to a payment of \$5,500. In total Allan received compensation of approximately \$27,000 from the bank and the insurance company.

Case study provided by Victorian Aboriginal Legal Service

RECOMMENDATION 10. Where borrowers hold a credit card, credit licensees should obtain credit card statements that cover the preceding period of 90 days at a minimum.

RECOMMENDATION 11. Licensees should verify borrowers' income summaries and tax returns for the previous two or three years (where available) and make further inquiries where there are any irregularities with declared income.

C1Q2: Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?

69. We consider that the examples included in Appendix 1 are generally appropriate and will significantly improve the guidance in RG 209.
70. In particular, we strongly support the inclusion of bank statements (both transaction account and credit cards) as a verification source for income, as has been included in Table 1. Such statements should also be used to verify overall financial situation, as proposed by Table 5.
71. We recommend stating that these accounts be for at least a 90-day period (6-month for home loans), but particularly to capture variable or seasonal income and expenses. In particular, these statements will help to identify existing buy-now-pay-later debts and liabilities, and this could be particularly referenced in Table 5.
72. Tables 3 and 4 conflates some variable and recurring expenses. For example, pay TV expenses are not usually variable.
73. Table 5 could also be improved by highlighting by noting a review of account statements should disclose the cost of major living expenses such as food, entertainment, and alcohol. References to these types of expenditure will encourage licensees to cast their mind to these expenses; our experience is that they are often overlooked.
74. Similarly, Table 5 could be enhanced by making specific reference to recurrent cash withdrawals. Regular large withdrawals should always prompt further inquiries. Cash withdrawals may help demonstrate the cost of regular living expenses, such as food and takeaway. Withdrawals may also be indicators of economic abuse or scams (see our response to proposal D2). This highlights the importance of bank statements in flagging the need for further inquiries.

RECOMMENDATION 12. Update Appendix 1 to make specific reference to living expenses, such as food, entertainment and alcohol, as well as recurrent withdrawals, so that licensees consider these expenses specifically when reviewing bank statements.

C1Q3: Are there particular issues with using data aggregation services that you consider should be raised in our guidance? Please provide details of those issues, and information that you consider should be included in our guidance. For example, would it be useful to include specific guidance on matters the licensee could, or should, raise with the consumer before obtaining the consumer's consent to use this kind of service?

75. Consumer Action is not convinced that data aggregation services, including account scraping technology, sufficiently identify and categorise a consumer's income and expenditure. There does not appear to be any standards for these services, so their quality depends on the whim of the technology provider. We are particularly concerned about the ability of these services to identify

whether certain transactions are recurrent or one-off. For example, we have seen examples where a one-off credit transaction (perhaps an internet banking transfer, for example) is presumed to be recurrent in the later assessment.

76. While Open Banking may lead to improvements in quality of these services, including through enhanced practices around consumer consent, privacy and data security, we consider it would be a mistake for ASIC to assume that the information generated by these services result in accurate assessments without independent verification. As part of any guidance about the use of data aggregation services, ASIC should commit to undertake regular independent assessments of these services and develop minimum quality standards for them.
77. We note that there are existing sources of information that licensees could access to improve assessment processes, but the industry appears to not have invested in technology to use this information responsibly. For example, since the credit reporting reforms of 2013, licensees have been able to share liability and credit limit information on credit reports.⁵⁰ Despite this, to date, the industry has not shared this information widely, despite its value for responsible lending assessments. It appears that this is because the industry has not seen a 'business case' to do so. This indicates to us that the finance industry, when using or investing in technology, prefer an outcome that delivers returns for the business rather than outcomes for consumers or compliance with legal obligations. We expect a similar approach will be taken to other forms of technology, such as data aggregation services.

RECOMMENDATION 13. That as part of any guidance about the use of data aggregation services to assist with verification obligations, ASIC should commit to undertake regular independent assessments of those services and develop minimum standard for them.

Proposal C2:

We propose to expand our guidance on what are reasonable steps to verify the financial situation of a consumer by:

- (a) more clearly stating that it is not sufficient merely to obtain verifying information but not have regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects of the consumer's financial situation; and
- (b) including an 'if not, why not?' approach—that is, if a licensee decides not to obtain or refer to forms of verifying information that are readily available, they should be able to explain why it was not reasonable to obtain or refer to those forms of verification in the circumstances of the particular consumer involved.

⁵⁰ *Privacy Act 1988* (Cth), section 21D

C2Q1: Do you consider that the proposed clarification of guidance on reasonable verification steps would be useful? Are there any other aspects of our guidance on verification that you consider would be useful?

78. We strongly support clarification that it is not enough merely to obtain verifying information without having regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other information. For example, if a person is receiving income from Centrelink, bank statements should be used to verify Centrelink income in addition to any other income and expenses. Using all provided sources of information to cross-check a person's application is particularly important to discern whether inconsistent information has been provided, which should prompt further inquiries.
79. Obliging licensees to have regard to information aligns with the expectations of responsible lending set out in case law which states that licensees must bring their "own inquiring mind" to the loan assessment.⁵¹
80. Beyond verifying individual expenses, a review of a prospective borrower's bank statements to an applicant's overall financial situation will enable licensees to discharge their other responsible obligations by:
- identifying any obvious inconsistencies between a consumer's statement expenses and transaction history;⁵²
 - detecting a pattern of income and expenditure which will elucidate whether the borrower can meet the additional financial obligations of further loan repayments;
 - determining whether all or the majority of money from the account is withdrawn on pay day (suggesting an inability to be able to repay further loans without substantial hardship);
 - assessing whether and how often the account is overdrawn;
 - assessing whether direct debits have been declined;
 - assessing whether the borrower has the ability to save funds or is living pay cheque to pay cheque; and
 - detecting whether the borrower has financial obligations owing to debt collectors or financially dangerous products like consumer leases and payday loans which suggest hardship or financial difficulty.

⁵¹ *Australian Securities and Investment Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174, [1804].

⁵² Royal Commission, Exhibit 1.87, 28 April 2017, KPMG Targeted Review 2016/2017, 9–10; Transcript, William Andrew Ranken, 19 March 2018, 474.

RECOMMENDATION 14. Clarify that a credit licensee must have regard to the verifying sources of information provided; it is not sufficient merely to obtain information.

C2Q2: Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?

81. While an 'if not, why not' approach may appear on its face to encourage improvement, we are hesitant to support its use due to concerns about its effect and potential ability to be misused thereby avoiding the spirit of responsible lending laws.
82. We welcome the statement that ASIC would be 'more likely to consider that the licensee has failed to take reasonable steps to verify the consumer's financial situation'⁵³ if it does provide an explanation as to why they did not consider information that was reasonably accessible in the circumstances. However, the approach is not explicit enough in its current form; it says little about the adequacy of the explanation. For example, it would be problematic if an explanation that 'it was not reasonable to obtain the information' was acceptable.
83. We are concerned that a 'if not, why not' approach will have a similar effect on industry to the introduction of rebuttable presumptions of unsuitability in relation to small amount credit contracts. This reform was intended to inhibit lending to a person who held two or more small amount credit contracts in the 90 days preceding the application based on a presumption that a third credit contract would cause substantial hardship.⁵⁴ Instead, in Consumer Action's experience, this presumption is rebutted frequently by lenders with no explanation other than simply that the contract in question is not unsuitable.
84. In the vast majority of lending applications, we expect that licensees would be required to collect verification information to enable them to undertake an assessment of suitability as required by law. We strongly recommend that if an 'if not, why not' provision is included in RG 209, it must be accompanied by specific guidance on acceptable explanations, as well as circumstances in which it would generally not be seen as reasonable.
85. For example, 'economic convenience' or similar should not be acceptable as a reason to explain why proper inquiries and verification were not undertaken, even though this explanation has been cited by licensees in the past. In its submission to the Royal Commission, ANZ pointed to its use of the HEM as reasonable verification of a customer's expenses due to 'the difficulties for customers and credit licensees in verifying living expenses, having regard to the number and variety of expenses

⁵³ ASIC, *CP 309 Update to RG 209: Credit licensing: Responsible lending conduct* para 29.

⁵⁴ *National Consumer Credit Protection Act* (Cth) s 131(3A).

customers may incur, when and how they are incurred, and whether they are one-off or regular'.⁵⁵ ANZ further submitted that until there are advances in technology, 'it would be neither appropriate nor practical to replace the use of the HEM benchmark with a process of manually assessing transaction account data (which may or may not be available). The manual assessment of transaction data would involve significant operational complexity, requiring comprehensive analysis of large volumes of transaction level data, with potential implications for the cost and availability of credit.'⁵⁶

86. Having regard to this and similar industry submissions to the Royal Commission, there is little to indicate that licensees would use 'if not, why not' other than a repository for their assertions that little to no actual verifications were necessary due to reasons of economic or administrative convenience or 'practicality'.
87. Similarly, Consumer Action has seen examples of licensees overriding certain assessment decisions with explanations such as 'experienced banker discretion'. This is done in situations where documentary evidence would otherwise conclude that a loan would cause substantial hardship. This sort of explanation should not be enough under an 'if not, why not' approach.
88. The continued use of scalability will also undermine the effectiveness of any 'if not, why not' provision. Scaling down of inquiries and verifications would simply be cited as the 'why not' response. For example, Westpac cited scalability⁵⁷ as a reason it did not take certain verification steps: 'in most cases, Westpac does not take steps to independently verify a customer's declared, estimated expenses in the context of auto finance applications. Such an approach, however, is reasonable in the circumstances and in light of the processes which are followed. Customer expenses are inherently difficult to verify...'.

⁵⁵ ANZ, 'Submission on findings and questions arising from case studies involving ANZ', Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 13 July 2018, p 1 – 2. Available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Australia-and-New-Zealand-Banking-Group-Limited.PDF> p7 para 2.28.

⁵⁶ Ibid. para 2.32.

⁵⁷ Royal Commission, Westpac Banking Corporation – *Submissions on Auto Finance Case Study*, 3 April 2018, [26] [28] Available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Westpac-Auto-Finance.pdf>.

RECOMMENDATION 15. An ‘if not, why not’ approach to verification practices should not be adopted unless it is accompanied by specific guidance on what would and what would not be acceptable explanations for not obtaining or referring to verification information that is readily available.

PART 3 – BENCHMARKS

Proposal C3:

We propose to clarify our guidance in RG 209 on the use of benchmarks as follows:

- (a) A benchmark figure does not provide any positive confirmation of what a particular consumer’s income and expenses actually are. However, we consider that benchmarks can be a useful tool to help determine whether information provided by the consumer is plausible (i.e. whether it is more or less likely to be true and able to be relied upon).
- (b) If a benchmark figure is used to test expense information, licensees should generally take the following kinds of steps:
 - (i) ensure that the benchmark figure that is being used is a realistic figure, that is adjusted for variables such as different income ranges, dependants and geographic location, and that is not merely reflective of ‘low budget’ spending;
 - (ii) if the benchmark figure being referred to is more reflective of ‘low budget’ spending (such as the Household Expenditure Measure), apply a reasonable buffer amount that reflects the likelihood that many consumers would have a higher level of expenses; and
 - (iii) periodically review the expense figures being relied upon across the licensee’s portfolio—if there is a high proportion of consumers recorded as having expenses that are at or near the benchmark figure, rather than demonstrating the kind of spread in expenses that is predicted by the methodology underlying the benchmark calculation, this may be an indication that the licensee’s inquiries are not being effective to elicit accurate information about the consumer’s expenses.

C3Q1: Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?

Using benchmarks to sense-check information

- 89. We generally agree that appropriate benchmarks can be helpful to flag where further inquiries and verifications are necessary to ensure responsible lending.
- 90. For example, after inquiries are made by a licensee as to a borrower’s expenses, a benchmark could be used to cross-check declared expenses. If they are too low, or if the borrower has declared expenses which fall within expense categories that are not included in the benchmark (for example, the HEM benchmark does not include categories of a discretionary expenses such as private school

fees, alcohol, tobacco and, until recently, childcare costs⁵⁸), then further verification steps should be undertaken. See also our comments in relation to discretionary expenses in relation to the HEM in response to question B1Q4.

91. Additional factors should be taken into account when cross-checking expenses for particular classes of applicants against benchmarks. For example, applicants that live outside metropolitan cities may incur greater transport costs than are generally included in benchmark figures.

Misuse of benchmarks

92. Despite the above, the use of benchmarks has been extremely problematic across the banking and finance sector,⁵⁹ with 'a significant rate of default to the Household Expenditure Measure (HEM)'.⁶⁰ We emphasise that the current advice in RG 209 which states that licensees are not to rely on a benchmark alone to verify a borrower's expenses has not deterred this very practice from occurring.
93. We consider the proposed clarifications to guidance about the use of benchmarks useful; however, we strongly recommend the guidance be more direct.⁶¹ RG 209 already specifies that benchmarks cannot be used to verify a borrower's expenses. However, this guidance is ignored by licensees and, unhelpfully, by FOS in some determinations.
94. For example, ANZ witness at the Royal Commission, William Ranken dismissed the need to make further inquiries and to verify expense information on the premise that it was 'very complex to design processes' to do this, despite a KPMG review of ANZ's home lending practices finding 73% of files tested defaulting to the HEM benchmark, and KPMG recommending cross-checking of borrowers' actual living expenses.⁶²
95. In fact, ANZ submitted to the Royal Commission (in response to the statement of Robert Regan, see case study 2) that RG 209 enabled lenders to use the HEM benchmark to verify borrower expenses and that using the HEM was recognised as the 'industry standard method' for reasonable

⁵⁸ Childcare costs were included in the June 2018 updated HEMs published by the Melbourne Institute. See Nicolas Héault, et al, Melbourne Institute, Applied Economic and Social Research, *Re-development of the Household Expenditure Measure (HEM) based on the Household Expenditure Survey 2015/16: a note for HEM subscribers describing a new approach and data* (June 2018).

⁵⁹ E.g. Westpac's use of the HEM rather than actual expenses for loan applications from late 2011 – early 2015; *ASIC v Westpac Banking Corporation* [2018] FCA 1733, [1], [3], [5].

⁶⁰ *Royal Commission* (Final Report, February 2019) Vol 1, p 55.

⁶¹ Eg. RG 209 para 58 references benchmark use as 'a reasonable step'.

⁶² *Royal Commission, Transcript of Proceedings* (Day 6, 19 March 2018) 473.

verifications of expenses.⁶³ Specifically, the ANZ argued that the benchmark is not a replacement for reasonable inquiries, but that it is appropriate for verification.⁶⁴

96. Notably, the use of benchmarks by FOS to assess general living expenses has been particularly out of step with the current RG 209 guidance. While it remains to be seen whether AFCA determinations will follow in the same vein, the existing FOS determinations have added to the confusion of what is required to be compliant with responsible lending.
97. FOS publishes its approach to responsible lending and also publishes its decisions. The FOS Approach document⁶⁵ says that benchmarks relied upon by financial service providers are often incomplete as they omit expenses for a borrower's particular needs, such as medical expenses and voluntary commitments such as school fees. Despite the position taken in the FOS approach, virtually all FOS determinations rely upon a benchmark to assess a borrower's living expenses. FOS has primarily used the HEM benchmark in recent years, although on occasion it has used the HPI plus a 10% buffer. As of October 2018, Consumer Action was only aware of one decision where actual living expenses were used by the FOS to determine that a loan was irresponsible.⁶⁶
98. We have reviewed multiple FOS Determinations which were published between 2016 and 2018. A review of those FOS Determinations show that:
- FOS uses a benchmark to assess general living expenses;
 - financial service providers are only required to assess affordability based on basic and essential living expenses;
 - financial service providers are not required to consider discretionary expenses when assessing affordability;
 - there can be an unwillingness to consider actual living expenses at the time of entry into a contract;
 - financial service providers are not required to verify disclosed living expenses beyond application of a benchmark;

⁶³ ANZ, 'Submission on findings and questions arising from case studies involving ANZ', Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 13 July 2018, p 1 – 2. Available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Australia-and-New-Zealand-Banking-Group-Limited.PDF> p7 para 2.28.

⁶⁴ Ibid. p 7, para 2.28 and 2.30.

⁶⁵ Financial Ombudsman Service, *The FOS Approach Responsible Lending Series* (July 2014)

⁶⁶ Financial Ombudsman Service, *Determination 438112* (23 January 2016). Determination 438112 rejected the use of the HEM in that dispute. It adopted the approach in ASIC RG209 Credit Licensing: Responsible Lending that use of a benchmark is not a replacement for making enquiries about a consumer's expenses and verifying those expenses. It noted that the consumer spent a significant amount for cigarettes and that expense had not been considered by the FSP. However, that decision also took the approach that retrospectively determining actual expenses might not always be possible.

- financial service providers are not required to consider transaction account statements to verify expenses;
 - financial service providers are not required to consider actual expenses that were readily apparent to the financial service providers;
 - FOS gives undue weight in favour of FSPs where a borrower has signed a standard form declaration that he or she has read and understood the contract and that their stated income and expenses are true and correct.
99. It is plain that the guidelines contained in ASIC RG209 are insufficient to safeguard consumers from licensees taking shortcuts when discharging their responsible lending obligation to verify expenses.⁶⁷ We strongly recommend that ASIC redraft the benchmark section of RG 209 bluntly, with an eye turned to the current variability in its interpretation.
100. Benchmarks of household expenditure do not always accord with reality. Reliance on benchmarks, including by using the higher of benchmark or actual expenses, cannot guarantee that a borrower will be able to comply with the financial obligations under the contract without financial hardship. A credit licensee must make further steps to satisfy that legislative requirement.
101. The Royal Commission Interim Report stated, the 'HEM represents the median spend on absolute basics, but only the 25th percentile spend on discretionary basics. Three out of four households spend more on things like alcohol and tobacco, adult clothing and childcare than HEM includes in its result. And, HEM takes no account of spending on 'non-basics'. Together, these considerations show why it is right to describe HEM as being used to calculate only 'modest expenditure'.⁶⁸
102. As set out in the *Channic* decision, 'the adoption of the notional figure is not conduct of "making" reasonable inquiries about the consumer's financial situation or conduct of "verifying" the consumer's financial situation. In truth, it is a substitute for doing either of those things.'⁶⁹ Relying on a benchmark does not adhere to the requirement of bringing an 'inquiring mind'⁷⁰ to an assessment.

Henderson Poverty Index (HPI) and use of internally generated benchmarks

103. We recommend RG 209 include guidance that use of the HPI alone is categorically unacceptable in relation to assessing the suitability of a loan. The HPI has been designed as a poverty level

⁶⁷ E.g. Where Commissioner Hayne found credit providers have relied on the HEM benchmark to verify a consumer's expenses when they applied for a car loan or home loan; Royal Commission, *Interim Report*, Vol 1, 28.

⁶⁸ Royal Commission, *Interim Report* (September 2018) Vol 1 p27-28.

⁶⁹ *Australian Securities and Investment Commission v Channic Pty Ltd (No 4)* [2016] FCA 1174, 456 [1736]

⁷⁰ *Ibid.* [1804].

indicator. A loan can never be assessed as suitable just because it does not leave a borrower in poverty. This does not meet the requirements of ensuring a person is not experiencing substantial hardship when making loan repayments.

104. ASIC also identified the harm caused by the use of an internally generated, creditor-defined benchmark rather than taking reasonable verification steps when it issued 30 infringement notices to Cash Converters in November 2016. Part of this related to 'Cash Converters appl[ying] an internally-generated assumed benchmark that had no relationship to the real expenses of the individual consumer'.⁷¹
105. The redrafted benchmark section of RG 209 should also state outright that using a creditor-defined benchmark is not responsible lending as its veracity cannot be checked. This would be clearer than stating that benchmarks must be adjusted for income, dependents, geographic location, etc. Through our case work, we have experience with a number of 'DIY' benchmarks, which have caused severe consumer harm. The case studies of Mr Smith (case study 5), Joe (case study 6) and Wanda (Case study 1) also demonstrates use of what appears to be an internally defined benchmark that is lower than HPI and HEM.

Case study 5: Mr Smith

Mr Smith is 33 years old, was previously bankrupt and his only source of income is the carer's allowance. Mr Smith is the full-time carer for his mother. In May 2017, Mr Smith applied for a Money3 car loan. Money3's suitability assessment records Mr Smith's general living expenses as \$200 per week, it is unclear where this figure comes from as it is significantly lower than Mr Smith's estimate of expenses provided to us and the Henderson Poverty Index.

Money3 appears to have used an automated system to analyse Mr Smith's Bank statements to verify his financial position. A review of Mr Smith's bank statements shows that his account was overdrawn on one occasion, and in the 90 days prior to the credit assessment his account the credits to his account exceeded the debits by only 17 cents. It also shows that Mr Smith was a debtor under a small amount credit contract and a consumer lease. Despite this, there is no record that Money3 made further inquiries about Mr Smith's financial position and approved the loan. The loan was unaffordable for Mr Smith and caused him financial hardship. Mr Smith managed to keep up payments for approximately a year by borrowing money from family, using buy now pay later products and pawning his possessions. This matter was resolved through AFCA and settled shortly after conciliation.

⁷¹ ASIC, "16-380MR Cash Converters to pay over \$12M following ASIC probe", (Media Release) 9 November 2016. Available at: <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-380mr-cash-converters-to-pay-over-12m-following-asic-probe/>.

Case study 6: Joe

Joe (name changed) is an Aboriginal man who lives alone in rural Victoria, he works casually. Joe came to the Victorian Aboriginal Legal Service (VALS) with a question about his car loan. Joe earns about \$500-\$600 per week and pays rent of about \$160 per week. Joe purchased the car from a car yard in 2017 for \$6,500. The car yard organised finance with the bank. Shortly after the purchase, Joe discovered that he owed approximately \$12,000 to the bank. Joe didn't understand how the price went from \$6,500 to \$12,000. It wasn't until his lawyers obtained the loan documents that Joe discovered he had been charged \$6,500 for the car, \$983 for Consumer Credit Insurance (CCI), \$770 brokers fee and \$350 for the loan establishment fee. The remainder of the \$12,000 amount was interest repayments on the loan.

Joe said he was never told about the CCI insurance or the broker's fee. It also appears from the documentation and Joe's instructions that the bank had significantly underestimated Joe's expenses and arguably breached responsible lending laws. Joe said the broker didn't ask him about his expenses at all. The bank's suitability assessment estimated Joe's expenses at \$1,100. This amount did not include any figure for rent and was well below the Henderson Poverty Index, which for someone's in Joe's position was \$1,496.43 (without housing). The \$1,100 figure also makes no allowance for any other common expenses that are irregular but routinely incurred such as clothing, pharmaceutical costs and repairs. The CCI insurance also appears to be of no value to Joe and was junk insurance.

VALS made an internal complaint to the bank requesting a waiver of all fees and charges. VALS also made a complaint to the insurance company seeking a refund of the CCI premium. The bank initially rejected Joe's complaint. VALS lodged a complaint with AFCA seeking that Joe retain the car and that all interest, fees and charges be waived. Before AFCA took any steps to resolve the dispute the bank offered to credit the loan account with approximately \$3,120. The dispute with the insurance company was resolved internally and they refunded the premium paid to the loan account.

Joe had already made payments of about \$6,000 to the loan account. After the \$3,120 and the \$983 were credited to the loan account the balance was paid off (with Joe getting a \$200 refund from the bank as the loan account was in the positive).

Case study provided by Victorian Aboriginal Legal Service

C3Q2: Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable.

106. We recommend RG 209 is explicit that a buffer alone does not make a benchmark reasonable to verify living expenses.

107. However, we would welcome guidance that requires licensees to include buffers within benchmarks not only for contingent expenses, but also to allow for savings. We consider that consumers that are not able to generate savings at all are likely to experience hardship.⁷²

108. It should be noted that the HEM is an intentionally modest figure.⁷³ It is therefore intended that the vast majority of Australians will have expenses that far exceed the HEM figures and, as such, is too conservative to assess whether a consumer can meet their financial obligations without financial hardship. It follows, then, that should lenders default their expenses to the HEM, even if they allowed an additional buffer, the vast majority of Australians would have expenses which exceed the amount relied upon by the lender to approve the loan. Part of the objective of requiring an assessment of financial position is to ensure that the borrower can repay with 'sufficient comfort', not to live 'at or below a poverty line'.⁷⁴

RECOMMENDATION 16. A robust benchmark, particularly with an added savings buffer, can be useful to cross-check against already verified expenses. Any other use would not meet the requirements for reasonable inquiries and verifications into a consumer's financial position.

RECOMMENDATION 17. When verified expenses fall outside of the range expected by an appropriately adjusted benchmark, this should prompt further inquiries and verification. It is not acceptable to simply default to using a benchmark as determining a customer's expenses in an assessment, even with any added buffer.

RECOMMENDATION 18. Benchmarks measured at the poverty line (e.g. HPI) or untested, unverified benchmarks created by lenders are not acceptable for cross-checking living expenses or for any other use in assessing the suitability of a credit product. This should be stated explicitly.

⁷² Financial Counselling Australia, 'Everyone needs a savings buffer: Why income and expenditure statements need a default savings category' (July 2016) Available at: <https://www.financialcounsellingaustralia.org.au/docs/everybody-needs-a-savings-buffer/>.

⁷³ This is apparent from the calculation methodology of HEMs based on the median spend on absolute basics but only the 25th percentile on discretionary basics.

⁷⁴ See FOS determination 319270 (27 November 2013), [23] Available at: <https://service02.afca.org.au/CaseFiles/FOSSIC/319270.pdf>.

PART 4 – CONSUMER’S REQUIREMENTS AND OBJECTIVES

Proposal C4:

We propose to update the current guidance in RG 209 on reasonable inquiries about the consumer’s requirements and objectives to reflect the findings and guidance in Report 493 Review of interest-only home loans: Mortgage brokers’ inquiries into consumers’ requirements and objectives (REP 493).

C4Q1: Do you consider that the proposed clarification of guidance about understanding the consumer’s requirements and objectives would be useful? Why or why not?

109. We generally support the proposed update of guidance on reasonable inquiries about the consumer’s requirements and objectives. We agree that guidance about the distinction between ‘objectives’ and ‘requirements’ is useful. The former goes to the consumer’s purpose, while the latter goes to particular things that the consumer needs or is obligatory for them (for example, ability to repay in a set timeframe or contract that has certain features or conditions).
110. However, we consider that there should be a stronger link between inquiries about a consumer’s requirements and objectives and the determination of suitability. Our experience is that inquiries about a consumer’s requirements and objectives is tokenistic and has limited impact on the determination of whether a loan or lease is ‘not unsuitable’.
111. This will require ascertainment of the consumer’s purpose to a sufficient level of specificity. For example, rather than citing the purpose of a loan as ‘cash’, it should be cited as ‘cash for electricity payments’. Such a purpose should inform the assessment of suitability of the loan—a loan to pay an electricity bill may not be suitable when electricity retailers are obliged by law to provide assistance to those with payment difficulty.
112. We particularly support the proposed guidance in paragraph 67(d) of the consultation paper that requires licensees to consider whether identified features, benefits and costs of the product meet the consumer’s requirements and objectives and, if not, to have further discussions with the consumer.
113. The guidance states that these discussions should assist ‘determine whether the consumer would consider the [contract] to be unsuitable’. This guidance should be clarified to make clear that this determination should be an objective assessment of whether the product is suitable, considering the consumer’s requirements and objectives. Our concern is that if it is to rely on the consumer’s subjective assessment about suitability, the consumer may not be aware of other options that may be more suitable (for example, seeking payment difficulty assistance from an energy retailer rather than obtain a loan to pay the electricity bill).

114. We are particularly supportive of guidance that requires licensees to have documented processes to resolve and record the outcomes of conflicting consumer requirements and objectives.⁷⁵ In particular, recording this information would enable a credit licensee to determine more easily whether a product is suitable for a consumer.
115. We agree that licensees should give consumers a summary statement of their understanding of the consumer's requirements and objectives.⁷⁶ However, it should be noted in RG 209 that any record of the consumer's requirements and objectives should not be used against them in a dispute. For example, in the case of Robert Regan (case study 2), ANZ submitted to the Royal Commission it was appropriate to rely on a statement of financial position signed by Robert Regan rather than conducting any inquiry or verifications into his actual expenses.⁷⁷ There is a risk that licensees will adopt the same approach with respect to statements of requirements and objectives. Our concern is that consumers may accept these written statements without understanding their import.
116. Consideration of requirements and objectives as part of an assessment of suitability is particularly important where debt is refinanced or where there is joint debt. As demonstrated by Yvonne's story (case study 12), refinancing and/or joint debts can be risk factors of economic abuse or family violence. In relation to refinancing, the consumer's purpose can be to address over indebtedness or merely to obtain a better deal—it is important for lenders to understand which purpose it is to inform a suitability assessment. In relation to loans in joint names, it is important for the licensee to identify the requirements and objectives of each individual borrower, and not assume that they share a joint purpose.
117. We also recommend that RG 209 specifically state that credit should not be considered suitable where its terms manifestly do not align with the consumer's requirements and objectives. For example, where the amount of a car loan is far greater than the cost of a vehicle being purchased, or a credit card with a limit that far exceeds the price of the consumer's intended purchase. The proportionality of the credit lent in relation to the purpose of the funds is crucial to determining whether a credit product is suitable.
118. In Consumer Action's experience, consumer lessors have particularly problematic practices in relation to inquiries about a consumer's requirements and objectives. Consumer Action has supported many consumers of consumer leases who intended and, in fact, believed they would

⁷⁵ ASIC, *Report 493: Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives*, September 2016, p 9.

⁷⁶ ASIC, *Report 493: Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives*, September 2016, p 10.

⁷⁷ ANZ, *'Submission on findings and questions arising from case studies involving ANZ'*, Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 13 July 2018, p 3-4 [2.13] Available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Australia-and-New-Zealand-Banking-Group-Limited.PDF>.

own the goods they were actually leasing. In other cases, the consumer considered that the lease was affordable when in fact repayments amounted to far in excess of the recommended retail price for the goods, such as “Alina” (Case study 7). Additional guidance should require that a lessor specifically inquire into whether the consumer seeks to own leased goods (as part of inquiring into objectives and requirements) and, if they do, necessitate a determination that the contract is unsuitable (see our response to question D5Q2 on related additions to Appendix 2).

Case study 7: Alina’s Story

Alina (name changed) is a single mother, who is living in public housing and receives Centrelink benefits as her sole source of income.

Alina entered into a number of leases with Rent4Keeps for household items when her fortnightly living expenses substantially exceeded her income from Centrelink. The assessments carried out by Rent 4 Keeps did not disclose Alina’s correct income and living expenses and Rent 4 Keeps did not verify the figures for income and expenditure it had assessed. Alina’s bank statements showed her outgoing cash flow exceeded her total incoming cash flow.

Alina was required to pay under the leases an amount for the goods greatly in excess of the recommended retail price: Contract 1 amount paid \$1664 recommended retail price (RRP)\$699; Contract 2 amount paid \$1534 RRP \$899; Contract 3 amount paid \$3510 RRP \$1199; Contract 4 amount paid \$1921 RRP \$999 indicating fees and charges for the contracts of between 171% and 293%.

RECOMMENDATION 19. Guidance should require that inquiries about a consumer’s requirements and objectives specifically inform a determination of suitability.

RECOMMENDATION 20. Inquiries about requirements and objectives should understand the consumer’s purpose and needs to a level of specificity to inform assessments of suitability.

RECOMMENDATION 21. Particular guidance should be provided as to inquiries about a consumer’s requirements and objectives with respect to joint loans, refinancing, consumer leases and the amount of credit provided.

PART 5 – PROPOSED NEW SECTION: WHEN THE RESPONSIBLE LENDING OBLIGATIONS DO NOT APPLY

Proposal D1:

We propose to include new guidance in RG 209 on the areas where the responsible lending obligations do not apply.

D1Q1: Are there any forms of lending where the responsible lending obligations are being used by licensees in situations where the law does not require the responsible lending obligations in the National Credit Act to apply? Please describe the situations where this takes place.

119. The Royal Commission demonstrated harm associated with lending practices across the board, and not just with respect to regulated consumer credit. If there are any forms of lending that are compliant with responsible lending obligations without being legally required to be, this is a positive and should be encouraged as good practice. We are concerned that the proposed additional guidance will only serve to provide incentives to non-regulated lenders to not abide by good practice. This would include buy-now-pay-later providers and small business lenders. Moreover, it may actually encourage untrustworthy, irresponsible behaviour in lending among these sectors.
120. We do not think this section would be helpful and recommend it not be included.

RECOMMENDATION 22. Do not include the proposed section on areas where responsible lending obligations do not apply as this carries the risk of deterring good practice.

PART 6 – PROPOSED NEW SECTION: FRAUD RISKS AND RISK FACTORS

Proposal D2:

We propose to include new guidance in RG 209 on:

- (a) the role of the responsible lending obligations, and in particular the obligation to take reasonable steps to verify information provided about the consumer's financial situation, in mitigating risks involved in loan fraud; and
- (b) risk factors that might indicate that additional verification steps should be taken.

D2Q1: Would specific guidance about loan fraud and the impact on responsible lending obligations of the licensee be useful? Would guidance encourage broader improvements in processes for identifying fraud and reduce the risk of consumers entering unsuitable credit contracts as a result of fraud? Why or why not?

121. Yes, we strongly recommend specific guidance about improvements in processes for identifying loan fraud. Guidance on the harm resulting from fraud, red flags, and the role credit licensees play in reducing fraud risk and harm would bring the relevant issues to the fore and potentially minimise its likelihood.
122. As part of licensees' responsible lending obligations, it is important that they recognise and consider the risk factors for fraud and abuse. Without recognising risk factors, licensees inadvertently enable harm caused by fraud and abuse. This submission contains a number of examples from Consumer Action's case work that indicate the severe continuing harm that results from fraudulent loans, whether the fraud is on the part of the lender, an intermediary or as a result of a scam or economically abusive situation.
123. Guidance should particularly recognise that consumers can be subject to external pressure such that information they provide to lenders is not entirely accurate. This could include in situations where the consumer is scammed or subject to economic abuse. This goes to the importance of red

flag identification, and undertaking further inquiries and verification where there appears to be competing requirements and objectives

D2Q2: Please provide details of any risk factors that you consider it would be useful to identify, and additional verifying steps you consider to be reasonable in those circumstances.

124. We have identified a number of fraud risk factors that should be included in RG 209. Licensees should be expected to conduct further inquiries and verification where these risk factors arise to ensure that they will not be enabling fraud or abuse.

Large withdrawals & transfers overseas

125. Large withdrawals and transfers overseas may indicate a consumer is a victim of a scam, including a romance scam. This risk factor can be flagged by verifying all transaction accounts for a minimum of 90 days immediately preceding a loan application (such as in the case of Robert Regan, case study 2). Bank statements should always be reviewed for these types of payments, with thorough inquiries made of the customer about the purpose of large withdrawals and/or overseas transfers.
126. If a consumer requests assistance with making a large money transfer overseas, this should be an easily identified red flag for a potential scam or fraud. Licensees should inquire about the requested transfer and compare this information with the information provided in a related credit application. In the case of Robert Regan, who was the victim of an overseas scam, the Royal Commission heard that reasons provided on a credit application were accepted at face value by ANZ despite assistance in transferring a large amount of money overseas.⁷⁸

Mortgaging a previously unencumbered home

127. Mortgaging a previously unencumbered home is a risk factor for financial abuse, particularly elder abuse. The customer's requirements and objectives should be closely reviewed. This may include: their intentions and plans for any such mortgage or loan, whether they will receive a benefit under the loan, their housing plans, whether the term of the home loan seems to align or conflict with their earnings, financial position and age. Mrs Smallwood's case (case study 8, below) demonstrates this harm.

⁷⁸ ANZ, 'Submission on findings and questions arising from case studies involving ANZ', Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 13 July 2018, p 1 – 2. Available at: <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-1-written-submissions/Australia-and-New-Zealand-Banking-Group-Limited.PDF>.

Signing documents at home/ online applications that are electronically signed

128. Signing documents at home or at another location without a bank representative or intermediary present, or applying for credit online, are risk factor for economic abuse, including family violence and elder abuse. Case study 8 demonstrates this. It is next to impossible for a licensee to discharge their obligations to inquire about a consumer's requirements and objectives for a loan if they do not discuss the credit with that person. As Commissioner Hayne opined, inquiries into a consumer's requirements and objectives 'cannot be made without engaging the consumer'.⁷⁹

Case Study 8: Ms Smallwood

Ms Smallwood is an aged pensioner whose first language is not English. She can speak English, but she has limited ability to read and write in English. Ms Smallwood owns her own home.

In 2012, Ms Smallwood was persuaded by a family friend, Ms Prusser, who also spoke her first language, to use the equity in her home to make a commercial real estate investment.

Ms Prusser took Ms Smallwood to an office building to sign some documents. Ms Smallwood understood that she was taking out a loan, but didn't understand any details about the loan including that she might lose her home if the repayments weren't made. Ms Prusser reassured Ms Smallwood that she would help Ms Smallwood if anything bad happened. No attempt was made to explain any of the loan or mortgage documents to Ms Smallwood, she was simply told where to sign.

Ms Smallwood entered into a loan with a third-tier lender, GFR, for more than \$300,000. The loan was secured against Ms Smallwood's home. Ms Prusser told Ms Smallwood that the loan was in both of their names and that she would make the repayments. By late 2013, the loan was in arrears.

Around this time, Ms Prusser took Ms Smallwood to a café to meet with a broker to sign some documents. Ms Smallwood signed as directed by the broker. Ms Smallwood trusted Ms Prusser, who told her payments would be made and that everything would be okay. Ms Smallwood understood she was taking out another loan, but again didn't understand any details about the loan including that she might lose her home if the repayments weren't made.

⁷⁹ Royal Commission, *Interim Report* (September 2018) Vol 2 p. 73.

In 2013, Ms Smallwood entered into a loan agreement with one of the major banks for more than \$350,000, which was more than what was owed to GFR, to be repaid over 30 years. The loan application contains false information about Ms Smallwood's financial position, including that she was permanently employed as an accountant earning almost \$60,000 gross per annum with \$800,000 in superannuation and life insurance and personal effects valued at \$75,000. Ms Prusser's address was listed as the mailing address on the loan application.

Ms Smallwood never received any benefit from either loan. The first she knew about her obligation to pay was when she received a default notice from the major bank.

Ms Smallwood and Ms Prusser are no longer friends and she is unable to afford to make any repayments on the loan given she continues to rely solely on the aged pension to survive.

Case study 9: Sally's story

Sally (name changed) is in her 60s. Since early 2007, her sole source of income has been a Disability Support Pension (DSP) of just under \$1,000 per fortnight. Approximately two years before Sally started receiving a DSP, she was diagnosed with cancer and given 14 months to live. She went into remission after treatment, but since that initial diagnosis she has suffered a heart attack, a stroke and return of the cancer.

She is currently living with her daughter, who is also her carer. Sally pays rent of \$400 per fortnight. Without including payments towards her substantial debts, Sally's fortnightly expenses leave her with less than \$40 at the end of each fortnight. She owns no significant assets.

Sally is a vulnerable person; she cannot read and write and cannot use a computer.

Sally is also a survivor of family violence. Her ex-partner, Nigel (name changed), opened a number of online credit contracts in her name without her authority. This included Visa cards through two different banks and a bank loan. Her relationship with Nigel ended after he assaulted her. Physical violence was common towards the end of the relationship.

Sally was "on and off again" with Nigel for approximately 2 years. She only discovered that he had opened the accounts when credit cards arrived in the mail. Nigel kept the cards and Sally believes that he used the money for gambling.

After the relationship ended, Sally attempted to dispute the accounts with the banks. Although Sally told the banks about the family violence and that she did not apply for the cards herself, the banks maintained the debts must be paid. Sally was offered payment plans that she could not afford on her DSP. The debt on one of the Visa bank cards was assigned to a debt collector.

By the time Sally contacted the banks, Nigel had accrued almost \$50,000 in debt on the cards. After talking to the banks Sally discovered that Nigel had provided her date of birth, and in at least one instance, submitted false pay slips. Sally received no benefit from the credit and the stress of worrying about the credit accounts prolonged the trauma of the family violence and undermined her efforts to rebuild her life.

Accordingly, Sally sought help from the Consumer Action Law Centre. With our assistance, the Visa debt was recalled from the debt collector, and the debts on the accounts allegedly owed by Sally were waived in full. Sally was satisfied with the bank's offer as a resolution to her case.

Credit arranged by brokers/introducers

129. Credit arranged by brokers or introducers can be at higher risk of fraud, given that the lender themselves may not have dealt personally with the borrower. The risk may be higher with respect to introducers who do not have any licensing obligations (for example, those exempted by the point of sale exemption). Intermediaries have incentives to engage in fraud given commission payments and other forms of reward benefitting them for arranging loans.
130. Consumer Action has represented consumers who have experienced hardship resulting from credit affected by fraud linked to a broker or other loan intermediary. Licensees cannot rely on brokers, introducers or other intermediaries to note risk factors for abuse and fraud, as case studies 10 and 11 demonstrate.
131. Building on recommendation 2.9 of the Royal Commission Final Report relating to financial advisers, we recommend that RG 209 require lenders, when they identify fraud, be proactive and be required to consider whether the fraud or misconduct occurred in respect of other borrowers and take steps to inform and remediate customers as appropriate.⁸⁰ While this seems to be the responsible and common-sense approach, the Royal Commission revealed that lenders have not done so.⁸¹

Case study 10: Nicola

Nicola is 52 years old, and suffers from chronic migraines, mental health issues and eyesight deterioration. Nicola told us that she was, and remains, reliant on Centrelink payments for her income.

⁸⁰ Royal Commission, *Final Report* (February 2019), Vol 1, p 204-205, Recommendation 2.9.

⁸¹ Royal Commission, *Interim Report* (September 2018), Case study 3: Aussie Home Loans, Vol 2, p 41.

In March 2014, Nicola was recommended to visit a finance broker in Melbourne, who told Nicola that he could arrange a loan of \$10,000 with Westpac. Nicola wanted to obtain a loan to purchase a car. The broker walked with Nicola to the Westpac branch in Coburg, where Nicola was provided with Westpac loan documents that she signed on the spot. Without her knowledge, the broker and/or the branch officer increased the loan amount from \$10,000 to \$31,600, which was approved by Westpac. The broker convinced our client to transfer him \$20,000 on the promise that he would repay the full loan, but he did not repay the loan and absconded with the \$20,000.

In 2015, the broker in question was banned by ASIC and his company's credit licence cancelled after ASIC found that the broker had submitted false documents to secure loan applications and failed to comply with licence conditions.

As early as June 2014, only about 4 months after being approved for the loan, Nicola called Westpac to explain that she could not afford the repayments. This should have acted as a red flag to Westpac to assess the suitability of the loan. Instead, Westpac proposed a payment plan, which Nicola complied with until April 2016, when Westpac advised her that the payment plan was only until April 2016 and declined further assistance. Nicola was unable to afford the repayments and fell into arrears. Despite serious questions being raised about the broker's conduct and Nicola being unable to afford the loan, Westpac sold the debt to a third-party debt collector. The debt collector proceeded to commence proceedings in the Melbourne Magistrates' Court against Nicola. We assisted Nicola in filing a complaint to stop enforcement proceedings. After Nicola's case study was published in Consumer Action's Royal Commission Submission, Westpac contacted us directly to resolve the complaint.

It has taken over 4 years since Nicola first raised an issue of affordability to resolve the dispute, and nearly a year of ongoing negotiations, as well as a FOS complaint, to finally resolve the dispute.

Case Study 11: Stefanie

In 2015, Stefanie (name changed) was given a \$30,000 personal loan from the ANZ. The original loan application, completed by a broker who Stefanie never met, was for \$50,000. The broker only ever spoke to Stefanie's husband, who applied for the loan under Stefanie's name.

The broker recorded Stefanie's expenses as:

- Housing – Rental: \$450
- General Living Expenses: \$200
- Proposed ANZ repayment: \$641

The broker recorded the purpose of the loan as "household goods". At the time Stefanie was working and earning \$44,000 per year.

The loan application also identified Stefanie as a single person, which was not correct.

The ANZ approved the loan for a reduced amount of \$30,000. Stefanie's expenses were significantly higher than \$200 per month, and consequently the loan repayments were unaffordable for her.

The loan amount was paid into Stefanie and her husband's joint account. Stefanie's husband spent this money and when Stefanie and her husband separated, Stefanie was left to pay this loan.

The ANZ appears not to have communicated directly with Stefanie about her requirements and objectives for the loan or about her income and expenses.

This matter was resolved between the parties.

Refinancing single debt to joint debt

132. Refinancing, especially from a single debtor to a joint debt, can indicate economic abuse and other family violence. It should not be assumed that a person wants to take on another person's debt. Thorough inquiries should be made into each applicant's requirements and objectives, including into whether there is a benefit to each applicant. Without thorough inquiries, a licensee may be facilitating devastating economic and other kinds of abuse toward a survivor of family violence.

Case study 12: Yvonne

In May 2015, Yvonne's then husband had an ANZ credit card that he was struggling to repay. He applied for a personal loan to pay out the credit card, in his and Yvonne's name jointly as her income was greater than his.

Yvonne's husband was financially and emotionally abusive during their relationship. He controlled the couple's finances, even withdrawing the full amount of Yvonne's salary shortly after it went into their account. This left Yvonne in a constant state of financial uncertainty.

When Yvonne's husband asked her to sign the joint personal loan application, she refused, and he threatened to leave her with their three children to manage on her own. In fear, Yvonne signed the application.

ANZ approved the loan application in Yvonne and her then husband's name jointly. The funds from the personal loan were applied to his credit card and to ANZ loan protection. Yvonne instructs that she derived no benefit from the loan. We are further instructed that Yvonne's then husband had applied Yvonne's income solely towards the loan from January 2016 to November 2016 as he used his income to pay a secured car loan.

This case study demonstrates highlights the importance of taking steps to mitigate risk of loan fraud, particularly in situations of family violence. It also shows a lack of consideration of Yvonne's requirements and objectives as part of the loan application.

Yvonne's dispute with ANZ was settled with Consumer Action's assistance.

Car loan when car not in same person's name or when borrower already has car

133. As demonstrated by case study 1, a car loan provided to a borrower who is not the user of the vehicle (especially if that person already has a vehicle) is a risk factor for family violence, including economic abuse. Further inquiries and verifications must be undertaken by the licensee, in particular, noting that the loan application may have been completed with the assistance of a person who has no responsible lending obligations due to point of sale exemptions from the NCCP Act.⁸²

English as a second language or poor literacy skills

134. When a consumer does not speak English or has poor literacy skills, a licensee should satisfy themselves that the consumer understands the credit product for which they are applying, that they actually want the credit product (as part of checking their requirements and objectives) and that they will receive a benefit from the loan. As demonstrated in Mrs Smallwood's story (case study 8), a trusted person or family member who conducts all interactions with a lender may not be acting in the interests of the consumer; in fact, they may be purposefully deceiving them to receive the benefit of a loan for which they will not be liable.

Verifying steps

135. In all of the above cases, the licensee should be expected to conduct sufficient inquiries to identify risk factors and should be make further inquiries and verifications to satisfy themselves they are not participating in fraud or abuse. We recommend ASIC provide the following examples of verifying steps that would help to reduce the occurrence of fraud:
- determining the identity of the applicant in person;
 - verifying the details and authenticity of documents (e.g. crosschecking pay slips with an employer); and
 - speaking to each party to a loan individually. Specifically, identifying a vulnerable party and giving them a private opportunity to discuss the loan. This may necessarily involve training staff as to the relevant flags and cues that will enable them to identify a vulnerable party.⁸³

⁸² *National Consumer Credit Protection Regulations 2010* (Cth) Regs 23.

⁸³ We note that banks have taken steps to improve identification and response to customer vulnerability: Australian Banking Association, *Banking Code of Practice 2019*, Ch 16 para 48.

RECOMMENDATION 23. Include guidance on fraud and abuse risk factors, including:

- large withdrawals and transfers overseas;
- mortgaging a previously unencumbered home;
- signing documents at home / online applications;
- credit arranged by brokers/introducers (including at point of sale);
- refinancing single debt to joint debt;
- car loan when car not in same person's name; and
- English as a second language or poor literacy.

RECOMMENDATION 24. Set out the expectation that additional inquiries and verification will be necessary to address fraud or abuse risk factors.

PART 7 – PROPOSED NEW SECTION: USE OF REPAYMENT HISTORY INFORMATION

Proposal D3:

We propose to include guidance in RG 209 to clarify how repayment history information may be used, including that:

- (a) the occurrence of repayment difficulties on one product will not necessarily mean that a new credit product will in all cases be unsuitable for that consumer; and
- (b) this information should instead trigger the licensee to make more inquiries to enable it to understand those repayment difficulties, and the likelihood that the circumstances of the consumer leading to those difficulties will mean that the consumer would also be unable to meet financial obligations under the new product being considered.

D3Q1: Would guidance about use of negative repayment history information and hardship indicators reduce the risk that credit providers consider it necessary to refuse applications for further credit products that may in fact be affordable for the consumer? Why or why not?

- 136. Repayment history information (RHI) and hardship indicators are less helpful in assessing credit suitability compared to inquiries and verifications into the consumer's actual financial position. This information does not necessarily correlate with the consumer's ability to afford a new credit contract.

137. With RHI becoming more common on credit reports, and the potential introduction of further hardship indicators,⁸⁴ there is a risk that licensees will rely on this information alone to comply with responsible lending obligations. RG 209 must be clear that obtaining and considering this information, on its own, will not satisfy licensees' obligations. We refer to the report from the NZ Privacy Commissioner which found there was no evidence of comprehensive credit reporting improving responsible lending practices in that country.⁸⁵
138. In relation to the concern identified in the consultation paper—that licences will interpret negative RHI as hardship indicators as reason to decline applications—we consider the greater risk will be the offering of higher-cost credit. We consider that higher-cost credit being targeted to consumers who have experienced late payments or hardship to be a particularly perverse outcome of the sharing of this information. Guidance should be provided about the circumstances in which the offering of such higher-cost credit would be unsuitable for the consumer.
139. Nevertheless, we agree that negative RHI or hardship indicators should trigger further inquiries by a licensee and welcome guidance in this respect. This would align with case law which has found that a licensee should bring their 'own inquiring mind'⁸⁶ to their assessment.

RECOMMENDATION 25. Guidance should be provided that obtaining and considering RHI and/or hardship indicators should not, on its own, satisfy responsible lending obligations.

RECOMMENDATION 26. Negative RHI or hardship indicators should trigger additional inquiries and verification.

PART 8 – PROPOSED NEW SECTION: MAINTAINING RECORDS

Proposal D4:

We propose to include new guidance in RG 209 about maintaining records of the inquiries made and verification steps taken by the licensee, reflecting our findings and recommendations on good recording practices included in REP 493.

⁸⁴ Attorney-General's Department, *Review of financial hardship arrangements*, March 2018, available at:

<https://www.attorneygeneral.gov.au/Media/Pages/Review-of-financial-hardship-arrangements-28-March-2018.aspx>.

⁸⁵ Privacy Commissioner, New Zealand, *Comprehensive Credit Reporting Six Years On: Review of the operation of Amendments No 4 and No 5 to the Credit Reporting Privacy Code*, 10 April 2018. P36, Part 2 Findings, available at:

<https://www.privacy.org.nz/assets/Uploads/Report-on-Review-of-CRPC-Amendments-No-4-and-No-5-PDF.pdf>.

⁸⁶ *Australian Securities and Investment Commission v Chanic Pty Ltd (No 4)* [2016] FCA 1174, [1804].

D4Q1: Do you consider that guidance on industry best practice for recording the inquiries and verification steps that have been undertaken would be useful for licensees? Why or why not?

140. We strongly agree with the proposal to include guidance on industry best practice for maintaining records of inquiries made and verification steps taken. Our experience shows many licensees do not adequately record critical aspects of a suitability assessment, particularly in relation to a consumer's requirements and objectives. We also note, as an example, the finding of REP 445 that almost no lenders kept 'sufficient evidence of inquiries into consumers' requirements and objectives when entering an interest-only home loan'.⁸⁷
141. The law already requires licensees to provide a consumer their written preliminary or final assessment upon request.⁸⁸ Guidance on maintaining records to inform that assessment will make compliance with this requirement easier. Importantly, it would also be useful for consumers and their advocates if licensees were given guidance on ASIC's expectations to maintain records, particularly to aid dispute resolution.

D4Q2: Please provide any comments on the particular recording practices identified as 'best practice' by ASIC, and whether you consider those practices are generally appropriate for licensees.

142. We support the guidance included in REP 493 about including 'a logically set out and detailed narrative account of the consumers' short and longer term requirements and objectives...' as well as a detailed description of 'the reasoning behind selecting a loan with particular features, terms and costs from a particular lender'.⁸⁹ See also our response to question C4Q1.

RECOMMENDATION 27. Provide guidance about maintaining records of the inquiries made and verification steps taken by a licensee.

PART 9 – WRITTEN ASSESSMENT CONTENT

Proposal D5:

We propose to provide additional guidance in RG 209 on what information we think should be included in a written assessment.

⁸⁷ ASIC, *Report 493: Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives*, September 2016, p 34 para 172 citing ASIC, *Report 445 Review of interest-only home loans*, 20 August 2015.

⁸⁸ ASIC, *Regulatory Guide 209: Credit Licensing: Responsible lending conduct*, November 2014, para 209.7.

⁸⁹ ASIC, *Report 493: Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives*, September 2016, p 8 para 28.

D5Q1: Would it be useful for ASIC to provide an example of a written assessment to illustrate the level of information that we think should be included? Why or why not?

143. We welcome the provision of a sample written assessment by ASIC to help illustrate the level of information that should be included in an assessment of suitability. A template assessment such as that provided in Appendix 2 should substantially support licensees to recognise the expectations for their compliance with the law.
144. We also stress the importance of the written assessment being completed at the time of actually assessing suitability for a specific consumer. Although it seems this would go without saying, it is our experience that this is not always the case. We recommend specifying that the written assessment must be completed as part of the suitability assessment, not after the fact or when copies of documents are requested in relation to a dispute or complaint. We note that the second bullet point under paragraph 209.138 of RG 209 may tend to imply that the written assessment can be prepared at the time a request is made, and we recommend this be reworded.

D5Q2: Please provide any comments on the example set out in Appendix 2.

145. While we are strongly supportive of the inclusion of an example assessment, we recommend that Appendix 2 be revised to enable easier capture of information relevant to inquiring into a consumer's requirements and objectives. Specifically, we recommend the following.

Requirements and objectives – Objective: Purpose of obtaining credit

146. In addition to being concise, the summary of the consumer's description of their purpose should be specific. Specificity will assist in the assessment of suitability.
147. The examples should better align to actual consumer objectives, particularly those of vulnerable consumers. The examples currently listed are not aligned to our experience of consumer objectives. For example:
 - A consumer may simply want a car that is reliable for the purpose of driving to and from work rather than specifying they desire a car of a specified value or quality. This objective may be met with a reliable but used, standard-model vehicle that has road-worthy certification and has been independently tested. A \$30,000 car may not be appropriate to meet the consumer's objectives because it is possible to purchase a reliable vehicle for far less.
 - A consumer may wish to furnish their two-bedroom apartment without spending a significant amount of their income to do so. This objective may be met with second-hand furniture. Leased furniture may not be appropriate to meet the consumer's objectives because they may spend far more than the recommended retail price for furniture that they would need to return after a few years.
148. RG 209 already includes a reference to case law that 'general descriptions of the purpose of a loan (such as 'personal' or 'living expenses') would not be sufficient' to meet the standard of reasonable

inquiries into a consumer's requirements and objectives.⁹⁰ Despite this, one of the examples listed in Appendix 2 is: '(c) have access to a line of credit for making general day-to-day purchases'. This example is similar to those that were not considered sufficient by Davies J in the *Cash Store* decision and should be elaborated on or removed from the appendix.

Requirements: Particular features requested or not necessary

149. As drafted, this section would not help identify whether a credit product would respond to a consumer's requirements and objectives. The approach risks placing the onus of responsible lending on the consumer by, for example, expecting them to specifically indicate they did not want a high credit limit or large loan that was far greater than one that would meet their objectives. This section could be improved by providing some guidance about what sort of credit products would generally meet consumer needs.
150. We also recommend including specific questions about particular features of a credit product as follows:
- Does the consumer intend to own the asset they are seeking? Or are they interested in leasing the asset with the eventual requirement to return the asset? Why are they interested or not interested in owning it?
 - Does the consumer understand the recommended retail price associated with an asset they are interested in leasing or owning, and the difference in price to the relevant credit contract?
 - Has the consumer approached the credit licensee or is the credit in question an unsolicited product?
 - Why is the consumer interested in a refinanced loan? Who was liable under the previous debt? If moving from a single debtor to a joint debt, why does the additional person want to be liable for the debt?

Credit contract or consumer lease meets the consumer's requirements and objectives

151. The first sentence should be amended as follows: *A statement of whether the terms of the contract meet each of the specified objectives and requirements, including how and why each specified objective and requirement is met or not met, and an explanation of how the terms of the contract are appropriate for the consumer's requirements and objectives.*
152. The second sentence seems to provide a loophole for licensees to provide consumers with a product that does not meet one or more of their requirements or objectives. If this is the case, the

⁹⁰ ASIC, RG 209 p18 para 209.35 citing Davies J in *ASIC v The Cash Store (in liquidation)* [2014] FCA 926.

written assessment must specifically indicate why the contract would be considered 'not unsuitable' for that consumer.

Consumer's capacity to meet repayments

153. This sentence should be amended to reflect the requirement that the consumer's capacity to meet repayments must be without substantial hardship.

Final assessment

154. Any example written assessment must include a specific section for the licensee to explain why the relevant credit product is not unsuitable for the consumer.

RECOMMENDATION 28. Clarify that written assessments should be produced at the time of the actual assessment, not when documents are later requested.

RECOMMENDATION 29. Incorporating suggested changes to Appendix 2 to better ensure assessments capture a consumer's requirements and objectives.

PART 10 - ADDITIONAL INCLUSIONS

Guidance on remedies

155. One of the objectives of the responsible lending regime is to 'curtail undesirable market practices'.⁹¹ We contend that including guidance on remedies in RG 209 will help to achieve this purpose and also assist with the practical application of responsible lending laws, particularly in the context of disputes.
156. Importantly, we consider improved guidance can deliver fairer redress to customers compared to remediation practises generally adopted by licensees and FOS. More data is needed on whether the AFCA approach will differ from that taken by the FOS. However, AFCA has stated its course will be to balance the interests of licensees and borrowers 'who should usually be required to repay' the 'principal funds loaned to them' if they've had the use of those funds, despite a finding of irresponsible lending.⁹²

⁹¹ NCCPB 2009 explanatory Memorandum para 3.11 s cited in RG 209 para 209.12.

⁹² AFCA, Submission No. POL.9100.0001.0863_0001 '*Response to Royal Commission's Interim Report*' to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 26 October 2018, p. 4. Available at: <https://financialservices.royalcommission.gov.au/Submissions/Documents/interim-report-submissions/POL.9100.0001.0863.pdf>.

157. When assessing loss in cases of irresponsible lending,⁹³ FOS's approach has been that the licensee should not profit from the transaction⁹⁴ and the consumer should be returned to the position they were in before the loan was approved.⁹⁵ The perception is that if the borrower does not account for the "benefit" they received from an irresponsible loan, this will cause an injustice to the FSP.⁹⁶ This approach suffers three flaws:
- it does not appreciate the significant harm caused to borrowers who experience financial hardship as a result of an irresponsible loan;
 - it undermines the objective of the responsible lending, which is to ensure strong consumer protection; and
 - it assumes that the amount lent was always to the borrower's 'benefit'.
158. In effect, the 'penalty' is that the lender is unable to charge fees and interest for the life of the loan, and the borrower must repay the principal. There is also little financial incentive to enter into a reasonable payment arrangement to repay that principal. While the lender is arguably returned to the original position by being able to recover the principal amount lent in a shortened period, the borrower may have to sell their family home or car to repay a loan they should never have received. This can cause severe financial and personal hardship. In many cases, the hardship imposed has serious long-term consequences that mean the borrower may never recover financially.
159. FOS can forgive a debt in resolution of a responsible lending dispute; however, debt waivers are quite rare.⁹⁷ Though there is legal precedent for irresponsibly lent contracts to be set aside ab initio as unjust transactions, borrowers are generally still required to repay the principal amount owed, and thus account for any "benefit" obtained under the loan.⁹⁸ It is difficult to understand how this represents what the community would expect to be fair and reasonable in all the circumstances.
160. We consider that regulatory guidance should state that borrowers be provided with a clear right to debt waivers when a licensee lends irresponsibly, including refunds of amounts already paid where appropriate. Where the loan is secured, the licensee should also release the security (for example, over a family home or car) where appropriate. This would provide fairer outcomes for victims of irresponsible lending, and incentive to lenders to comply with responsible lending laws.
161. This would align with the approach under section 180 of the NCCP Act. Under section 180, if a lender engages in 'unlawful credit activity', the borrower is not liable for future payments and is

⁹³ Clause 1.2, Financial Ombudsman Service, *The FOS Approach to Responsible lending series: How we work out a consumer's loss*, p.2

⁹⁴ Assuming what FOS calls the "credit risk".

⁹⁵ Assuming what FOS calls the "investment risk"

⁹⁶ *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482; *First Mortgage Managed Investments Pty Limited v Pittman* [2014] NSWCA 110.

⁹⁷ FOS Determination 266568, p.15

⁹⁸ *Australian Securities and Investments Commission v Channic* [2016] FCA 1174

entitled to recover any amounts already paid under the loan. Currently, 'unlawful credit activity' applies to limited offences under the NCCP Act: engaging in unlicensed credit activity and providing short-term credit for a term of less than 16 days. Given that irresponsible lending to consumers is also a criminal offence,⁹⁹ it seems appropriate that this approach be extended to unaffordable loans. While law reform might assist to develop this position, we note that EDR schemes can make determinations on the basis of what is fair and reasonable in the circumstances.

162. Where a borrower would be 'unjustly enriched' from the use of a secured asset (for example, living in a house), regulatory guidance should provide a straightforward and fair calculation for determining the value of the benefit they derived. This should take into account any distress or hardship the borrower experienced as a result of the irresponsible loan. If the value of the benefit is more than the amount already paid under the loan, the residual amount owed should only be repaid in affordable instalments. A reasonable repayment plan ought to begin with repayments being made within the original term of the loan.
163. We recognise that the above approach amounts to a departure from current practices and that RG 209 does not currently provide guidance about remedies. Nevertheless, licensees also have an obligation to act 'efficiently, honestly and fairly'.¹⁰⁰ Particularly given ASIC's description of the 'fairness imperative',¹⁰¹ we consider that RG 209 should apply this fairness obligation by setting out an approach to remedies for irresponsible lending that accords with community expectations.

RECOMMENDATION 30. Include guidance on remedies in RG 209, in particular, that borrowers have a clear right to debt waivers where a licensee lends irresponsibly, including refunds of amounts already paid where appropriate.

Contact

Please contact Brigette Rose, Senior Policy Officer at Consumer Action Law Centre on 03 9670 5088 or at brigette@consumeraction.org.au if you have any questions about this submission.

⁹⁹ *National Consumer Credit Protection Act 2009* (Cth) s 133.

¹⁰⁰ *National Consumer Credit Protection Act 2009* (Cth) s 47(1)

¹⁰¹ James Shipton, ASIC Chair, Speech, AFR Banking & Wealth summit, 27 March 2019, available at: <https://www.asic.gov.au/about-asic/news-centre/speeches/the-fairness-imperative/>

APPENDIX A

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 1. Any updates to RG 209 must consider consumer harm due to irresponsible lending exposed during the Royal Commission.

RECOMMENDATION 2. Where a principles-based approach has not delivered compliance, provide a more detailed prescription as to how licensees can comply with responsible lending obligations.

RECOMMENDATION 3. Ensure overall readability and clarity of RG 209, including emphasis on main expectations of credit licensees.

RECOMMENDATION 4. Recognise the substantial costs of non-compliance with responsible lending obligations to both consumers and industry in the relevant regulatory impact statement.

RECOMMENDATION 5. RG209 must make it clear that reliance solely on automated processes does not fulfil a credit licensee's responsible lending obligations as it does not enable a licensee to properly assess 'each individual customer's needs, objectives and financial capacity'.

RECOMMENDATION 6. Remove references encouraging 'scaling down' reasonable inquiries and verification steps, or include examples of very limited, specific circumstances in which it might be reasonable.

RECOMMENDATION 7. Update Table 3 so RG 209 better identifies factors which could lead to enhanced inquiry and verification obligations in relation to different credit products and practices.

RECOMMENDATION 8. Credit licensees must inquire about both income and expenses. This should include the categories of expenses which appear on the AFCA Statement of Financial Position form as well as discretionary expenses.

RECOMMENDATION 9. Credit licensees must review at least 90-days' worth of account statements as part of verification, and review documentary evidence of expenses including rent or board, insurance, child maintenance, school fees, travel expenses, childcare, utility bills, telecommunication, and TV subscriptions.

RECOMMENDATION 10. Where borrowers hold a credit card, credit licensees should obtain credit card statements that cover the preceding period of 90 days at a minimum.

RECOMMENDATION 11. Licensees should verify borrowers' income summaries and tax returns for the previous two or three years (where available) and make further inquiries where there are any irregularities with declared income.

RECOMMENDATION 12. Update Appendix 1 to make specific reference to living expenses, such as food, entertainment and alcohol, as well as recurrent withdrawals, so that licensees consider these expenses specifically when reviewing bank statements.

RECOMMENDATION 13. That as part of any guidance about the use of data aggregation services to assist with verification obligations, ASIC should commit to undertake regular independent assessments of those services and develop minimum standard for them.

RECOMMENDATION 14. Clarify that a credit licensee must have regard to the verifying sources of information provided; it is not sufficient merely to obtain information.

RECOMMENDATION 15. An 'if not, why not' approach to verification practices should not be adopted unless it is accompanied by specific guidance on what would and what would not be acceptable explanations for not obtaining or referring to verification information that is readily available.

RECOMMENDATION 16. A robust benchmark, particularly with an added savings buffer, can be useful to cross-check against already verified expenses. Any other use would not meet the requirements for reasonable inquiries and verifications into a consumer's financial position.

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 17. When verified expenses fall outside of the range expected by an appropriately adjusted benchmark, this should prompt further inquiries and verification. It is not acceptable to simply default to using a benchmark as determining a customer's expenses in an assessment, even with any added buffer.

RECOMMENDATION 18. Benchmarks measured at the poverty line (e.g. HPI) or untested, unverified benchmarks created by lenders are not acceptable for cross-checking living expenses or for any other use in assessing the suitability of a credit product. This should be stated explicitly.

RECOMMENDATION 19. Guidance should require that inquiries about a consumer's requirements and objectives specifically inform a determination of suitability.

RECOMMENDATION 20. Inquiries about requirements and objectives should understand the consumer's purpose and needs to a level of specificity to inform assessments of suitability.

RECOMMENDATION 21. Particular guidance should be provided as to inquiries about a consumer's requirements and objectives with respect to joint loans, refinancing, consumer leases and the amount of credit provided.

RECOMMENDATION 22. Do not include the proposed section on areas where responsible lending obligations do not apply as this carries the risk of deterring good practice.

RECOMMENDATION 23. Include guidance on fraud and abuse risk factors, including:

- large withdrawals and transfers overseas;
- mortgaging a previously unencumbered home;
- signing documents at home / online applications;
- credit arranged by brokers/introducers (including at point of sale);
- refinancing single debt to joint debt;
- car loan when car not in same person's name; and
- English as a second language or poor literacy.

RECOMMENDATION 24. Set out the expectation that additional inquiries and verification will be necessary to address fraud or abuse risk factors.

RECOMMENDATION 25. Guidance should be provided that obtaining and considering RHI and/or hardship indicators should not, on its own, satisfy responsible lending obligations.

RECOMMENDATION 26. Negative RHI or hardship indicators should trigger additional inquiries and verification.

RECOMMENDATION 27. Provide guidance about maintaining records of the inquiries made and verification steps taken by a licensee.

RECOMMENDATION 28. Clarify that written assessments should be produced at the time of the actual assessment, not when documents are later requested.

RECOMMENDATION 29. Incorporating suggested changes to Appendix 2 to better ensure assessments capture a consumer's requirements and objectives.

RECOMMENDATION 30. Include guidance on remedies in RG 209, in particular, that borrowers have a clear right to debt waivers where a licensee lends irresponsibly, including refunds of amounts already paid where appropriate.