AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

ARCA'S SUBMISSION

CONSULTATION PAPER 309

Update to RG 209: Credit licensing:
Responsible lending conduct

CONTENTS

EXECUTIVE SUMMARY **5**

GENERAL OBSERVATIONS **8**

FIRST PRINCIPLES OF RESPONSIBLE LENDING – 'WHY, WHAT, HOW' **11**

WHY **12**

Assuming perfect information to help understand the 'Why' 13

Financial capacity assessment: relative vs objective assessment 14

Relationship with the requirements and objectives assessment 16

Implications of using an objective assessment 17

Setting the 'objectively established minimum standard' 18

ARCA's formulation 19

Consumers who may already be 'struggling' 19

Current RG209 approach to expenses 20

WHAT **21**

Interpreting the NCCP requirements 21

'What' a licensee is trying to understand 23

Inquiries and verification – what and when 23

General issues impacting the responsible lending requirements 25

Privacy implications of the responsible lending assessment 25

Meaning of reasonable 27

'Likely' – meaning of "a real chance or possibility" 28

'Likely' – buffers, income-shaving and future 'upsides' 29

Scalability 30

Specific issues impacting the responsible lending requirement 31

Reducing spending – requirement to make further inquiries 31

'Lifestyle-choice' expenditure: gambling, smoking, drinking etc 32

Predicting future changes to a consumer's financial situation 33

Refinancing – less inquiries and verification required 34

Unused credit card limits 35

HOW **36**

General clarification of existing guidance in RG209 36

Open Banking – standardised consents 36

ANSWERS TO QUESTIONS IN CP309 .... **38**

ABOUT ARCA

The Australian Retail Credit Association (ARCA) is the peak industry association for credit providers in Australia. Our Members include all of the 14 largest banks, large mutuals, and a diverse range of finance companies including the three largest consumer finance providers, specialist auto lenders, and a broad range of established and startup fintechs. The four national credit reporting bodies are also Members. Together, our Membership is responsible for well over 95% of all lending to consumers in Australia. All our credit provider Members are licensed under the National Consumer Credit Protection Act, administered by ASIC.

For further information in relation to ARCA, please visit www.arca.asn.au

1 ARCA welcomes ASIC’s review of Regulatory Guide 209 Credit licensing: Responsible lending conduct (RG209). Licensees within the credit industry have now been subject to the responsible lending obligations for over eight years. In that time, ASIC has conducted numerous reviews of licensee’s responsible lending practices, while the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, also examined those practices in detail.

2 We believe that this review is an opportunity to consolidate and document the experience and learnings that the regulator, licensees and other stakeholders have developed since the implementation of the National Consumer Credit Protection Act (NCCP). It is also an opportunity to recognise developments in technology and other matters that have impacted, or will soon impact, the credit industry, such as the emergence of ‘fin-tech’ participants and new ways of sharing consumer data.

3 Our submission is structured into four sections:

1. An executive summary of the key areas of feedback included in our submission
2. General observations in relation to the responsible lending obligations
3. A detailed discussion of our understanding of the requirements of responsible lending, structured around the “Why”, “What”, and “How” of responsible lending
4. A section which provides feedback on the specific questions raised in Consultation Paper 309 (CP309)

EXECUTIVE SUMMARY

4. Feedback from our Members has shown the need for clearer and better principles-based guidance. However, there is a strong view that the guidance in RG209 should continue to provide a flexible and scalable approach to the provision of credit to consumers who can afford it.

5. The development of clearer and better guidance will be helped by a re-evaluation of the responsible lending obligations from a first principles basis, which we have described as being the 'Why, What and How of Responsible Lending'.

WHY

6. In the 'Why' section we discuss the reasons 'why' the responsible lending obligations require a licensee to undertake the responsible lending assessment, i.e. what 'harm' is the law trying to prevent.

7. The responsible lending provisions have two aims: (i) to reduce the risk that a consumer will experience 'substantial hardship' as a result of the loan, and (ii) to help make sure the loan meets the consumer's 'requirements and objectives'. Our submission largely focusses on the first of those aims (although it makes some comments in relation to the second aim).

8. While the avoidance of 'substantial hardship' is a key aim of the responsible lending provisions, ASIC does not provide any definitive guidance or formulation on what 'substantial hardship' means in the current RG209 and does not propose further guidance in CP309. We believe that without a clear understanding of the 'harm' that is being addressed, the guidance will lack clarity.

9. Accordingly, we propose that the guidance should address what is meant by 'substantial hardship' including:

   a. Whether the responsible lending decision should be based on a 'relative' or 'objective' assessment of the consumer's post-loan lifestyle (i.e. the lifestyle that the consumer is able to afford given their post-loan financial situation); and

   b. What level of 'lifestyle' (as indicated by the consumer's predicted post-loan financial capacity) represents 'substantial hardship'.

10. Based on our analysis (particularly that a consumer should be free to choose to reduce their 'variable' expenditure to afford the loan), we propose the following formulation:

    A consumer will not, after the loan is given, experience substantial hardship if the consumer is predicted to be able to:

    (i) pay their forecast fixed expenses (including the proposed loan's repayments);

    (ii) pay their variable, non-discretionary expenses (assessed based on what is necessary for a consumer in their circumstances to live a modest lifestyle); and

    (iii) afford variable, discretionary expenses (assessed based on what is appropriate for a consumer in their circumstances to live a modest lifestyle)

11. This means that a consumer is free to reduce their variable expenditure (including regular commitments such as gym memberships and pay TV accounts) down to a minimum threshold, that reflects a 'modest' standard of lifestyle, in order to afford the loan. That minimum threshold would be set based on an objective assessment of the consumer's post-loan financial needs.

12. We note that this analysis clarifies the reasons why a licensee is expected to understand a consumer's pre-loan variable expenditure and helps to identify the limitations of that process. For example, while a consumer's pre-loan expenditure does not definitively establish what a consumer's post-loan needs are, it provides a baseline to the licensee to predict those post-loan needs (while also recognising that the licensee may need to turn their mind to the question of how the loan could impact the consumer's on-going variable expenses). Understanding a consumer's pre-loan expenditure will also help the licensee to identify whether the additional financial commitments of the loan will require the consumer to significantly change their lifestyle (which may be relevant to whether the loan meets the consumer's requirements and objectives).

WHAT

13. In the ‘What’ section, we discuss the principles behind ‘what’ inquiries and verification steps a licensee is required to make, and ‘what’ the licensee is required to do with that information.

14. The core information that the licensee should be seeking to understand when assessing the financial capacity of the consumer is:

    a. What post-loan available funds will the consumer have to services their financial obligations under the contract (given their other post-loan needs)?

    b. What is likely to materially change the above things during the life of the loan?

15. While inquiries about a consumer’s actual income, fixed expenses and variable expenses may, in most cases, be the best means of gathering information for the ‘not unsuitable’ assessment, other methods of understanding the consumer’s post-loan available funds could be effective in some situations (e.g. by understanding the consumer’s savings history).

16. In order to provide clearer and better guidance on ‘what’ inquiries and verification a licensee should make, and ‘what’ it should do with that information we identify a number of general issues relating to the responsible lending obligations that we believe need further consideration:

    a. **Privacy**: the responsible lending provisions inherently involve the invasion of a consumer’s privacy. In providing guidance, ASIC should recognise this and seek to ensure that the guidance does not result in unwarranted interference with the privacy of the consumer and third parties.

    b. **Meaning of reasonable**: the inquiries and verification steps required under the NCCP should be considered in conjunction with the substantive obligations to assess whether the loan is ‘not unsuitable’. Further guidance on this issue, that recognises the limitations of those inquiries and verification steps, would provide more clarity to licensees.

    c. **Meaning of ‘likely’**: while the Cash Store case has confirmed that ‘likely’ means a “a real chance or possibility”, in practice this raises significant issues as to when a loan must be assessed as “not unsuitable”.

    d. **Use of buffers, income shaving and future ‘upsides’**: our submission notes that there are many forms of buffers and suggest that further guidance is needed in respect of how such buffers work together.

    e. **Scalability**: we identify that additional guidance is required in relation to the concept of ‘scalability’.

17. We also identify a number of specific issues that we believe need further consideration:

    a. **Reducing expenditure**: we discuss whether, if a licensee has assumed a consumer will reduce their expenditure following a loan, the licensee must make further inquiries of the consumer. We identify that this will depend on the circumstances and the nature of the expenditure.

    b. **‘Lifestyle-choice’ spending, such as gambling, smoking and drinking**: we discuss the need for further guidance about these specific types of expenditure, including the need to ensure a licensee is not required to make unwarranted inferences with the consumer’s privacy.

    c. **Predicting future changes to a consumer’s financial situation**: we discuss the need for further guidance about the expectation for licensees to identify potential future changes to the consumer’s circumstances, particular where those changes are of a personal nature and attempts to identify possible changes (e.g. pregnancy) are likely to be seen as invasive and unwarranted.

    d. **Refinancing**: we recommend that further guidance is required in relation to refinancing applications, including that the fact a consumer has been maintaining the loan with another lender is relevant to the required inquiries and verification steps.

    e. **Unused credit card limits**: we suggest that further consideration of ASIC’s views in REP 590 is needed.

HOW

18. In the 'HOW' section, we note the flexibility provided by the NCCP responsible lending provisions and call for the RG209 guidance to recognise and support that flexibility. We also describe the work that is being commenced by ARCA to create 'standardised consents' for lenders to use as part of the Open Banking regime, and note how this could work with the guidance under RG209 (particularly in light of our comments in relation to the privacy of consumers and third parties).

Answers to questions in CP309

19. In our specific answers we:

    a. Reiterate our view that clearer and better guidance is required in RG209, however that guidance should continue to recognise the wide-range of consumer credit products and distribution models, and reinforce the flexibility that the responsible lending provisions give to a licensee to determine how they will comply with the law.

    b. Suggest that RG209 provide further guidance on how a licensee may implement a risk-based approach to their responsible lending obligations to better integrate their credit risk and responsible lending practices.

    c. Note our concern with the proposal to include a list of verification sources that are readily available.

    d. Suggest that the proposal relating to a licensee being required to have regard to verification sources potentially beyond the purpose for which it was obtained needs to be carefully formed (particularly in light of the issues relating to privacy identified in our submission).

    e. Discuss how benchmarks are used and how that impacts the level at which the benchmark should be set (including any buffers).

    f. Provide feedback on the proposals in relation to the use of repayment history information.

GENERAL OBSERVATIONS

20. We recognise that the development of guidance that is clear and consistent with the NCCP responsible lending obligations is challenging. While the overall intent of the law is clear (i.e. to reduce the risk of inappropriate lending), how that is to be achieved without inappropriately impacting the availability or cost of credit to Australian consumers and home buyers is complex. Likewise, while the wording of the responsible lending provisions appears, on first reading, to be clear, we consider that there is still significant uncertainty as to how those provisions can, and should, be interpreted.

21. It is important to develop the guidance with a clear understanding of both the aim of the law and the legal meaning of the provisions. The guidance should generally be targeted towards a licensee who is reputable and is trying to lend responsibly and efficiently. The guidance should not be based on the 'worst-case' scenario of poor compliance conduct and culture as is sometimes seen by ASIC (and was evident in the Cash Store case).

22. Based on the content in CP309 (particularly the proposals in C2), we are concerned that there may be a tendency for the guidance to simply be about 'more' – i.e. more inquiries, more verification etc – without an equal consideration given to whether those additional steps are 'reasonable' (see 155) or even effective (see 137).

23. It is important to recognise that the consequences for a licensee breaching the NCCP responsible lending provisions are punitive. However, the nature of making 'lending decisions'; which involves a significant degree of judgment, skill, experience and subjective assessment, means assessing compliance is not well suited to a black and white result of 'yes' or 'no'. Given the significant penalties that follow from a breach, a finding of guilt should require a clear and unambiguous failing to comply with the law. On this basis, we question whether the framing of the responsible lending obligations as civil penalty provisions was the best way to improve lending standards.

24. In practice, we consider that framing of the provisions in this way is likely to result in the court finding that they impose an overall standard that is lower than what they may be assumed to set. We note that it may have been more appropriate to develop the responsible lending obligations in the context of the 'unjust' contract provisions of the National Credit Code, supported by general license obligations under the NCCP (i.e. similar to the provisions related to complaints handling).

25. ASIC's review of RG209 is being undertaken at a time when there is significant attention being placed on licensee's lending practices, including that of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the Australian Prudential Regulation Authority's (APRA's) intervention in the home loan market in relation to investment and interest-only lending and the review of ARPA's credit risk prudential standard. At the same time, Australia is experiencing a significant drop in house prices, together with a perception of increasing credit tightening (that is often attributed, at least in part, to the responsible lending laws).

26. One of our Members has noted that this has created significant personal concern for some credit assessment staff that they will be prosecuted for failing to comply with the responsible lending laws. While an employee that is diligently following their employer's processes should never fear personal retribution, our Member reports that they are having difficulty convincing some staff that this is the case. This has resulted in some staff taking an extremely conservative approach to understanding the consumer's spending history, even where such expenditure was immaterial. The additional inquiries and verification steps being undertaken are both onerous and invasive for the consumer.

27. Despite all the things happening in relation to consumer credit, we do not think that this changes the approach that should be followed in respect of the guidance. The NCCP responsible lending provisions provide a flexible and scalable approach to the provision of credit to consumers who can afford it, and RG209 should continue to support and reinforce that approach.

28. We consider that our feedback in this submission supports that flexibility, while also identifying particular issues on which clearer and better guidance may be appropriate to improve clarity and compliance. The guidance in RG209 should continue to be in the form of principles and avoid making too many specific recommendations on the particular steps that the licensee 'should' take. This approach was strongly supported by almost all our Members.

29. However, ARCA received feedback from some Members supporting stricter guidance. The support for such stricter guidance was largely due to two reasons:

    a. To ensure a clear, level playing ground that doesn't allow for less scrupulous lenders to take advantage of a regulatory arbitrage situation (i.e. between those that seek to comply with the guidance and those that look for holes to exploit), which results in an unfair competitive landscape. (This concern was shared by all Members, including those who did not want to see prescription.)

    b. To remove uncertainty as to the regulators' expectations of licensees which, for those Members, is currently causing operational problems that are more significant (at least in the short term) than would result from even a complex and inflexible "tick the box" regulatory regime.

30. While we believe concerns raised by those advocating for more strict guidance are genuine, we remain of the view that more strict guidance would inhibit innovation, have adverse consumer outcomes in terms of experience and access to credit, and, ultimately, not prevent less scrupulous licensees from ignoring the regulator's guidance. Further, we believe the most effective way to address the concerns will be by developing clearer and better guidance in RG209, but in a manner which does not limit innovation or result in poorer consumer outcomes.

31. We note that developing such guidance will be assisted by the regulator and stakeholders now having over 8 years' experience of the responsible lending requirements. Our Members generally recognise that they have been on a learning curve with the responsible lending provisions and consider that there is room for developing better and more sophisticated methods of complying with the law. As noted in RG209.41, a lender's credit application and behavioural scoring systems can have a role in assisting the lender to meet its responsible lending obligations. Opportunities exist for lenders to align their risk and responsible lending practices and – just as importantly – be able to describe how those processes align. In this context, we note our comments in relation to the meaning of 'reasonable' (see 155).

32. Nevertheless, a consistent concern of our Members is the way in which the Australian Financial Complaints Authority (AFCA) has applied, and will apply, the responsible lending obligations. Importantly, our Members are concerned that any 'list' of inquiries and verification steps, or uses of data, included in RG209 will be treated as being a mandatory check list by AFCA. This is regardless of how such 'lists' are presented by ASIC in the guidance (e.g. as an 'illustrative' position only). Likewise, in the absence of guidance from ASIC as to the limit on what is required of licensees, AFCA may – typically with the benefit of hindsight judgment – place expectations on licensees to make inquiries and verification steps, and use the collected data, that goes beyond what is reasonable and can involve an unacceptable invasion of the privacy of the consumer and, potentially, third parties (see, for example, 194 and 207).

33. The process of completing this submission has emphasised to ARCA the complexity of the responsible lending provisions. Yet it has also demonstrated that there is still significant uncertainty and, potentially, disagreement on fundamental aspects of the regime (e.g. the meaning of 'substantial hardship', 'likely' and 'reasonable') that should be addressed before ASIC makes further guidance.

34. We believe that this first step in the consultation process is an excellent way of uncovering the various stakeholders' views on what the responsible lending provisions require (or should require). We believe that further consultation processes, including roundtable discussions, would also be an invaluable step prior to ASIC developing its further guidance. Likewise, to the extent that the guidance is developed on the basis of a particular interpretation of the meaning of the responsible lending provisions, transparency regarding ASIC's process to interpret those provisions will assist with understanding and acceptance of the guidance by stakeholders.

35. In preparing our submission, we have sought to closely analyse the purpose and meaning of the responsible lending provisions and, where appropriate, challenge existing assumptions that we consider may not be supportable. In doing so, some of our observations are of a technical or 'theoretical' nature, which may not be reflective of current practice.

36. This is most evident in our discussion of the manner in which a licensee could make inquiries of post-loan variable expenses, where we suggest that the most direct method of quantifying the amount of those expenses is to understand the consumer's post-loan circumstances and to apply a benchmark to identify an amount of funds which the consumer would need to avoid being in 'substantial hardship'. We note that this is different to the current practice of asking the consumer about their 'current' expenses or, for licensees with the capability, examining past transaction records. We are not suggesting that licensees need to change their practices as the current approach is likely going to be more efficient and easily undertaken. However, our analysis recognises that, in relation to satisfying the 'purpose' of the responsible lending provisions (and, we believe, the strict requirements, see 130), the inquiries regarding historical (i.e. pre-loan) variable expenditure is a means to estimate post-loan variable expenses, rather than being the end itself.

37. Likewise, we make several observations about 'how' a licensee may meet their obligations under the responsible lending provisions. Some of those methods are representative of a sophisticated compliance regime, which may not yet exist. Nevertheless, we consider that it is important that the guidance leaves open such possibilities as it gives something for licensees to strive toward.

38. Although we have questioned the basis or reasoning for some of the inquiries and verification steps that are currently seen as standard or even mandatory, we are not suggesting that compliance with the responsible lending obligations requires anything radically different to what ASIC has described in the existing RG209. However, a clearer recognition of the purpose and meaning of the responsible lending provisions helps to focus licensee's efforts on certain issues (e.g. as described in 37) and draws attention to issues where further guidance is necessary.

FIRST PRINCIPLES OF RESPONSIBLE LENDING – ‘WHY, WHAT, HOW’

39. The current RG209 – and the proposed changes within CP309 – largely focus on the inquiries and verifications steps that a licensee is required to undertake in order to satisfy the responsible lending obligations. That is, to not enter into a credit contract if it is likely that the contract will result in the consumer experiencing ‘substantial hardship’ (‘financial capacity assessment’) and whether the contract will meet the consumer’s ‘requirements and objectives’ (‘requirements and objectives assessment’).

40. In this submission, we focus on the need for clearer and better principles-based guidance in respect of the financial capacity assessment. We also observe that the two forms of assessment must be recognised as distinct – although, in some cases, related – obligations. We do, however, discuss the requirements and objectives assessment as it relates to the question of whether the lender must compare a consumer’s ‘lifestyle’ after the loan to the ‘lifestyle’ they had prior to the loan (see 63).

41. The financial capacity assessment obligation requires a lender to assess whether it is likely that a “consumer will be unable to comply with the consumer’s financial obligations under the contract, or could only comply with substantial hardship”. While there are two elements to the financial capacity assessment (i.e. ‘unable to comply’ vs ‘comply with substantial hardship’), we consider that the reference to “unable to comply” is, in practice, largely superseded by the reference to ‘comply with substantial hardship’. For example, provided the consumer’s net income is greater than the minimum loan repayments, the consumer will always theoretically be capable of meeting their obligations – if they do not spend any money on any other expenses. This would almost certainly mean that the consumer is only able to comply with ‘substantial hardship’.

42. Accordingly, for the sake of clarity in our submission we have simply referred to whether the loan would ‘result in substantial hardship for the consumer’ (or similar) as a summary of the financial capacity assessment, i.e. the avoidance of ‘substantial hardship’ is the harm that the law is trying to mitigate.

43. The current RG209, however, does not include a definitive definition of what is meant by ‘substantial hardship’ and, as a result, does not establish a clear understanding of the ‘harm’ that the law is intending to mitigate. Without this clarity, the guidance relating to ‘what’ a licensee must do to satisfy its responsible lending obligations risks lacking clarity and potentially leads to expectations in relation to the inquiries and verification steps that are not supported by the law. Likewise, without a clear understanding of what substantial hardship involves, a perception could arise that certain types of historical discretionary spending (e.g. ‘Uber eats’) could be seen as interfering with a consumer’s ability to afford the loan going forward.

44. For example, CP309 includes a proposed list of ‘verification sources’ that includes “contracts, invoices or accounts, or bank statements recording relevant transactions, for example: …regular entertainment or recreation services (pay tv, sports activities, telephone/internet costs outside plan schedule, gambling accounts)”. This infers that an inability to pay for these services following the loan would constitute ‘substantial hardship’ (i.e. the lender must make inquiries and take verification steps in respect of the consumer’s capacity to pay for these services).

45. The inclusion of the list of verification sources also infers that, if the customer has previously chosen to spend their disposable income on these types of services, this would potentially prevent the consumer from affording the loan, i.e. not having the disposable income to pay for the services after the loan presumably means the consumer is experiencing substantial hardship. For some of those services (i.e. pay tv, sports activities and, in most circumstances, gambling accounts – see our comments in 194 in relation to gambling) we strongly disagree that this is the case. Consumers will, by and large, be able to cease use and payment for those services, and assuming otherwise reduces the consumer’s freedom to choose how to spend their own money.

46. For these reasons, we believe that there is a need for ASIC to re-evaluate its guidance from a first principles basis, which we have described as being the ‘Why, What and How of Responsible Lending’.

47. We consider that the lending industry would benefit from clearer and better guidance on the ‘Why’ and ‘What’ elements of responsible lending.

48. There is also room for clearer and better guidance on the 'How' (i.e. how a licensee makes the expected inquiries and verification steps, and how it should use the information gathered), however that guidance should reinforce the flexibility provided by the responsible lending provisions, and should avoid providing lists of what 'should' be done or inflexible examples that do not recognise the multiple ways a licensee may comply. The guidance should be clear enough to avoid a regulatory arbitrage situation (as noted in 29). However, it is entirely appropriate for licensees to have freedom to innovate on the 'How'. For example, one lender may ask fewer questions at the inquiry stage and use a buffered-HEM figure to sense check a consumer's disclosed expenses. As a result, that lender takes a more conservative approach to how much it will lend. Another lender may take additional care in the inquiries stage and may invest in processes to better verify that information using data obtained through the Consumer Data Right – which may allow that lender to assess the loan using a lower expense figure and permit a higher value loan. Both of those lenders should be looking to do the same thing (i.e. the 'What') but should have freedom to determine 'How' they do it.

49. If ASIC does provide explicit guidance or examples on 'How' a licensee can comply with the responsible lending obligations, it should be made clear that such guidance or examples are only one way to comply and are not mandatory steps. In addition, ASIC should equally provide guidance on the limits to what a licensee is expected to do to comply with the responsible lending obligations, see, for example, 194 and 207.

WHY

50. The key question in relation to understanding the 'Why' of responsible lending (as it relates to financial capacity) is whether the consumer will experience 'substantial hardship' following the loan.

51. In the current RG209, ASIC notes that "it does not propose to give any definitive formulation of what substantial hardship means" (see RG209.97). CP309 does not contain any proposals to further define what is meant by 'substantial hardship'.

52. Nevertheless, ASIC does provide some observations (at RG209.97 onwards) that provide insight into what the regulator considers may constitute 'substantial hardship', including:

    a. referencing from a superannuation context that "whether a person is in 'severe financial hardship' is that 'the person is unable to meet reasonable and immediate family living expenses'".

    b. whether the consumer is likely to have to sell their assets, such as a car, to meet their payment obligations.

    c. not having sufficient funds for "realistic family living expenses" (see Example 10).

53. We believe that there are there are two key questions in respect of the meaning of 'substantial hardship' which require further guidance:

    a. Does the responsible lending obligation require an assessment of the consumer's post-loan financial capacity against their pre-loan capacity (i.e. a 'relative assessment)', or against a level of financial capacity that is objectively assessed as not involving 'substantial hardship' (i.e. an 'objective assessment')?

    b. What level of financial capacity represents 'substantial hardship', whether that is calculated as the difference in pre- and post-loan financial capacity (under the relative assessment) or an absolute measure of financial capacity (under the objective assessment)?

54. In the following sections we discuss these two issues and, through that discussion, propose the following formulation for when a licensee can assume the consumer is likely not to experience substantial hardship.

    A consumer will not, after the loan is given, experience substantial hardship if the consumer is predicted to be able to:

    (i) pay their forecast fixed expenses (including the proposed loan's repayments);

    (ii) pay their variable, non-discretionary expenses (assessed based on what is necessary for a consumer in their circumstances to live a modest lifestyle); and

    (iii) afford variable, discretionary expenses (assessed based on what is appropriate for a consumer in their circumstances to live a modest lifestyle)

55. It is important to note that we have constructed this formulation in the negative (i.e. when a consumer won't be in substantial hardship). We explain the reasons for this in 102 onwards.

56. The licensee would need to take reasonable steps, at the time of making the assessment, to ensure that this is true at the start of the loan and, based on what they know at the time of assessment, during the term of the loan (see discussion in 162).

Assuming perfect information to help understand the 'Why'

57. Before considering those two key questions, it is important to distinguish our discussion of the 'Why' element of responsible lending from the 'What' and 'How' elements. In this section on the 'Why' of responsible lending, we discuss the purely theoretical question of what harm the responsible lending assessment is intending to mitigate (as noted above, this submission focuses on assessing the financial capacity of the borrower rather than the whether the loan satisfies the consumer requirements and objectives; although see 82). The practicalities of undertaking the responsible lending assessment are discussed in the 'What' and 'How' sections.

58. In seeking to understand the 'Why' of responsible lending it is a useful exercise to assume that the licensee has all available information about the consumer's circumstances. This includes information about the consumer's current financial situation and matters that may potentially impact the consumer's future financial situation. In this way, the complexity associated with obtaining that information (i.e. the inquiries and verification steps) is kept separate from the theoretical consideration of when it should be deemed that a loan is 'likely' to result in a consumer experiencing substantial hardship.

59. In the real world, the licensee will always be dealing with imperfect information when making the responsible lending assessment. Whether it is the asymmetry of information under which the consumer invariably knows more about their own financial situation than the licensee, or the simple impossibility of ever having all information (including matters that will happen in the future and are dependent on unknowable factors such as human behaviour, illness or natural disaster).

60. The types of information that could, in a 'perfect information' situation be relevant to the lender's responsible lending assessment are almost endless. For example, apart from the standard issues of 'current' income and expenses, information such as the following could be relevant:

    a. Information about the consumer's personal circumstances that could impact future income or costs of living, including age, gender, race, religion, sexuality, disability etc. This could be through the impact on income or expenses due to the inherent nature of the circumstances (e.g. disability may require higher expenses) or through discrimination resulting from those matter (e.g. 'the glass ceiling').

    b. Information about a third party that could impact the consumer's ability to repay a loan, such as the likelihood that an ex-partner will pay their required child support payments.

    c. Information about economic or other circumstances (such as climate change) that could subsequently impact the consumer income or expenses (e.g. risk of bushfire or cyclone that destroys the consumer's home).

61. To be clear this is an overly detailed (but arguably not exhaustive) list of information that could potentially assist the licensee's assessment. It does not reflect what a licensee should or can know.

62. A licensee seeking to make inquiries about many of these types of information would involve a significant invasion of the consumer's right to privacy (see 144) and potentially anti-discrimination laws. In some cases, the general public may consider it acceptable for a licensee to make inquiries of the consumer directly regarding the information, but find attempts to verify that information – or derive that information from verification sources – unacceptable. Information that relates to another person is particularly problematic. See 159 for a discussion how of this may be relevant to what are 'reasonable' inquiries and verification steps.

Financial capacity assessment: relative vs objective assessment

63. This 'Why' section focuses on how the consumer's historical (i.e. pre-loan) and predicted post-loan variable expenses and expenditure are relevant to the financial capacity assessment. These types of spending are broadly equivalent to the term 'living expenses' as used in RG209.

64. We believe that it is important to recognise the distinction between the concept of 'expenses' (i.e. what a consumer needs to pay to avoid substantial hardship) and 'expenditure' (i.e. what the consumer has actually spent or what the consumer may like to have available to spend after the loan).

65. In respect of income and fixed expenses, the reason 'why' licensees are required to make inquiries and verify those matters is more clearly understood and accepted. For that reason, this section does not discuss the consumer income and fixed expenses in detail.

66. Most consumers will automatically adjust their level of variable spending based on their level of available funds. That is, if the consumer takes out a loan and then has less available funds due to the loan repayments, they will adjust their spending on other things. The extent to which a consumer can or will adjust their spending will depend on numerous factors, including their personal circumstances (e.g. where they live, number of dependents etc) and their pre-loan available funds.

67. It is important to recognise that both types of spending can, and will, be adjusted based on a consumer's available funds (assuming the consumer is not currently experiencing substantial hardship). For example, a consumer may reduce their non-discretionary expenditure on food by purchasing cheaper brands of food, or use less electricity by adjusting the thermostat setting on the heater. In the longer term, a consumer may reduce their housing costs by renting a cheaper property.

68. We believe that it is worthwhile to separate these two forms of expenditure as the approach taken by a licensee in making inquiries and verification, and how the information is used in the assessment, may change depending on whether the expenditure is 'necessary' (e.g. food, housing, health etc) or discretionary (e.g. entertainment, holidays etc) – although we recognise that the distinction between discretionary and non-discretionary is often blurred.

69. An example of how the approach can vary depending on the type of spending would be that for truly discretionary expenditure such as entertainment and holidays, it may be appropriate to assume the consumer is able to reduce this expenditure significantly, or even to zero (e.g. for a personal loan of 2 years it may be reasonable to assume the consumer would be able to have no holiday costs). However, it may be less acceptable to assume the consumer can reduce non-discretionary expenditure by as much (e.g. a consumer may be able to survive on baked beans and toast for 2 years, but that would not be generally seen as acceptable).

70. The ability to reduce spending based on available funds applies to the consumer's variable expenditure (including those that may involve 'regular commitments', such as gym memberships or pay TV accounts) – but not to expenses that are truly fixed (such as existing loan repayments which are not being refinanced by the loan).

71. It is possible for the distinction between 'fixed' and 'variable' expenditure to be blurred (noting that in the long run, everything is 'variable'), such as in relation to expenses like private school fees (i.e. a strictly technical view of such fees is that the expenses are variable if the child can be withdrawn at any time – particularly without financial penalty). We make proposals for guidance in relation to such expenditure in the 'What' section (see 207).

72. As with fixed and variable expenditure, the distinction between non-discretionary and discretionary expenditure can, at times, be blurred. This is particularly the case for expenditure that may relate to an addiction, such as smoking, gambling and drinking (noting that, at least for gambling and drinking, spending on such things by most consumers is not indicative of an addiction). Again, we discuss this issue in the 'What' section (see 194).

73. Subject to the above comments, a 'relative assessment' of whether a consumer is likely to experience substantial hardship following the loan involves comparing the consumer's historical (i.e. pre-loan) 'lifestyle' against the consumer's predicted (i.e. post-loan) 'lifestyle' after the loan. For example, if the consumer had high disposable income prior to the loan and lived a 'luxury' lifestyle, then high loan repayments (e.g. for a large home loan) may significantly reduce the consumer's disposable income such that they are required to live a more 'basic' lifestyle after the loan. An assessment done on a relative basis may deem such a required change to involve 'substantial hardship' for that particular consumer, even though they are still able to pay all their bills and costs of living (possibly more comfortably than many other Australians).

74. If the financial capacity assessment is assumed to require a relative assessment this has the following implications:

   a. A consumer' pre-loan lifestyle will require 'protection', such that licensees will have to apply a different standard to consumers living a 'luxury' lifestyle than those living a more 'basic' lifestyle.

   b. A consumer's autonomy and freedom to choose how to live their life will be reduced as a licensee will have to take steps to protect the consumer's pre-loan lifestyle. That is, a consumer, who has demonstrated a prior desire to live a particular lifestyle (i.e. through their pre-loan spending), will have a restricted ability to change their lifestyle in order to afford the loan. This leads to the current situation where a consumer's clearly discretionary and adjustable expenditure (e.g. Uber eats) are apparently preventing consumers from getting a loan.

   c. The uncertainty and lack of clarity relating to responsible lending is increased as there is no clear understanding of what substantial hardship involves as it dependent on each consumer's existing 'lifestyle' and how much that lifestyle will be required to change after the loan. This has flow on effects to credit availability, costs of credit etc.

75. An 'objective assessment' of whether a consumer is likely to experience substantial hardship following the loan involves comparing the consumer's probable 'lifestyle' after the loan to an objectively established minimum standard.

76. In this context, we would suggest that the 'objectively established minimum standard' ('minimum standard') would take into consideration such matters as the consumer's number of dependents and location as these are both relevant to the amount of funds necessary to afford the minimum standard (i.e. the standard is not one standard dollar figure but rather relates to the capacity to live the minimum standard 'lifestyle' – see 101). It would not take into account a consumer's income as this would introduce an element of a 'relative assessment' (although (i) see our comments in 82, relating to the requirements and objectives assessment; and (ii) we recognise that a consumer's fixed expenses are likely to be influenced by their income).

77. In the example above, an objective assessment of the consumer's probable financial capacity after the loan would find that the consumer would not be likely to experience substantial hardship (based on a comparison of the predicted post-loan lifestyle to the minimum standard).

78. We do not believe that such a minimum standard has been developed before (and in this respect the HEM model would be relevant but is not in itself the answer, see 104).

79. The implications of someone not satisfying the financial capacity assessment (i.e. they are deemed to be 'likely' to experience substantial hardship after the loan) must also be considered. As noted earlier, the financial capacity assessment should be distinguished from the requirements and objectives assessment. If a consumer does not satisfy the financial capacity assessment, the licensee must not proceed (e.g. the lender can't offer the loan). There is no option for the licensee and consumer to discuss potential changes to the consumer's lifestyle in order to afford the loan (although in practice, there may be an opportunity to clarify/correct some of the information that the licensee has relied upon in the assessment).

80. An objective assessment recognises that a consumer can – and should be permitted – to adjust their variable expenditure in order to afford the loan. By providing for a methodology based on a minimum standard of lifestyle that applies equally to all consumers, consumers will be treated equally under the law.

81. Accordingly, we recommend that the updated RG209 recognise that when undertaking the financial capacity assessment, whether the consumer is likely to experience substantial hardship following the loan generally requires an objective assessment (subject to a limited exception as discussed in 115). That is, a consumer is free to reduce their variable expenditure in order to afford the loan (subject to being able to maintain a minimum standard of lifestyle).

Relationship with the requirements and objectives assessment

82. As noted earlier, the NCCP responsible lending provisions require two forms of assessment; the financial capacity assessment and the requirements and objectives assessment.

83. The requirements and objectives assessment includes an assessment of the loan product, features etc to assess whether it meets the consumer's needs. This part of the 'not unsuitable' assessment is largely separate to the financial capacity assessment.

84. However, we believe there is a cross-over between the two forms of assessment to the extent that the licensee should ensure that the consumer's financial capacity after the loan is consistent with the consumer's requirements and objectives. For example, if the lender's approval of the loan is dependent on the consumer significantly reducing their variable expenditure compared to pre-loan expenditure, whether the consumer is aware of that assumption, and accepts it, is relevant to the requirements and objectives assessment.

85. This analysis is similar to the commentary in Example 6 in RG209, in which ASIC recognises that the financial capacity of the consumer may be relevant to the assessment of the consumer's requirements and objectives (in addition to the financial capacity assessment).

86. Similarly, in RG209.100, ASIC notes that:

    In addition, you may wish to take into account any other conversations that you have had with the consumer about how the credit contract or consumer lease will affect their living standards. For example, a consumer may be willing to make reasonable changes to their lifestyle to enable them to afford a loan without substantial hardship (such as cutting back on non-essential spending).

87. While the above paragraphs support the view that a consumer would be able to cut-back on their variable expenditure in order to afford the loan, the comment in RG209.100 is made in the context of what is 'substantial hardship'. We believe that this is more appropriately considered as part of the requirements and objectives assessment (in a similar way to Example 6).

88. We believe that it is important that the consumer understands if the loan is likely to require a significant change to their lifestyle (beyond what a consumer would naturally expect). Accordingly, while we consider that the financial capacity assessment allows for an objective assessment of the consumer's post-loan variable expenses, we also consider that the licensee should ensure that the lifestyle that has been 'assumed' in the financial capacity assessment is not inconsistent with the consumer's requirements and objectives for their post-loan lifestyle.

89. In theory, knowing the consumer's pre-loan expenditure is not necessary to make this assessment as the assessment simply relies on the consumer being comfortable with their post-loan lifestyle (rather than necessarily being a comparison to their pre-loan lifestyle). However, in many cases, the process of ensuring the consumer understands and accepts their post-loan lifestyle will be made easier by using their pre-loan lifestyle as a starting point of comparison.

90. It will be simplified further if the standard of lifestyle assumed as part of the assessment is similar to the consumer's pre-loan lifestyle (i.e. the assumed post-loan expenditure is similar to the pre-loan expenditure). For example, in this case the licensee may not need to make further inquiries of the consumer as the loan will not significantly impact the consumer's lifestyle.

91. We discuss this further in 185, however it may be appropriate to add this consideration to the list of factors relevant to the requirements and objectives assessment in RG209.122 (nothing that it will, of course, be subject to a scalable approach).

Implications of using an objective assessment

92. Recognising that the financial capacity assessment should be done on an objective basis has important implications for the required inquiries and verification steps.

93. As a summary of the discussion above, we consider that, in making the:

    a. financial capacity assessment, a consumer will not be likely to experience substantial hardship if they will have enough available post-loan funds to support a minimum standard of lifestyle (in addition to fixed expenses).

    b. requirements and objectives assessment, a loan will meet the consumer's requirements and objectives if the consumer is comfortable with the lifestyle that they will be able to afford post-loan (in addition to ensuring the loan product, features etc also meet the consumer's requirements and objectives).

94. This is only a starting point and what a licensee will or can do in order to meet their responsible lending obligations will be subject to the issues discussed in the 'What' and 'How' sections.

95. Significantly, this starting point emphasises the need to understand the consumer's circumstances that go to influencing their level of expenses, including how those circumstances may change after the loan. This could include the standard personal information, such as number of dependents and where the consumer lives. But it could also include more specific matters, such as whether the consumer has health needs that would change their variable expenses (noting our discussion in 144 and 207 regarding what is an inappropriate invasion of privacy).

96. From a requirements and objectives basis, it means that the licensee needs to take care to ensure that the loan does not, from the consumer's perspective, require a significant change to the consumer's lifestyle (beyond what a consumer would naturally expect).

97. It also clarifies understanding of why a licensee may need to make inquiries and take verification steps about the consumer's pre-loan expenditure. Simply because it is historical, a consumer's pre-loan variable expenditure has little or no direct relevance to whether the consumer will experience substantial hardship after the loan. In fact, a dogmatic approach to inquiring, verifying and using pre-loan expenditure can result in poor consumer outcomes. For example, if a consumer is borrowing money to buy a house, then using their pre-loan transport (e.g. car, public transport) expenditure could result in a poor lending decision if the consumer is moving much further away from their work location.

98. Accordingly, based on a recognition that an objective approach should be adopted, knowing the consumer's actual pre-loan expenditure is relevant to:

    a. Helping to understand the consumer's circumstances that influence their post-loan expenses (in addition to also helping to identify fixed expenses). For example, if a licensee has made inquiries as to whether the consumer has above average transport expenses, and the consumer has said they don't, significant spending at petrol stations shown on verification sources could give an indication that further inquiries are necessary. In practice, inquiries and verification of pre-loan expenditure may act as a partial replacement for inquiries around the consumer's circumstances as it may be easier to undertake those inquiries and verifications steps (compared to making inquiries about the more amorphous idea of the consumer's 'circumstances') – particularly if a relevant benchmarking tool is not available (see 105).

    b. Providing a base-line to help with the assessment of whether the loan meets the consumer's requirements and objectives (as described in 89) on the assumption that the consumer's pre-loan expenditure reflects a level of lifestyle that the consumer is satisfied with. Although we note that there could be other ways to do this, such as using a high assumed figure for the minimum standard of lifestyle and/or making very specific steps to understand the consumer's circumstances (where that process would provide the base-line for the requirements and objectives assessment).

99. In practice, we believe that licensees, and the regulators, have recently focussed on improving inquiry and verification processes in respect of consumers' pre-loan expenditure. However, this has potentially been at the cost of understanding the consumer's circumstances that resulted in that expenditure (and which may result in significantly different expenses after the loan). We would expect that better guidance on this issue would result in more focus on understanding the consumer's circumstances, rather than dogmatically inquiring, verifying and using pre-loan expenditure.

100. Subject to this guidance being given, we expect that many licensees will find it efficient and effective to use a mix of inquiries about the consumer's circumstances and their pre-loan expenditure to predict the consumer's predicted post-loan expenses.

Setting the ‘objectively established minimum standard’

101. The minimum standard is a level of lifestyle that is accepted as not involving the consumer experiencing ‘substantial hardship’. Based on a consumer’s circumstances, the licensee would then identify a required amount of available funds (after fixed expenses) to support that lifestyle, which would then be compared to the consumer’s predicted post-loan financial capacity. For example, if, for a single person, aged 25 years and living in suburban Melbourne, the required funds to live the minimum standard was $1,000 per month, then the consumer would pass the financial capacity assessment if the consumer’s predicted post-loan available funds was at least $1,000 per month (subject to the use of buffers, see 166).

102. As noted in 55, the formulation we have proposed as the test under the financial capacity assessment is structured in the negative (for the reasons discussed in further detail below). Accordingly, based on that formulation, the minimum standard actually results in a dollar figure which, if the consumer’s predicted post-loan financial capacity exceeds that figure, provides assurance that the consumer will not experience substantial hardship – however, it does not mean that the consumer would necessarily be experiencing financial hardship below that figure. Depending on the level at which the minimum standard was set, the licensee may be able to make further inquiries and take further verification steps to comfort themselves that the consumer was not likely to experience substantial hardship as a result of the loan (see 115 for a further discussion).

103. We do not propose to nominate a definitive description of the ‘minimum standard’ as this is something that would require input from all stakeholders. Although, for the purposes of this submission, we believe that the minimum standard should relate to a ‘modest’ lifestyle.

104. We do note that the HEM figure uses a median expenditure of ‘absolute basic’ goods and services (e.g. most food purchased from a supermarket, children’s clothing and child care) combined with the 25th percentile of expenditure on ‘discretionary basic’ goods and services (e.g. alcohol, eating out, domestic travel and adult clothing). Given the basis upon which the benchmark is calculated, HEM could be seen as setting a higher level that what we would consider reflects a ‘modest’ lifestyle (although we note ASIC’s view in CP309 that HEM reflects ‘low budget’ spending). In any case, the HEM figure is not directly relevant to this issue as it is a tool relevant to verification (if not a source of verification itself), rather than one that establishes what ‘substantial hardship’ looks like (i.e. it would be possible to lend on the basis of assumed post-loan expenses below the HEM figure provided the licensee has satisfied that it has taken adequate inquiries and verification steps).

105. It may be that, for the purposes of giving effect to our formulation, a different form of benchmark could be created. In creating the benchmark it would need to be recognised that: (i) as it effectively sets a minimum amount of funds that a consumer should have to afford the loan (subject to our comments in 115), setting it too high would inappropriately limit credit to a consumer who could afford it if they are willing to accept the required modest lifestyle; and (ii) as it is designed to represent a ‘modest’ lifestyle, additional care would need to be taken to ensure it is sufficiently adjustable to account for the variables that significantly influence a consumer’s financial needs (e.g. dependents, geographic location etc, but not income). Unlike the HEM benchmark, which provides one total ‘overall’ figure, it may be appropriate for a benchmark to provide a categorised figure for some of the major expense categories (e.g. food, utilities, health etc) as an additional precaution. For example, if a consumer had particular needs that meant their minimum needs for ‘health’ was higher than people who are otherwise shared their traits, the licensee could add an additional amount to this category.

106. We consider setting the minimum standard at a ‘modest’ level is still above the standard that is required to avoid ‘substantial hardship’ as that term is used in the NCCP responsible lending provisions. In fact, we believe that a strict legal interpretation of the meaning of ‘substantial hardship’ leads to the conclusion that the level of hardship that is relevant under the law is quite extreme.

107. As an illustration, the drafters of the NCCP felt it necessary to include a specific provision to deem that a consumer is experiencing substantial hardship if they are forced to sell their home in order to comply with their financial obligations under the contract (unless the contrary is proved). It is telling that the drafters felt that this provision was necessary as most people would assume that being forced to sell one’s home to pay a loan is already an extreme example of a consumer financially ‘struggling’.

108. We note that, given the punitive nature of the provisions and the significant penalties attached, it would make sense for ‘substantial hardship’, under the law, to relate only to a reasonably extreme level of hardship. This is particularly so, given the fact that lending ‘responsibly’ is not going to be a clear cut issue and the need to ensure that credit to Australian consumers is not overly restricted.

109. As an aside, we note the concept of 'hardship' is also raised in Division 3 of the National Credit Code. Despite the commentary in the Explanatory Memorandum for the NCCP Bill (at 3.154), we do not believe that direct parallels should be drawn between these two concepts as that would infer that the hardship processes in Division 3 were much more restricted than is generally considered. It is important to recognise the different contexts in which the 'hardship' concept is used. Under Division 3, hardship relates to a consumer unexpectedly, and for reasons beyond their control, being placed in a position of struggling to pay a loan already made, or being forced to adjust their lifestyle. In contrast, the responsible lending concept of 'substantial hardship' dictates whether a consumer can voluntarily and knowingly accept a particular level of 'lifestyle' in order to get the loan (where that lifestyle may be more basic than what they currently experience).

110. Despite our view about the legal meaning of 'substantial hardship', we do not believe that an overly narrow approach to assessing a consumer's financial capacity to 'afford a loan' (as opposed to not experiencing 'substantial hardship' as a result of the loan) is good for any stakeholders, including licensees. Accordingly, we have suggested that lenders treat the minimum standard as representing a 'modest lifestyle' (rather than something more basic).

111. In addition, setting the 'minimum standard' at a level that is above the threshold required under the law will help provide a 'buffer' that will reduce the compliance risk of licensees. For example, the minimum standard (and the associated minimum available funds required by the consumer) will depend on the circumstances of the particular consumer. Given the impossibility of ever getting 'perfect information', licensees will always struggle to be fully aware of all those relevant circumstances, however setting the minimum standard above the 'substantial hardship' threshold will reduce the compliance risk of not identifying all the relevant 'circumstances'.

ARCA's formulation

112. Based on the above, ARCA considers that a licensee can assume the consumer is not likely to experience substantial hardship based on the following formulation.

A consumer will not, after the loan is given, experience substantial hardship If the consumer has the predicted financial capacity to:

(i) pay their forecast fixed expenses (including the proposed loan's repayments);

(ii) pay their variable, non-discretionary expenses (based on what is necessary for a consumer in their circumstances to live a modest lifestyle); and

(iii) afford variable, discretionary expenses (based on what is appropriate for a consumer in their circumstances to live a modest lifestyle)

113. While the requirements relating to non-discretionary and discretionary expenses are largely the same (i.e. they involve a comparison against an idea of a 'modest' lifestyle), retaining the distinction emphasises that in practice, a licensee is likely to take a more stringent (or conservative) approach to setting the relevant dollar amount in respect of non-discretionary expenses.

114. For example, the licensee may take more steps to understand the consumer's circumstances that will impact their non-discretionary expenses. Or, a licensee may, for a reasonably short-term loan, assume a more basic version of the 'minimum standard' for discretionary expenses, compared to non-discretionary (i.e. as it would be possible for go without entertainment, holidays etc in the short term but not food, housing etc).

Consumers who may already be 'struggling'

115. As noted above, our formulation establishes when a licensee can be assured that a consumer will not experience substantial hardship after the loan. That formulation is based on a minimum standard of living associated with a 'modest' lifestyle, and the available funds that would be necessary to support that lifestyle.

116. The most recognised buffer, commonly referred to as an interest rate buffer, is the practice of adding an interest rate margin to a variable loan to allow for potential increases to interest rates, and also to provide for a general contingency for unexpected changes in expenses.

117. Some of these consumers should not be granted credit as it will result in, or add to, substantial hardship (so that the NCCP would prohibit the provision of further credit). However, other consumers may still benefit from credit even though they are currently ‘struggling’ yet not be in ‘substantial hardship’.

118. For such consumers, it may be appropriate to take a more ‘relative’ approach to the assessment (as opposed to the standard objective approach) to test whether the consumer’s life will be improved by the credit even though they may be struggling. For example, if a consumer who is struggling needs credit to purchase a household appliance, a relative assessment may determine that the benefit of the purchase outweighs the additional ‘hardship’ caused by that credit (noting, in all cases, a consumer could not be experiencing ‘substantial hardship’). Such an assessment would require a higher degree of care from the licensee in the inquiries and verification steps.

119. This approach is broadly consistent with the commentary in Example 12 in RG209 however that example discusses the ability of a struggling consumer being able to reduce their ‘financial’ hardship by refinancing their existing credit on terms that are better suited to them. It may be appropriate to also consider whether the provision of credit may reduce the consumer’s hardship as it exhibits in other forms (such as described above).

120. This is a complex issue and we think requires more discussion amongst stakeholders to ensure that a proper balance is reached between credit availability and ensuring consumers are not placed in loans that will cause substantial hardship.

Current RG209 approach to expenses

121. As noted earlier, the current RG209 refers to ‘living expenses’ without distinguishing between ‘non-discretionary’ and ‘discretionary’ expenses. The guidance doesn’t clearly indicate whether (and to what extent) a licensee must allow for a level of ‘discretionary’ expenses, although it does note (at RG209.33) that ‘reasonable inquiries’ may include “the consumer’s other expenditure that may be discretionary (such as entertainment, take-away food, alcohol, tobacco and gambling)” – without providing further context.

122. In addition to the matters noted in 85, Example 10 (Regular family expenses) in RG209 also states:

In assessing whether a credit contract will cause a consumer to experience substantial hardship, a credit licensee might set one or more levels of realistic family living expenses required to meet the consumer’s (and their dependants’) living costs. The consumer would need to be able to meet these living costs from their income, after deducting the ongoing repayments under the credit contract (and all other repayments and regular financial commitments of the consumer). Below this level, the licensee would, as a policy, not consider the consumer to have the capacity to repay the loan without substantial hardship, regardless of their circumstances.

123. Likewise, at RG209.106 the guidance states (emphasis added):

We would expect credit providers and lessors to have detailed policies and processes to assess whether a consumer will be able to meet their payment obligations under a credit contract or consumer lease. These include processes for calculating what funds a person needs to pay for basic living expenses in order to determine how much they can borrow or commit to making lease payments (i.e. at what level a consumer can make repayments).

124. The above two paragraphs appear to confirm that the ‘minimum standard’ for living expenses (i.e. variable non-discretionary and variable discretionary expenses) should be based on an objective assessment. However, we do note the potentially contradictory guidance referred to in 86, which may infer that a change to the consumer lifestyle is relevant to the issue of ‘substantial hardship’ rather than requirements and objectives.

125. In addition, we note that as licensees begin to get more visibility of a consumer’s expenditure through transaction data, there may be a temptation to treat that historic expenditure as evidence of what the ‘basic living expenses’ should be. We do not believe that this would be correct (particularly noting a consumer’s ability to vary their living expenses based on their available funds).

WHAT

126. In this section, we discuss ‘what’ is required of a licensee under the responsible lending provisions. That is, ‘what’ inquiries and verification steps should, or could, be taken in support of the ‘not unsuitable’ assessment required by the NCCP, and ‘what’ the licensee is supposed to do with that information. As with the previous section, our analysis focuses on the financial capacity assessment and the requirements and objectives assessment as it relates to the comparison of the consumer pre- and post-loan ‘lifestyle’ (see 82).

127. Our analysis in this section – which follows on from the conclusions in our discussion of the ‘Why’ – shows that it is not necessary (either under the NCCP or based on the ‘purpose’ of the responsible lending provisions) to always make inquiries and take verification steps in respect of the separate matters of ‘income’ and ‘expenses’ (including in relation to the actual dollar figures for those things). Further, given our discussion of the ‘Why’, we conclude that inquiries and verification steps in respect of a consumer’s pre-loan variable are not the most direct way of understanding whether the consumer’s post-loan variable expenses will result in the consumer experiencing substantial hardship.

128. We recognise, however, that making such inquiries (i.e. of the separate matters of ‘income’ and ‘expenses’), and taking steps to verify that information, may often be an appropriate means of obtaining information to assist with the ‘not unsuitable’ assessment (and may, in many circumstances, be the best means of doing so). Likewise, understanding a consumer’s past expenditure will go a long way to helping a licensee to understand a consumer’s future needs (and may be more efficient and effective than seeking to understand the consumer’s ‘circumstances’ which is otherwise a more direct indicator of the consumer’s post-loan needs).

129. By noting the above, our submission recognises that:

   a. Licensees who wish to invest in compliance may identify better, more efficient ways to understand a consumer’s ability to afford a loan than just inquiring about ‘income’ and ‘expenses’ as separate matters, such as by understanding the consumer’s savings history (being the difference between income and expenditure); and

   b. Licensees will better understand the context and reasons for making inquiries of, and seeking to verify, pre-loan expenditure. For example, recognising that such expenditure is only indicative of post-loan needs, highlights the potential need to understand how the loan will change those needs (particularly for home loan customers).

Interpreting the NCCP requirements

130. In this submission, we discuss what we consider to be effective inquiries and verification steps given the purpose of the NCCP responsible lending provisions (i.e. to mitigate the risk of a consumer experiencing substantial hardship as a result of the loan and ensure the loan meets the consumer’s requirements and objectives).We recognise, however, that the NCCP does imposes specific, procedural obligations on a licensee to make certain inquiries and verification steps.

131. We consider that, given the broad wording of those requirements, a purposive interpretation of the legislation allows licensees significant flexibility to determine the most appropriate means of complying. We do, however, believe that certain matters (see 133) would benefit from clarification within RG209.

132. We note that in respect of some of these matters, ASIC appears to have formed judgments as to the interpretation of the wording of the responsible lending provision (such as shown in RG209.30 – 32), some of which we do not believe are clear cut. To the extent that these interpretations have been drawn from commentary in the Cash Store case, we believe that that commentary be considered in the light of the circumstances of the case, i.e. an undefended application in respect of conduct that was clearly unacceptable. If ASIC gives guidance in RG209 that is based on a particular legal interpretation of the procedural requirements of the NCC responsible lending provisions, we think it would be appropriate for ASIC to take a transparent approach by publicising the reasoning behind that interpretation. This will assist with stakeholder understanding and acceptance of the guidance.

133. We consider the following interpretations are appropriate (using the provisions applicable to credit providers as an example):

a. The ‘financial situation’ (as referred to in s130(1)(b) and (c)) that is relevant to the financial capacity assessment is the one that will apply during the term of the loan.

We note that the Cash Store judgment referred to the ‘current’ financial situation, which is reflected in RG209.30.

In relation to the consumer’s fixed expenses and income, treating the consumer’s pre-loan situation as being the ‘current’ situation will generally be appropriate as it is likely that these matters will be unaffected by the loan. That is, the consumer’s income is unlikely to be affected by the loan. Likewise, the consumer’s obligation to meet their fixed expenses will not be affected by the loan, unless those fixed expenses are being paid out by the loan – in which case, the inquiries are clearly relevant.

However, we consider that it is not correct that a requirement to inquire about ‘current’ variable expenses requires a lender to make inquiries about pre-loan variable expenditure. As noted previously, a licensee may make inquiries about pre-loan variable expenditure as a means to understand and predict post-loan variable expenses. However, it is those post-loan variable expenses that are relevant to the consumer’s financial situation (see 142).

b. Inquiries ‘about’ the consumer’s financial situation (s130(1)(b) and (c) and s131(4)) do not always need to include the actual dollar figure for matters such as income and expenses.

We note that ASIC at RG209.30 state that the licensee is required to obtain information about the consumer’s “actual” income, expenses and other circumstances. We disagree with this view. While this will ordinarily be the approach taken by licensees, there are other possible ways to understand a consumer’s financial situation. For example, understanding a consumer’s circumstances that influence their post-loan needs is a more direct (although arguably more difficult) way of understanding the consumer’s likely post-loan variable expenses. As a further example, a licensee may not need to inquire about a consumer’s actual income if that consumer is subject to a mandated pay scale (where the loan is affordable based on the lowest salary in that scale) and the licensee has otherwise confirmed their employment.

c. There is no requirement to separately inquire about ‘income’ and ‘expenses’. Inquiring about a consumer’s savings history and current savings would, for example, be an inquiry ‘about the consumer’s financial situation’ (s130(1)(b) and s131(4)).

Again, we consider that ASIC’s observation in RG209.30 that licensees must obtain information “about the consumer’s actual income, expenses and other circumstances” is not correct. As noted by ASIC in RG209.18(b), a licensee is required “to determine whether the consumer has the capacity to meet their payment obligations under the credit contract or consumer lease being considered”. It is possible to make this assessment without inquiring about the consumer’s income and expenses as separate matters.

d. The requirement in s131(4) does not mean that the licensee is only limited to the use of information collected and verified under s130(1) as part of their assessment. A licensee may use other information that is still “information about the consumer’s financial situation, requirements or objectives”, including information that is derived or inferred from the information collected as part of the inquiries.

e. Inquiries under s130(1)(b) do not have to be inquiries made of the consumer. For example, a credit provider may make inquiries of their own data.

134. Despite the above statement, we recognise that the inquiries and verification steps taken by the licensee for a particular loan must be ‘reasonable’ for the situation (see our comments at 155 and 175).

135. It is possible for the flexible approach allowed by the NCCP to not work properly in some circumstances so that specific regulation may be required, such as was done with small amount credit contracts and unsolicited credit limit increases on credit cards.

136. If specific practices of licensees – which are otherwise compliant with the flexibility provided for in the general NCCP responsible lending obligations – are of concern, they should be addressed through regulatory change (whether by changing the NCCP or through ASIC exercising its powers under the NCCP (if available)). ASIC should not seek to ‘prohibit’ those practices through the provision of guidance as this risks creating a two-tier industry – those licensees who seek to comply with the regulator’s expectations and those who ignore that guidance to potentially gain a competitive advantage.

‘What’ a licensee is trying to understand

137. The core information that the licensee should be seeking to understand for the financial capacity assessment is:

    a. What post-loan available funds will the consumer have to services their financial obligations under the contract (given their other post-loan needs)?

    b. What is likely to materially change the above things during the life of the loan?

138. We note the above description is consistent with RG209.18(b) that describes the purpose of the reasonable inquiries about the consumer’s financial situation as being “to determine whether the consumer has the capacity to meet their payment obligations under the credit contract or consumer lease being considered”.

139. The consumer’s post-loan available funds will be the sum of:

    Incoming funds (e.g. salary, investment or business income, government benefits, gifts etc, or drawn down savings or investments in limited circumstances, see, for example, RG209.110)

    less

    Fixed expenses

    less

    Variable, non-discretionary expenses

    less

    Variable, discretionary expenses

140. In effect, this is the same sum as our formulation in 54 but simply showing the ‘inflow’ of funds as well as the ‘outflows’. Provided the sum above results in a consumer having positive available funds (i.e. a ‘surplus’), the loan will not – based on a point-in-time assessment – cause the consumer substantial hardship (although, see our comments in 166).

Inquiries and verification – what and when

141. In our submission, we have suggested that a detailed consideration of the purpose of the responsible lending provisions, i.e. what harm is the law intending to mitigate (see ‘Why’ section) indicates that different forms of inquiries and verification than are commonly adopted by licensees (and expected by the regulators) are permitted and, in an ideal situation, may be better suited to meeting the purpose of the law (although more difficult to undertake).

142. Our key points are summarised in the table below, including some resulting implications, and how this may impact licensees in practice.

KEY POINT	IMPLICATION	IMPACT TO LICENSEES
Whether the consumer can afford the loan depends on the amount of available funds they are predicted to have after the loan.	The licensee could short-cut the inquiries and verification processes to look at the consumer's regular savings pattern, rather than income and expenses (as this is a more direct measure of whether the "consumer has the capacity to meet their payment obligations under the credit contract", as per RG209.18). If the regular savings were greater than the loan repayments, the consumer could afford the loan. If the regular savings were less than the loan repayments, the licensee could make inquiries of the consumer to understand which particular pre-loan expenditure can be reduced in order to afford the loan. In each case, the licensee would need to understand whether the consumer's circumstances would change post-loan to impact the funds available.	Licensees are likely to continue make inquiries and verify income and expenses as separate matters; however, this could be used as a complementary method of assessment. Identifying this implication may assist with product or process innovation.
Variable expenditure is adjustable and, subject to understanding the consumer's circumstances that go to influencing the consumer's 'needs', it is open to the licensee to apply a variable expense figure based on a minimum standard of lifestyle.	Understanding the consumer's circumstances, and how they may change post-loan, is important. Understanding the consumer's pre-loan variable expenditure, while arguably not directly relevant to the financial capacity assessment, may be: • A way to help verify the consumer's circumstances in order to establish the minimum standard; and • Used as a proxy to identify an assumed variable expense figure (that reflects an acceptable standard of lifestyle for the consumer), in order to reduce the need to make inquiries about the consumer's circumstances (i.e. the consumer's pre-loan expenditure represents an acceptable standard of lifestyle).	Licensees may need to put additional focus on understanding the consumer circumstances that influence their post-loan variable expenses. However, this is arguably a more difficult task than reviewing a consumer's pre-loan expenditure. Likewise, detailed inquiries and, importantly, verification attempts to understand the detail of the consumer's circumstances may be invasive and unacceptable to consumers (see 144 and 207). In practice, licensees are likely to continue using the consumer's pre-loan expenditure as a proxy for the consumer's circumstances. However, recognising how this expenditure fits into the financial capacity assessment, will help licensees better use that information. For example, it makes it clear that pre-loan variable expenditure, such as Uber eats, does not prevent a consumer from affording the loan (i.e. that pre-loan expenditure is not assumed to continue).

KEY POINT	IMPLICATION	IMPACT TO LICENSEES
The lifestyle that the consumer can afford after the loan should meet the consumer's requirements and objectives.	A consumer's pre-loan expenditure does not prevent the consumer's free choice to change their post-loan lifestyle in order to afford the loan. The licensee may need to take action to ensure the consumer is comfortable with the post-loan lifestyle assumed as part of the assessment.	The extent of this obligation will depend significantly on scalability issues, such as: • The size and type of loan, e.g. a credit card provider may need to take less action, while home loan providers may need to take more. • The value of variable expenses that have been assumed as part of the financial capacity assessment, e.g. if the licensee has assessed the affordability of the loan allowing for a relatively high dollar figure of post-loan expenditure (ie that represents a higher lifestyle) there would be less need to confirm with the consumer whether they are satisfied with the assumed post-loan lifestyle. • How that the figure for assumed post-loan variable expenses was derived, e.g. if the assumed post-loan spending figure was derived from the consumer's pre-loan expenditure, it may be possible to assume the consumer was comfortable with that pre-loan lifestyle. While this assessment appears to be similar to that required under the financial capacity assessment, overall, we would expect the level of inquiries and verification done for this task may be lower than for the similar financial capacity assessment.

General issues impacting the responsible lending requirements

143. In the following section we discuss some general issues that impact what should be expected of a licensee when complying with the responsible lending obligations, i.e. making inquiries and taking verification steps, and using that information to assess whether the loan is 'not unsuitable'. We consider that these issues would benefit from clearer and better guidance in RG209.

Privacy implications of the responsible lending assessment

144. The responsible lending requirements involve a significant invasion of an individual's privacy. Depending on how they are interpreted by ASIC and applied by AFCA, the invasive nature of the inquiries and verification steps, and how the information is expected to be used, arguably results in an unnecessary and unacceptable interference with the consumer's right to privacy.

145. Importantly, the legislation potentially creates a requirement for private sector entities to collect and use an individual's personal information – including sensitive information – without any clear limitations, other through the vague concepts of what it is "reasonable" to collect and whether the information makes it "likely" that the contract would be unsuitable. As such, what are "reasonable" inquiry and verification steps and whether it is "likely" that the contract is unsuitable must be considered in light of the potential invasiveness of the responsible lending requirements of the NCCP.

146. Given the harsh penalties that apply to a failure to make “reasonable” inquiries and verification, or for providing unsuitable credit, there is a strong incentive for licensees to collect more information as a means of reducing compliance risk, such that there may be further unnecessary interference with the individual’s privacy.

147. We also note:

   a. There is an expectation (see, for example, the example written assessment in CP309) that licensees obtain information about third parties (i.e. individuals who are not a party to the credit contract), potentially in situations where the third party is not aware of the collection (e.g. obtaining information about child or spousal support payments paid by an estranged ex-partner).

   b. Likewise, there is potentially an expectation that a licensee should collect information relating to sensitive personal information such as physical health, mental health (see 205) and, potentially, reproductive intentions (see 212) if they are considered as being ‘likely’ to impact a consumer’s ability to afford the loan.

   c. Such expectation may not be limited to collecting that information directly from the individual concerned but could extend to collecting that information indirectly from verification sources (potentially where those verification sources were provided for completely separate reasons – see Proposal C2 in CP309).

   d. Given the unclear limitations on how a licensee is required to use the information, the licensee is not able to tell the individual clearly and definitively how their information is to be used.

148. Such outcomes are inconsistent with the expectations set out in the Australian Privacy Principles (APPs). To the extent that the APPs permit certain conduct if ‘required or authorised by or under Australian law, or a court/tribunal order’, given the imprecise drafting of the NCCP, it is in no way certain that such exemptions would apply – even if the licensee was purporting to act in accordance with ASIC’s guidance or a prior AFCA determination. Of course, whether or not the conduct is consistent with the APPs does not diminish the fact that the above outcomes involve an undeniable invasion of the consumer’s privacy.

149. Likewise, these outcomes are inconsistent with the Article 17 of the International Covenant on Civil and Political Rights:

   1. No one shall be subjected to arbitrary or unlawful interference with his privacy, family, home or correspondence, nor to unlawful attacks on his honour and reputation.

   2. Everyone has the right to the protection of the law against such interference or attacks.

150. The Human Rights (Parliamentary Scrutiny) Act 2011 (‘human rights scrutiny Act’), requires all bills and legislative instruments subject to disallowance to be accompanied by a statement of compatibility with certain core United Nations human rights treaties as they apply to Australia, including the International Covenant on Civil and Political Rights. Unfortunately, the human rights scrutiny Act was introduced after the NCCP Bill was considered and we believe that the requirements of the NCCP, including the responsible lending provisions, have not been reviewed under that Act.

151. The human rights scrutiny Act established the Parliamentary Joint Committee on Human Rights (Committee) which, in addition to scrutinising bills, can examine Acts and conduct broader inquiries on matters related to human rights referred to it by the Attorney-General.

152. Given the above, we recommend that ASIC, in preparing its guidance, closely consider the risk of the customers’ and third parties’ privacy being subject to severe and unwarranted interferences. We also recommend that the subject matter expertise of the Office of the Australian Information Commissioner be sought, potentially with the view to referring the NCCP responsible lending provisions to the Committee for consideration. We note that, to the extent that the Committee identifies inconsistencies with the relevant human rights, a court, when considering any ambiguity in the NCCP responsible lending provisions could refer to the Committee’s report in their judgment. This would assist with obtaining certainty in relation to the requirements of the NCCP responsible lending provisions and help ensure they are consistent with the International Covenant on Civil and Political Rights.

153. To assist with this consideration, we note that the proposed Consumer Data Right regime includes the following principles which reflect a modern approach to privacy and which may equally apply in respect of the collection of data for the responsible lending assessment (drawn from the ACCC CDR Rules Outline):

a. Data minimisation: a data recipient should minimise its collection and use of data (i.e. personal information) to the extent that is reasonably necessary to provide the product or services (or, in the case of the NCCP, to undertake the 'not unsuitable' assessment).

b. Clear consent: Consent must be voluntary, express, informed, specific as to purpose, time limited and easily withdrawn.

154. In addition, we recommend that, in respect of the specific issues impacting the responsible lending requirement, discussed below, the protection of the consumer and third parties from unwarranted invasions of their privacy be considered as a primary consideration.

Meaning of reasonable

155. Other than in respect of specific matters (e.g. small amount credit contract and reverse mortgages), the NCCP responsible lending requirements do not establish the particular inquiries and verification steps that are required of licensees. Rather, the legislation requires 'reasonable' inquiries and verification steps.

156. The current RG209 does not contain a detailed discussion of what is meant by 'reasonable' as it is used in relation to the inquiries and verification steps. We consider that a better understanding of the meaning of this term would assist in providing clearer and better guidance.

157. We consider that what is 'reasonable' must be considered in the context of the harm that the responsible lending provisions are intending to mitigate. In respect of the financial capacity assessment, the 'harm' is the likelihood of the consumer's experiencing substantial hardship as a result of the loan. The Cash Store case recognises (at paragraph 21) that the procedural requirements of the responsible lending obligations "must be read in conjunction" with the substantive obligation to assess whether the loan is 'not unsuitable'.

158. We consider that the following implications flow from the requirement to undertake 'reasonable' inquiries and verification steps:

a. It would not be 'reasonable' for a licensee to take detailed inquiries and verification of matters that are likely to be significantly different after the loan. e.g. where a consumer is applying for a home loan to purchase a property interstate (which necessitates a change of job), it is unlikely to be 'reasonable' for a licensee to undertake detailed inquiries about the consumer's existing income. Likewise, to the extent that the consumer's variable expenditure is related to the consumer's existing living arrangements, it is unlikely to be 'reasonable' for a licensee to undertake detailed inquiries about that spending. In both cases, the consumer's pre-loan situation is irrelevant to the question of whether the consumer can afford the loan. It would be more reasonable for the licensee to undertake inquiries and verification steps in respect of the post-loan matters.

b. Where a licensee can undertake different forms of inquiries and verification, what is 'reasonable' should be considered in all the circumstances, including the costs to the licensee and consumer, the privacy implications and the effectives of those steps in mitigating the targeted 'harm'. For example, if a lender is able to show that the 'consumer outcomes' in respect of a portfolio of customers is not materially improved through the imposition of a more onerous processes (which involve additional costs and invasion of the consumer's privacy), it would not therefore be 'reasonable' for the licensee to undertake those processes. In this context, we recognise that 'consumer outcomes' would require a consideration of a broader range of outcomes than just default/loss rates.

159. In developing guidance in respect of what constitutes 'reasonable' inquiries and verification steps, we think it is important to recognise the limitations on what a licensee can inquire and verify. As noted in 57, the licensee will always be making their assessment based on 'imperfect information'. Some of the most important information points that dictate whether a consumer will experience 'substantial hardship' cannot be collected or verified, such as whether the consumer:

a. intends to resign from their job or their job is at risk.

b. is likely to separate from their current partner (such that their living expenses will increase).

c. has failed to disclose all their dependents.

160. In respect of such matters, the licensee must take the consumer on their word (i.e. job status and dependents) or it is simply unacceptable to make the inquiry (relationship breakup). The licensee is largely dependent on the consumer either telling the truth or taking responsibility for their own financial wellbeing by not taking on credit when their personal circumstances do not support that additional liability.

161. In the context of what is 'reasonable' verification, if a consumer must be taken on their word in relation to significant matters as above, it appears less reasonable to require verification (as a standard practice) on less consequential matters.

'Likely' – meaning of "a real chance or possibility"

162. The NCCP 'not unsuitable' assessment provides that the contract will be unsuitable, "if, at the time of the assessment, it is likely that" the loan will cause the consumer substantial hardship or will not meet their requirements and objectives.

163. The concept of 'likely' is relevant in two ways: (i) whether it is 'likely' that a future change (or changes – see b, below) to the consumer's financial situation would result in the consumer experiencing substantial hardship (noting that it is not just a matter of whether the event is 'likely' to happen but also, if it does happen, whether it is 'likely' to result in substantial hardship to the consumer); and (ii) whether it is 'likely' that imprecise information used in the 'not unsuitable' assessment results in an inaccurate prediction of the consumer's financial capacity to afford the loan (recognising that the assessment will always involve a degree of estimation and assumptions).

164. The above matters are discussed further in our discussion of buffers (see 166), however, we consider that there is also lack of clarity in the meaning of the word "likely". For example:

    a. What level of 'likelihood' does it refer to? The Cash Store case notes the expression imports as a matter of ordinary meaning "a real chance or possibility" (see paragraph 23). In the context of the "not unsuitable" assessment, what are more 'remote' possibilities that do not need to considered?

    b. To what extent is the licensee expected to consider isolated changes affecting the consumer's financial situation, compared to the potential for multiple cumulative changes (where those changes may be related or independent of each other)? It may be more straightforward to account for significant isolated changes that may potentially impact the consumer's financial situation (e.g. increases in the interest rate of the home loan being taken out), than for the possibility of multiple, smaller changes that have the cumulative effect of making the loan unaffordable.

    c. In assessing the 'probability' of changes occurring, to what standard is the licensee being held? Is it to the standard of a 'reasonable person' or does it require the expertise of economists, futurists etc? While it may be reasonable to assume that very large licensees may have some of these skills available (but probably not all), it would be unrealistic and unfair to assume smaller licensees would have those skills available.

    d. Does the potentially availability of hardship assistance under the NCC mean that some forms of potential changes can be discounted for the purpose of the 'not unsuitable' assessment? See, for example, the natural disaster and medical examples below.

165. For example, should a licensee be required to deem it 'likely' that the consumer would not be able to afford the loan 'without substantial hardship' in the following situations:

    a. **Gambling**: if academic studies show that an 'active' gambler has a 10% risk of becoming a 'problem' gambler (which would affect their ability to afford the loan). In this context we would note that the outcome of the responsible lending provisions would mean that all consumers who meet the definition of an 'active' gambler would be deemed as 'likely' to experience substantial hardship, i.e. the 90% of active gamblers who are predicted not to become problem gamblers would not be able to access credit.

    b. **Natural disaster**: if meteorological evidence shows that a town in Far North Queensland is likely to have a devastating cyclone once every 59 years which would cause a consumer substantial hardship, so that the risk of a cyclone occurring over a 30 year loan term is slightly higher than 50% (noting our questions above regarding the relevance of the hardship variation provisions of the NCC). The impact would be that no person within that town would be able to access a 30-year home loan.

    c. **Medical**: if the consumer is in remission from cancer which has a 25% chance of re-occurring during the term of the credit contact (and which would result in the consumer not being able to work).

d. **Economic**: historical CPI rises suggest that it is virtually certain the consumer would not be able to afford a home loan over 30 years, but past history indicates that salary increases are most likely going to be enough to counter the CPI increases.

e. **Economic**: If a single mother dependent on welfare with three children under 10 has only a 25% probability of returning to the full-time workforce after the children cease to be dependents (and welfare payments are reduced). In this case, if the welfare payments associated with the children were critical to the serviceability of the loan, does it mean that single mothers in this and similar circumstances should never be granted credit?

'Likely' – buffers, income-shaving and future 'upsides'

166. Buffers can be used by licensees to help reduce the risk that a consumer is 'likely' to experience substantial hardship as a result of subsequent changes to the consumer's financial situation or through the reliance on imprecise information as part of the 'not unsuitable' assessment (see 163).

167. The most commonly recognised buffer is the practice of adding an interest rate margin to a variable home loan which tests whether the consumer would be able to afford higher repayments resulting from a potential future interest rate increase or other changes to their financial situation.

168. However, other common practices also apply a form of 'buffer' to reduce the likelihood of the consumer experiencing substantial hardship as a result of the loan, including, for example:

    a. Discounting (either in part or in full) some forms of income, such as overtime and bonuses, as part of the financial capacity assessment in recognition that there is a higher likelihood that this income may not continue ('income shaving').

    b. Using the HEM expense figure when it is higher than the consumer's disclosed figure to account for the possibility that the consumer may have understated their expenses (i.e. 'imprecise information' as described above) and as a replacement for undertaking further inquiries and verification steps.

    c. Providing for variable discretionary expenses in the affordability calculation (as per ARCA's formulation in 54) as this type of spending could be reduced in response to changes to the consumer's financial situation.

169. Any of the following practices would amount to an application of a buffer (i.e. by reducing the amount that the consumer could borrow compared to their 'raw' financial situation):

    a. Requiring a larger surplus (i.e. the result of the calculation in 139 would be set a figure higher the $1).

    b. Applying a fixed or percentage buffer on some or all the inflows or outflows in 139.

    c. Assuming a higher 'minimum standard' in respect of variable expenses (i.e. so that the cost base of the minimum standard is greater than what is required to avoid 'substantial hardship', which results in higher figures used in the variable expense components).

170. In practice, it is likely that a licensee will apply a mix of some or all these buffers.

171. What is important is for a lender to recognise what buffers are being applied and understand how they help address 'likely' future changes to the consumer's financial situation and impact what is 'reasonable' for the purposes of the responsible lending provisions (i.e. how they address the risk of imprecise information).

172. As part of this, the licensee should consider whether those buffers should apply independently of other buffers (i.e. which would have a cumulative effect in reducing assumed 'inflows' and increasing 'outflows') or whether they can be 'pooled' (i.e. so that one 'buffer' can account for multiple 'likely' future changes to the consumer's financial situation). This would depend on a number of issues, including whether changes are likely to be correlated or not.

173. For example, a licensee may need to consider whether it is appropriate to rely on the same buffer to account for potential interest rate increases on a home loan issued by that licensee and an existing home loan held by the consumer with another lender (i.e. given that it is likely that interest rate increases will happen to both loans at the same time). In this case, the licensee may need to keep the buffers separate or assume a higher single buffer. Whereas, the licensee may be able to rely on the same buffer to account for potential interest rate increases on the existing home loan and potential increases in the general cost of living (assuming the licensee can reasonably show that those changes are typically not correlated).

174. In addition to buffers, it is important to recognise the potential impact of future ‘upsides’ to the consumer’s financial capacity. This would ordinarily involve increases in salary, including both ‘cost-of-living’ increases but also increases that result from promotion or career progression. Although likely to be less significant, it could potentially also include reductions in expenses as goods or services become cheaper. Such upsides are key to a consumer being deemed to be able to afford a loan, particularly a home loan. For example, if a licensee had to assume a consumer’s income was fixed for the life of the loan, yet had to assume increases in expenses, it would almost certainly mean that no consumer could afford a loan over 30 years. In practice, we expect that most licensees would ordinarily assume that ‘cost-of-living’ increases to income will counter ordinary inflationary increase to expenses.

Scalability

175. The concept of ‘scalability’ recognises the flexibility that the NCCP responsible lending provisions provide to licensees to determine how they will meet their obligations under the law. ASIC includes useful guidance on this topic in Table 3 of the current RG209, however we believe that stakeholders would benefit from an expanded discussion of the factors relevant to scalability.

176. We note that this topic is complex and, as part of this submission, we identify and comment on the following issues and propose initial thoughts on possible solutions . We would welcome the opportunity to discuss these issues with you further.

177. The current factors in RG209’s Table 3 identify the ‘potential impact on the consumer of entering into an unsuitable credit contract or consumer lease’. We recognise that this should be one of the primary factors to be considered. Nevertheless, described in that way, it infers that a licensee is required to design its compliance processes to deal with all potential situations, i.e. to be able to scale up to the highest levels of inquiries and verification.

178. In practice, while it may be cost effective for a home loan provider to implement processes that allow for responsible lending processes to ‘scale up’ to that level, it would be less cost effective for the provider of lower value products such as personal loans and credit cards. As a result, the providers of those products may be less willing to service some consumer segments (i.e. on the basis that the required responsible lending assessment would be cost prohibitive) and those consumers may be forced to seek credit from more expensive providers (e.g. providers of payday loans).

179. At a minimum, the guidance should note that the relevant level of ‘scalability’ should be informed by an assessment of all the factors together, rather than each in isolation (which tends to result in the requirements being ‘scaled-up’).

180. While the guidance (at RG20.25) already recognises that “what amounts to a ‘reasonable level of inquiries’ and taking ‘reasonable steps to verify’ can differ, depending on the types of services and products you provide to consumers”, consideration should be given to providing clearer guidance that would allow a licensee to recognise the size of their loan products as a factor relevant to scalability, in conjunction with all the other factors identified in Table 3. To be clear, such guidance would not mean that, as a payday loan was ‘smaller’ than a small sized personal loan, the payday loan provider could automatically take less inquiries and verification steps (given the high-cost of their loan products and the fact that such providers often target more vulnerable consumer).

181. Likewise, consideration should be given to providing clearer guidance that recognises that a licensee’s own business model, including distribution channels, may be relevant to the issue of scalability. That is, what is ‘reasonable’ should include an assessment of what is cost effective, possible and practicable for the particular licensee. Such recognition would help to reduce some of the competitive disadvantage that the responsible lending provisions risk placing some licensees at (e.g. those who do not maintain ‘face to face’ channels).

182. In addition, we note that RG209’s Table 3 currently sets out factors in respect of the ‘capacity of the consumer to understand the credit contract or consumer lease’ as being relevant to the level of inquiries needed in respect of a consumer’s requirements and objectives. We believe a consumer’s financial experience and literacy should also be relevant to the level of inquiries and verification steps required generally.

183. In particular, a customer's financial experience and literacy can factor into a licensee's assessment as to whether:

a. the customer understands the impact of the proposed loan and likely to manage their financial circumstances to continue to avoid substantial hardship post-loan;

b. the customer understands if some of the identified features, benefits and costs of the product do not meet their requirements and objectives and has determined that the product is nevertheless not unsuitable for them (as set out in CP309 para 67(d));

c. the customer is aware of any specific behaviour that they are required to undertake if they are to access particular features or benefits of the credit product (as set out in CP309 para 67(e)).

Specific issues impacting the responsible lending requirement

184. In the following section we discuss some specific issues that arise in relation to the "not unsuitable" assessment. We note that any guidance provided in respect of these issues should be informed by the general issues discussed above. In particular, we believe that some of the issues may require guidance as to the limits of what a licensee is required to do so as to reduce the risk of a licensee inappropriately invading the consumer or a third party's privacy as part of the assessment (or, importantly, being expected to do so under ASIC's guidance or by the application of the responsible lending provisions by AFCA).

Reducing spending – requirement to make further inquiries

185. As noted in 66, a consumer will automatically adjust their level of variable expenditure based on the funds that they have available. We consider that the guidance in RG209 should recognise that, subject to a minimum threshold, a consumer will – and should have the freedom to – adjust the level of both their variable, non-discretionary expenditure and their variable, discretionary expenditure in order to qualify for the loan.

186. That guidance will also need to address what steps the licensee is required to take in order to confirm that the consumer is willing and able to reduce that spending. We note this issue will become more relevant as more licensees gain access to transaction data as part of the verification process.

187. Currently, a licensee's visibility of a consumer's expenses and expenditure will largely be formed by making direct inquiries of the consumer. If those inquiries show enough surplus based on the consumer's income, the consumer will be deemed to have the financial capacity to afford the loan. If there is not enough surplus, some Members have said that they will make further inquiries of the consumer (i.e. to see if the disclosed expenses can be reduced), while others have said they would reject the application. The approach followed may also depend on the type of credit contract (e.g. it is more likely to be a simple rejection for lower value products like credit cards).

188. If a licensee gains access to the consumer's transaction data, it will become more obvious whether the consumer will be required to reduce their spending in order to afford the loan, e.g. if a consumer has not been saving regularly, they will clearly need to reduce their spending. Such expenditure is likely to include both discretionary expenditure and non-discretionary expenditure at a higher level than what is required to maintain a 'modest' lifestyle.

189. We consider that whether a licensee is required to make additional inquiries of the consumer as to their ability and willingness to reduce that spending will depend on a number of factors, including the type of expenditure (e.g. a licensee may need to take more action if the reduction is required to non-discretionary expenditure), the significance of the required reduction and the manner in which the information was collected (i.e. by asking the consumer to nominate their expenses or through reviewing account statements).

190. It is, however, important that the guidance recognises that further inquiries of the consumer will not be necessary in all cases as this would impose a significant operational burden on licensees. As an example, we consider that it may be acceptable for a licensee to discount previous expenditure, without further inquiries, on clearly discretionary items such as Uber eats and also large, once-off expenditure like an overseas holidays or a wedding. We note that, as a separate a matter, a licensee would need to consider whether further inquiries would be required of the consumer as to the consumer's requirements and objectives (see 88).

191. A licensee may also need to recognise that certain types of expenditure that is ostensibly 'variable' may, due to their nature, be more akin to a 'fixed' expense.

192. A key example would be private school fees. Given both the significance of the expenditure and the implications of giving-up that expenditure (i.e. the requirement for the child to change schools), it would not be appropriate for a licensee to simply assume that the consumer can or would want to stop that spending. Accordingly, if the consumer's ability to afford the loan is subject to the consumer giving-up the private school fees, it would be appropriate for the licensee to explicitly confirm with the consumer that they are willing to reduce this form of spending. Such inquiries would need to be carefully recorded.

193. We consider that this issue would benefit from additional ASIC guidance.

'Lifestyle-choice' expenditure: gambling, smoking, drinking etc

194. Certain types of discretionary expenditure may potentially involve elements of 'addiction', including smoking, gambling and drinking. Such types of spending raise two related issues:

   a. Is it appropriate to treat the expenditure as 'discretionary' so that the licensee can assume the consumer is able to forgo the expenditure to afford the loan?

   b. Does the expenditure indicate an addiction that could impact the probability of the consumer experiencing substantial hardship (i.e. is there a risk the addiction could escalate so that they will not be able to afford the loan)?

195. We note that how this type of spending should be treated was subject to significant debate and difference in opinion among our Members. A key concern of Members was not to be placed in a position under which the licensee becomes the 'moral police' by judging how a consumer chooses to spend their money. Several Members considered that these types of spending should be treated no differently to all other types of variable, discretionary expenditure. That is, it can be assumed the consumer will reduce their spending in response to reduced post-loan available funds.

196. Likewise, there was concern across our Members that they may be expected to identify signs of addiction as part of the responsible lending assessment and, if they miss such signs, will be held accountable and liable to the consumer for losses caused by their addiction. As noted above, this expectation raises significant concerns regarding the invasion of a consumer's privacy – particularly if the expectation to identify signs of addiction involves obtaining that information indirectly from verification sources (which may require specialist knowledge that a licensee is not likely to have).

197. We consider that further consideration of this issue is necessary, particularly as it relates to a broader question of how vulnerable consumer are treated by licensees.

198. As a starting point, we consider that the mere fact that a consumer has chosen to spend their money on such lifestyle expenditure should be irrelevant to the responsible lending assessment if it does not impact the consumer's ability to afford the loan and there is no clear indication of problematic addiction (i.e. addiction that may result in escalating spending that would subsequently cause the consumer substantial hardship).

199. If, however, the consumer's ability to afford the loan is dependent on the consumer giving up spending money on potentially addictive lifestyle expenditure, the licensee may need to take some action to assess whether it is likely that the consumer has or will reduce that particular expenditure.

200. Of course, the licensee may, as part of their assessment, simply assume that the consumer will spend the same amount on these types of matters (so that they will reduce the consumer's ability to borrow money).

201. What would be required in respect of 'lifestyle-choice' spending would depend on both the type of expenditure (i.e. smoking, gambling or drinking) and the extent of the spending. In respect of our comments below, we note that our view is based on our understanding of the addictive nature of such activities. It may be appropriate for stakeholders (either individually or on an industry basis) to seek the input of experts on addiction to confirm the approach.

202. Drinking and gambling for most consumers will involve purely discretionary expenditure which can be given-up or reduced at will by the consumer. On that basis, a licensee should be entitled to accept that the consumer will give-up or reduce that expenditure on the same basis as any other discretionary expenditure (see 185).

203. Smoking is typically accepted as involving a strong physical addiction. Where a consumer's ability to afford the loan is dependent on the consumer giving up smoking, we consider that the licensee would need to consider the likelihood of that happening (i.e. what is the likelihood that the consumer will continue smoking and, instead, reduce spending on fixed expenses or non-discretionary spending for themselves or their family – potentially causing substantial hardship). We are not suggesting that the licensee should – or could – make this assessment on a consumer-by-consumer basis.

204. Rather, it may be appropriate for a licensee to point to evidence (e.g. developed by government smoking bodies) of the probability of an individual giving up smoking. If that evidence supported the view that most individuals can give up smoking, then it would be reasonable for the licensee to accept the consumer's statement that they would do so.

205. In respect of potentially problematic addiction, we believe that it is inappropriate for a licensee to be subject to a vague, unrestricted expectation to identify such behaviour. That is, a licensee should not be required to review verification documentation for signs of behaviour that may indicate the consumer is experiencing a mental illness. This would be a serious invasion of the privacy of all consumers who are subject to a responsible lending assessment and would place the licensee at significant risk of being judged in hindsight. For example, it would, in hindsight, be tempting to conclude that a consumer's developing gambling addiction should have been evident by regular cash advances made near gaming venues. However, given the number of people who work or live near gaming venues, this behaviour is much more likely to involve the innocuous conduct of using an ATM that was convenient.

206. Nevertheless, if it is possible to identify and document clear and specific indicia of a problematic addiction, it may be appropriate for licensees to look for such indications without any further obligation to proactively seek to identify such mental illnesses. We note that stakeholders (either individually or on an industry basis) could investigate developing a list of indicia (with the help of relevant experts). If this approach is followed, it would be important for ASIC's guidance to establish that licensees are expected to look for the indicia but no more. See also our comments (in 238) in relation to developing standardised consents in relation to Open Banking.

Predicting future changes to a consumer's financial situation

207. We consider that additional guidance is required in relation to the obligation for a licensee to predict future changes to the consumer's financial situation where those changes could relate to either personal, often sensitive matters, such as pregnancy or illness, or to broader changes that could impact the consumer, such as potential macro- or microeconomic changes.

208. Importantly, given the private and often sensitive nature of these potential matters, this guidance should recognise the limitations of what is expected of a licensee, particularly noting our comments in respect of privacy, above.

209. The guidance would need to address the expectation for licensees to predict the changes in the following situations:

   a. Where the change is potentially evident from verification sources (e.g. medical expenses; pregnancy-related expenses shown in transaction data).

   b. Based on general information about the consumer's personal situation (e.g. a consumer approaching likely/mandatory retirement age; a consumer within the age range where they may become pregnant).

   c. Based on general information that may impact the consumer (e.g. a consumer that works in a field that is likely to be disrupted by automation; a consumer that works for the major employer in a town where that employer is likely to close).

210. The current RG209.33 notes that 'reasonable inquiries' could include "any significant changes to the consumer's financial circumstances that are reasonably foreseeable (such as … changes to the consumer's employment arrangements such as … impending retirement and plans to fund retirement—for example, from superannuation or income-producing assets)". Example 9 in RG209 provides guidance on how a licensee may deal with a consumer approaching retirement age.

211. Some changes, such as impending retirement, will be obvious and inevitable, and inquiries in relation to those matters are unlikely to cause concern to the consumer.

212. However, many other changes will not be as ‘inevitable’ as retirement yet are still ‘likely’ to affect certain portions of the population (i.e. are arguably reasonably foreseeable). The most obvious example is that women within a certain age range (and, particularly, within a long-term relationship) are, depending on how the term is interpreted, ‘likely’ to become pregnant. Our Members have significant concern that the current guidance in RG209 would require them to treat the chance of a woman (and her partner, if applicable) becoming pregnant as being a “reasonably foreseeable” change when making the responsible lending assessment. The result of this would be to, potentially, require licensees to make specific inquiries of all consumers who are within a certain age band regarding their reproductive intentions. We believe that this approach would be unacceptable to most ordinary Australians and, in practice, would likely result in the unfortunate situation of many consumers misleading the licensee about their intentions.

213. Likewise, ARCA considers that an expectation that licensees ‘look’ for indications of personal matters, such as pregnancy or illness, within a consumer’s verification documents is an unreasonable invasion of the consumer’s privacy and would not be supported by the general public. In fact, from a privacy perspective, the expectation should be that lenders do not look for such signs.

214. In respect of micro- and macroeconomic changes, we note that care must be taken in respect of imposing expectations on a licensee to take account of such potential changes. At worst, the ‘possibility’ of a change impacting a group of consumers could become a self-fulfilling prophecy (i.e. as credit availability for that group dries up).

215. We believe that guidance in the following form would be appropriate:

   a. Licensees should make inquiries in general terms of the consumer about potential future changes. i.e. this would be in the form of a questions such as “Are you aware of any potential upcoming changes to your personal or financial situation that could impact your ability to pay the loan?” (or similar)

   b. Licensees may need to take further steps in relation to future changes that are clearly evident, imminent and inevitable, such as the consumer approaching retirement age, but not, for example, pregnancy.

   c. A pragmatic approach should be taken to what is ‘clearly evident, imminent and inevitable’, e.g. the fact that a 45 year old takes out a 30 year home loan does not necessarily raise any need to deal with the person’s retirement plans (i.e. as the average term of a home loan is significantly shorter). The guidance could include further principles that apply to when a change becomes ‘imminent’

   d. Otherwise, the licensee should not be required to take further steps to predict future changes (for the reasons discussed above).

Refinancing – less inquiries and verification required

216. We consider that further guidance is required in relation to a lender’s responsible lending obligations when assessing a loan that will refinance an existing loan.

217. The current RG209 (in Example 2) notes that a credit licensee offering a ‘debt consolidation service’ would be expected to “undertake a greater level of inquiries and verifications to gain a more comprehensive understanding of a consumer’s financial situation”.

218. The ability for a consumer to refinance their home loan (in particular) has been a key focus of government and regulators. For instance, reforms in 2011 removed a home loan provider’s ability to charge ‘exit fees’ to promote a consumer’s ability to easily switch home loans. Likewise, the Open Banking implementation of the Consumer Data Right has identified improving the ease of ‘switching’ as one of the key use cases for the sharing of bank data.

219. We consider that, while a lender may need to take additional steps in regards to a consumer’s requirements and objectives in refinancing (as set out in Example 2 and RG209.132), it should also be recognised that, when assessing what level of inquiries and verification is appropriate for a particular consumer, the fact that the consumer has been meeting (or even exceeding) their required payments on the existing loan is relevant.

Unused credit card limits

220. We believe that further consideration is required in relation to the expectation that licensees make the financial capacity assessment based on the assumption that a consumer will draw down the full balance of all their credit card limits – particularly given ASIC's expansive view set out in Report 580 Response to submissions on CP 303 Credit cards: Responsible lending assessments:

    We consider that it is consistent with the intent of the reform for credit licensees to assess applications for new consumer credit products on the basis that the consumer continues to have the capacity to repay their full financial obligations under an existing credit card contract within a reasonable time.

    Accordingly, we think credit licensees should consider assuming a higher amount of repayments consistent with repaying the full balance of the credit card within three years, and not merely their contractual minimum repayments.

221. A licensee is required to assess whether a consumer is likely to experience substantial hardship as a result of taking out a credit contract. The requirement introduced by, for example, s131(3AA) deems that, in respect to a credit card application made to the licensee, a consumer is likely to face substantial hardship if they do not have the capacity to repay the full limit within 3 years (as that period has been determined by ASIC). Nevertheless, the updated NCCP makes no reference to the treatment of other credit cards in that assessment, or the treatment of credit cards in credit applications generally.

222. The credit card reforms that introduced by s131(3AA) followed consideration of the issue by the Senate Standing Committee on Economics. The Committee noted that "too many Australians are struggling under the weight of high-interest bearing credit card debt that they have no prospect of repaying in the short-to-medium term". The Committee also observed that, "a problem arises when a cardholder consistently fails to pay their outstanding balance at the end of statement periods, and ends up using their credit card as a borrowing facility, rather than to manage cash" (see www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Credit_Card_Interest/Report/c05).

223. If, as noted by the Committee, the maintenance of a long-term balance on a credit card is a poor use of the card, there are numerous beneficial purposes for credit cards that do not involve the consumer using the card in a way that involves such debt.

224. For instance, a significant proportion of consumers use their card as a short-term, interest-free source of credit for their living expenses, which includes paying off the balance each month. In addition to the interest earned on their retained savings, those consumers may also receive other benefits, such as ease of payments, rewards points, insurances and other complimentary extras, and fraud protection. Consumers may hold multiple cards to use in particular circumstances to maximise those extra benefits. Likewise, a consumer may keep a card open to be used only in specific circumstances (such as when they travel overseas).

225. In those circumstances, the consumer is unlikely to experience substantial hardship as they will not need to make repayments that relate to their full credit limits. Likewise, they are unlikely to develop debt that they will struggle to pay off.

226. Requiring a licensee to consider the consumer's ability to pay the full limits of those other credit contracts within 3 years, while separately accounting for their living expenses, effectively double counts those expenses where there is evidence that the card is only used for month-to-month living expenses and not as a source of ongoing credit.

227. It is consistent with both the current general responsible lending requirements, and with the avoiding the harm identified by the Committee, for a consumer to be able to demonstrate to a new lender that they have not used their cards in a way that will cause substantial hardship following the provision of a new loan.

228. As observed in 136, following the review conducted by the Committee, the Parliament identified a particular concern with the practices of credit card providers and enacted specific provisions to deal with those concerns. We do not consider that it is appropriate for the guidance to impose additional expectations that go beyond those provisions, particularly where the guidance (if set out in same terms as REP 580) is not consistent with the purpose and requirements of the NCCP.

HOW

229. In this section, we discuss 'how' a licensee can undertake the inquiries and verification steps required by the responsible lending obligations, and 'how' it then uses that information in the 'not unsuitable' assessment. As with the previous section, our analysis focuses on the financial capacity assessment and the requirements and objectives assessment as it relates to the comparison of the consumer pre- and post-loan 'lifestyle' (see 82).

230. The responsible lending provisions of the NCCP are drafted in a way that provides flexibility for licensees to determine how they will comply. The guidance provided by ASIC should recognise and support that flexibility and be formed in a way that allows for innovation and rewards licensees who are prepared to invest in sophisticated responsible lending compliance systems.

231. We do not consider that the guidance given by ASIC should place limitations on how a licensee is to comply with their responsible lending obligations. Given the risk that ASIC's guidance will be treated as an inflexible 'tick the box' compliance requirement (particularly by AFCA) we believe that the guidance should avoid making too many specific recommendations as to the particular things that the licensee 'should' do. While examples can be useful to illustrate a point, the guidance needs to clearer identify the limitations of those examples (see 234).

232. Nevertheless, we consider that there is room for ASIC to provide clearer and better guidance to licensees on the principles to be applied by licensees when establishing their responsible lending compliance frameworks.

General clarification of existing guidance in RG209

233. As noted in 130, we believe that there a number of assumptions (either implicit or explicit) regarding the legal meaning of words in the responsible lending provisions that ASIC has made in providing its guidance. We believe such assumptions should be reviewed and, where necessary, the guidance should be transparent regarding those interpretations by including the reasoning for the interpretation.

234. ASIC's guidance generally assumes that inquiries will need to be made of the individual matters of income, fixed expenses and living expenses (see RG209.32). As noted in our submission, while this will often be the case, we do not consider that this is a mandatory requirement of the NCCP responsible lending provisions. We recommend that the guidance acknowledges that other forms of inquiries may be appropriate (e.g. inquiries as to the savings history of the consumer) and include principles-based guidance on when this may be appropriate. In addition, to the extent that the guidance continues to identify that inquiries of the separate matters of income, fixed expenses and living expenses are 'generally' required, we recommend that a further discussion of 'why' they are so required be included.

235. Likewise, RG209.33 includes a list of reasonable inquiries that 'could also' be made. Further guidance as to the 'circumstances of the particular consumer' would assist understanding.

Open Banking – standardised consents

236. ARCA has confirmed its strong support for the Consumer Data Right (CDR), of which Open Banking is the first implementation, and has noted in our submissions that:

    a. A lender's ability to successfully assess a consumer's credit worthiness and undertake the responsible lending assessment ('risk and responsible lending practices') is dependent on the availability and accessibility of relevant, accurate, and up-to-date data about the consumer.

    b. The CDR will make such data available (with the consent of the consumer) and so will help to improve a lender's risk and responsible lending practices (although we note the limitations described in C1Q1 in the 'Answers to questions in CP309' section). This is consistent with Treasury's observation that the CDR is "intended to support" improved compliance with regulations including the responsible lending obligations (Treasury, Privacy Impact Assessment, Consumer Data Right, March 2019, see p32).

    c. Despite the developments that allowed 'comprehensive credit reporting', Australia's credit reporting system still severely restricts the depth and breadth of data that may be reported in Australia compared to other markets such as the UK, Canada and the US. The CDR, particularly Open Banking, will provide access to additional data sets in respect of a consumer's credit arrangements, together with other data relevant to the risk and responsible lending assessment.

d. It is likely that lenders will rely on a combination of credit reporting data and CDR data to make the risk and responsible lending assessment. It is also likely that some – if not most – lenders will at some point make consent to access CDR data a precondition of making an application for credit (see C1Q1 in the 'Answers to questions in CP309' section, where we note guidance may be necessary to address the situation of a consumer refusing consent).

e. Unlike the credit reporting system – which strictly limits the types of information that can be shared, the entities with whom it can be shared and the uses for which it can be used – the CDR regime is based on consumer 'consent' (although the Australian Competition and Consumer Commission has suggested certain 'prohibited uses and disclosures').

f. While the rules will provide that consent must be "voluntary, express, informed, specific as to purpose, time limited and easily withdrawn", the limits on a consumer's ability to understand and appreciate what they are consenting to is widely acknowledged.

g. Also, given the number – and range – of businesses that are likely to be active data recipients, it will be a significant task for the regulators (ACCC and OAIC) to oversee how businesses are collecting and using data obtained under the CDR regime.

237. On that basis, ARCA has identified that that there is a clear opportunity to create a number of 'standardised consents' in respect of use cases for CDR data that are high volume, complex and sensitive applications, including risk and responsible lending practices. Such standardised consents would set out the form of consent, the types of data included and the purposes for which the data is used. In this way, a consumer would see a common consent across all similar data recipients, which will remove complexity and ensure transparency – which, in turn will maximise consumer acceptance and engagement with the Consumer Data Right. Further, the task of regulating the collecting and use of data by data recipients using the standardised consents will be simplified.

238. ARCA, in consultation with its Members, is about to commence work on developing a range of risk and responsible lending standardised consents. An important aspect of standardising the consents is to establish the data that credit providers need (and therefore should access), and how that data should be used, to undertake their risk and responsible lending processes. Accordingly, this process will be informed by the guidance that ASIC has provided in the current RG209, and by the updated guidance coming out of this review process.

239. However, we note that the process of developing the standardised consents may also help address some of the issues that ARCA has identified in our submission, particularly relating to how the guidance in RG209 can better protect the privacy of consumers and third parties. For example, subject to ASIC's guidance, in developing the standardised consents, the limits on what a lender will and won't use the data for could be documented (see 194 and 207) which would allow a lender to properly inform the consumer on how their data will be used.

ANSWERS TO QUESTIONS IN CP309

PROPOSAL	YOUR FEEDBACK	
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?	ARCA does not consider that ASIC should identify the inquiries and verification steps that should be taken. The NCCP responsible lending requirements are written in a way that permits flexibility and allows innovation. Including a list of steps that a licensee 'should' take will inevitably limit that flexibility and reduce innovation, even if that list was presented as a 'starting point' only. Further we consider that guidance would have adverse consumer outcomes in terms of experience and access to credit, and, ultimately, not prevent less scrupulous licensees from ignoring the regulator's guidance (where it does not clearly reflect the *requirements* of the law). By including such a list, the guidance is likely to encourage a 'tick-the-box' approach to compliance that does not improve consumer outcomes and results in higher costs. Nevertheless, we believe that there is a need for clearer and better principles-based guidance on the matters identified in our submission. In developing that additional principles-based guidance, we recommend that ASIC reconsider the requirements of the NCCP responsible lending provisions from a first principles basis. This would include providing guidance on the meaning of fundamental aspects of the responsible lending provisions, such as the meaning of the terms 'substantial hardship', 'reasonable' and 'likely'. In the absence of such clarity, the guidance in RG209 will not provide appropriate context to what ASIC expects of licensees. The guidance in RG209 should recognise the wide-range of consumer credit products and types of credit providers (e.g. size, sophistication and distribution models) and reinforce the flexibility that the responsible lending provisions give to a licensee to determine how they will comply with the law.
	B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.	As noted in B1Q1, the guidance should not limit the ways in which a licensee may seek to satisfy the NCCP responsible lending requirements. However, further principles-based guidance that better outlines how a licensee could take a risk-based approach to the responsible lending requirements would assist a licensee to better integrate their credit risk and responsible lending practices. Many licensees (particularly credit providers) maintain sophisticated credit risk processes that, based on their experience, are better able to predict the likelihood of a consumer repaying compared to a basic review of a consumer's pre-loan 'inflows' (e.g. salary) and 'outflows' (e.g. expenses and expenditure). While we recognise that the NCCP responsible lending obligations require a licensee to consider the consumer's 'capacity' to repay (not just the likelihood), a risk-based approach would allow a licensee to more efficiently assess a loan application from consumers who are considered 'low-risk' (on an integrated basis) while taking more stringent inquiries and verification steps of a consumer who has indicators of higher risk.

PROPOSAL	YOUR FEEDBACK	
		While the current RG209 includes guidance in respect of 'scalability', we believe that this guidance should be expanded upon and informed by the additional guidance that we have recommended in respect of the meaning of 'reasonable' and 'likely' as they are used in the responsible lending provisions, and the need to limit how those provisions result in an invasion of a consumer's privacy. A risk-based approach would allow licensees to take a simplified approach to inquiries and verification for low risk consumers, and a more stringent approach to higher-risk consumers. In this context, higher risk could be based on the 'scalability' matters identified in the current RG209 but could also include, for example, the consumer's behavioural score. By its nature, a risk-based approach is not fool proof. It is possible that, even with an effective and efficiency process, a consumer may be deemed 'low risk' (so that a simplified inquiries and verification process is used) even though a more stringent process may have identified concerns regarding the financial situation. The guidance must recognise that the inquiries and verification steps taken by the licensee, based on their assessment of the consumer as 'low risk' were still 'reasonable' even though additional steps may have identified relevant information.
	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.	While we do not support the inclusion of a list of credit products, consumer or circumstances, we believe that clearer and better guidance in relation to the principles to be applied would be appropriate, including in relation to: • Consumers that are refinancing a loan (see 216). • Consumers with a higher degree of financial literacy and experience (see 182)
	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	The licensee needs to inquire about a consumer's capacity to service the loan. While this may ordinarily involve making inquiries about the consumer's 'inflows' (e.g. income) and 'outflows' (e.g. expenditure) as separate matters, the guidance should not state that it must be done in all circumstances. The guidance should recognise other means of doing this, such as through inquiries and verification of savings history. As noted in 215, it may be appropriate for a licensee to ask a consumer a general question as to whether the consumer anticipates future changes to their circumstances that could materially impact their financial situation.

PROPOSAL	YOUR FEEDBACK	
	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	The licensee needs to take steps to verify a consumer's capacity to service the loan. While this may ordinarily involve verifying elements of the consumer's income, fixed expenses and living expenses the guidance should not state that these individual matters must be done in all circumstances. The guidance should recognise other means of doing this, such as through inquiries and verification of savings history, and the requirement to verify is always subject to what's reasonable in light of the substantive obligations (see 157).
	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?	See our response to B1Q1.
	B1Q7 What would be the effect on business costs of ASIC identifying particular inquiries and verification steps? Please provide details of the effect on compliance costs for the licensee, and any factors that are likely to affect the level of cost or cost savings	See our response to B1Q1.
	B1Q8 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.	See our response to B1Q1.

PROPOSAL	YOUR FEEDBACK	
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?	We are concerned that the inclusion of the list of verification sources without a clear description of the reasons why such verification needs to be made will result in the list being treated as a mandatory and inflexible checklist. See, for example, our commentary in 44 in relation to the verifying sources of Living Expenses in Table 4 of Appendix 1 (where we note that we believe that a consumer's ability to pay for things such as pay tv is unlikely to be relevant to whether a consumer will experience 'substantial hardship' and, on that basis, should not be subject to the verification requirement). The general guidance in RG209 must first be clarified to provide a better explanation of why and when those verification sources will be relevant. We note that many of the verification sources are stated as being 'readily available from consumer'. We disagree that this is the case. The mere fact that a consumer may have the ability to access documents does not mean that the documents are 'readily' available. The Consumer Data Right reforms recognise that, while a consumer may have 'access' to their data (e.g. banking, utilities etc) it is not currently an easy process to share that data. From a consumer's perspective, it is likely that a consumer would recognise and accept the need to provide some of the forms of verification for larger loans such as a home loan. However, consumers would likely consider it to be an onerous and invasive process to provide those documents for a simpler loan product, such as a credit card (particularly if this is required of all consumers; see our comments in B1Q2 about taking a risk-based approach to inquiries and verification). In addition, the 'availability' of those verification sources should not be considered in isolation; consideration must be given to the circumstances in which the assessment is being undertaken. For example, it would not be realistic to assume that the verification documents would be 'readily' available to a consumer making an application for credit while shopping in a retail store. What is 'reasonable' must be assessed in light of a broad range of factors, including the distribution channels used by the licensee (noting, again, our comments in B1Q2 about taking a risk-based approach to inquiries and verification). In respect of the proposal that 'reasonable steps' will change over time, we agree that certain developments will make it easier for licensees to verify elements of the consumer's financial situation. For example, the introduction of Open Banking may make it easier for the credit provider in the paragraph above to verify elements of the consumer's financial situation through the Open Banking regime as it would no longer be reliant on the consumer coming into the store with their paper documentation. However, the guidance should acknowledge that this would be subject to consideration of the purpose of verification as discussed in the Why section of our submission, together with the general issues identified in the What section (particularly those related to privacy). The limitations of new data sources (such as through Open Banking or account aggregation services) should be recognised. Such data sources are not a panacea to all issues of inquiries and verification.

PROPOSAL	YOUR FEEDBACK	
		Transaction data and other account data may provide a better source of verifying (or even inquiring about) certain types of information. For example, they will show: • the balance of credit products and the payments actually made (noting that in other developed economies this information is available through the credit reporting system). • the existence of undisclosed liabilities (through payments from the accounts). • amounts paid for certain non-discretionary expenditure where the amount paid is likely to be a better representation of what the consumer's actual minimum requirements. This would include electricity and gas bills where it is unlikely that a consumer would choose to pay higher amounts (this should be contrasted with other non-discretionary expenditure as discussed below). However, those data sources will not, by themselves, show definitively what a consumer's required variable post-loan expenses (i.e. 'living expenses) are, noting that: • the transaction data will only show the amount spent at a particular shop; not the items bought. For example, it will show that $100 was spent at Woolworths but not whether that was made up of 'necessities' or discretionary items, or even a cash withdrawal. Likewise, $100 spent at a service station does not indicate that the consumer spent that much on transport expenses given that other items can be purchased. • as discussed in the Why section, the mere fact that a consumer spent a particular amount on a non-discretionary item in the past, does not mean that this represents what the consumer 'needs' to have available post-loan in order to avoid substantial hardship. For example, the pre-loan spending may have included more expensive versions of the non-discretionary spending. In practice, a credit provider is likely to still need to apply their own commercial judgment to interpret the data. This could include developing and applying benchmarks in respect of the data e.g. a benchmark that treated a certain percentage of supermarket spending as 'non-discretionary'). The guidance should also recognise that, unlike the credit reporting system, access to these data sources are subject to the consent of the consumer (and, in the case of Open Banking, the restrictions imposed under the Consumer Data Right regime). Guidance will be required to address whether ASIC considers that a credit provider is required or permitted to refuse to accept an application if the consumer doesn't provide consent.

PROPOSAL	YOUR FEEDBACK	
	C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?	We consider that the list of verification sources: • does not recognise forms of verification that may be an effective method of confirming a consumer's ability to afford the loan (such account statements showing savings history, see B1Q5 and our comments at 133(b) relating to alternate methods of verifying income); and • includes examples of verification documents (particularly relating to expenses) without an adequate consideration of the relevance (see 44) or materiality (see 159) of the matters being verified to the consumer's financial situation.
	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?	See our comment in C1Q1.

PROPOSAL	YOUR FEEDBACK	
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.**	**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?	We recognise that it may be inappropriate for a licensee to ignore information on a verification source that is clearly relevant to the responsible lending assessment. However, any such guidance should consider and apply the general and specifics issues raised in the 'What' section, particularly those relating to privacy, the meaning of 'likely' and 'reasonable', and the need to predict future matters. A licensee must have clarity on the principles that it should be applying when reviewing verification documents for relevant information. Such principles should acknowledge the issues we have identified in respect of the privacy of the consumer and, potentially, third parties (see 144). They must also recognise and support the ability of licensees to use automated systems to review verification documents; it cannot be assumed that a human will review those documents. It is unreasonable for a licensee to have an open-ended obligation to look for anything that may, potentially, be relevant to the consumer's financial situation and places too high a risk of 'hindsight' judgment being applied if the consumer subsequently has trouble meeting their obligations. The guidance should recognise that in some cases it may be appropriate: • to look for specific indications of matters that are potentially relevant to the consumer financial situation, without a requirement to look beyond those indications (see our comments regarding looking for signs of problematic gambling in 205). • to not look for indications of specific matters giving the need to limit the invasion of a consumer's privacy (see our comments regarding pregnancy in 212).
	C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?	See our comment in C2Q1.
	C2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	See our comments in C2Q1 regarding the potential for guidance that places limits on what a licensee is required to 'look for'. In the absence of such limits, it is likely that consumers' privacy will be subject to unacceptable interference.
	C2Q4 What additional business costs would be involved in this approach?	Guidance that does not clearly define the extent of a licensee's obligation to identify inconsistent information in the verifying document is likely to increase costs for those licensees who are trying to meet the regulator's expectations.

PROPOSAL	YOUR FEEDBACK	
	C2Q5 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.	See our comment in C2Q4.
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;**	**C3Q1** Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?	Proposal C3 relates to the use of benchmarks for 'validation' purposes, i.e. to assess whether the information collected from the consumer is 'plausible' and to decide whether (based on a risk- based approach) it is necessary to undertake verification of the particular elements of the consumer's financial situation (i.e. income; fixed expenses; variable, non-discretionary expenses; variable, discretionary expenses). We believe that it is important to recognise that there are multiple possible ways to use a benchmark in the responsible lending assessment. As discussed in the 'Why' section, a consumer's disclosed pre-loan variable expenditure is relevant to whether the loan meets the consumer's requirements and objectives (i.e. whether the consumer is required to significantly reduce that expenditure – and, change their lifestyle – in order to afford the loan). However, a consumer will, for the purposes of the financial capacity assessment, not experience substantial hardship if they have enough available post-loan funds (for their variable expenditure) to support a 'modest lifestyle' (where those available funds are calculated on an objective basis). A form of benchmark can be used for both these purposes and the approach to calculating the benchmark will depend on how it is being used. We discuss below how these benchmarks could, in-theory, be used and how that relates to the way benchmarks are currently used by licensees. In addition to the two situations described below, we also note our comments in C1Q1 regarding the use of benchmarks to help understand transaction data. **Benchmarks – requirements & objective assessment** A licensee may make inquiries of the consumer about their 'current' living expenses (which is likely to reflect the consumer's pre-loan variable expenditure). For the purposes of the requirements and objectives assessment, the licensee would compare this expenditure (and, by inference, the pre-loan lifestyle that it represents) to the level of available expenditure that has been assumed as part of affordability assessment. If the assumed available expenditure is significantly less than the pre-loan expenditure, the licensee may need to take make further inquiries of the consumer to confirm that the loan meets their requirements and objectives. If the consumer has understated their pre-loan expenditure, the licensee may not recognise that the loan will require a *significant* change to the consumer's lifestyle and, as a result, the loan may not meet the consumer requirements and objectives (i.e. if the licensee does not make further inquiries).

PROPOSAL	YOUR FEEDBACK	
(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.		The licensee may use the benchmark as a validation tool to assess the risk of the consumer understating their pre-loan expenditure. This recognises that consumers often find it difficult to quantify how they have spent their money (which could result in an under- or overstatement). How effective this validation step is will depend on the level of expenditure given by the benchmark (and, by inference, the lifestyle that it represents). As noted in CP309, the HEM figure is based on the spending of Australian consumers at particular 'percentiles' (with the HEM figure used by licensees typically calculated at the median absolute basic spending and the 25th percentile for discretionary basic spending). Therefore, a person whose *actual* pre-loan expenditure was around the HEM benchmark figure will experience no change their lifestyle if the licensee assumes the HEM benchmark when assessing if the consumer can afford the loan. This is the case whether the consumer has, due to their inability to quantify their spending, under- or overestimated their spending as part of the inquiry process (Note: we recognise the standard approach is to use the higher of the benchmark or disclosed expenditure). If a consumer's pre-loan expenditure was at a higher level than provided for in the current HEM model, and the licensee based their assessment on the HEM levels in the affordability assessment, that consumer would be required to adjust their lifestyle if they took out the loan. Whether the loan met the consumer requirements and objectives (and, whether the licensee needed to make further inquiries of the consumer) would depend on the significance of the difference, i.e. if the difference was small, the risk of the loan not meeting the consumer requirements and objectives is lower (particularly as most consumers would recognise that a level of 'belt tightening' is necessary when taking out a loan, particularly a home loan). This may mean the licensee is not required to make further inquiries. It may also be relevant whether the required change is in relation to discretionary or non-discretionary expenditure, i.e. a consumer is more likely to recognise, and accept, changes to their discretionary spending, compared to non-discretionary spending. We acknowledge that it may be appropriate for the benchmark, when used in this context, to reflect "different income ranges, dependants and geographic location" as proposed by ASIC. This is because the benchmark is being used to validate the consumer's actual pre-loan variable expenditure (which will be influenced by those matters, including income).

PROPOSAL	YOUR FEEDBACK	
		In relation to proposal C3(b)(ii), we recognise that the higher the level of expenditure allowed for under the benchmark, the greater the comfort that the validation step will help reduce the risk of a consumer understating their needs. However, this guidance should also recognise that: • in this context, underestimating a consumer's pre-loan expenditure relates to whether the loan meets the consumer's requirements and objectives, not whether the consumer will experience substantial hardship after the loan. As noted above, a small underestimation of the consumer's pre-loan expenditure is unlikely to cause the consumer concern (i.e. the consumer would probably expect that to be necessary). • the benchmark is being used to validate the consumer's self-disclosed pre-loan expenditure. If the licensee's inquiry processes are working well (i.e. helping the consumer to accurately quantify their own expenditure) which would be reflected in the distribution of disclosed expenditure matching the distribution predicted by the HEM model, there is less need to rely on the validation of the benchmark. Applying a buffer to that benchmark would simply create inefficiencies (as the licensee is forced to take unnecessary verification) or reduce credit to consumers who are able to afford it (i.e. if the licensee bases the financial capacity assessment on that higher figure). When used in this context, the benchmark figure is not being used to assess whether the consumer can actually 'afford' the loan. It is simply being used to validate whether there is a need to take further steps to understand what a consumer's post-loan variable expenses could be, which could involve further inquiries about the consumer's circumstances that influence those expenses, or additional steps to verify the consumer's pre-loan expenditure (on the basis they are good predictor of post-loan expenses). **Benchmark – financial capacity assessment** The amount of available funds that a consumer needs to have after the loan to pay for their variable expenses (i.e. 'living expenses') should be an objectively set amount based on an amount required to have a 'modest lifestyle' (see 101). In theory, this would involve a licensee making inquiries of the consumer as to the consumer's personal circumstances that are relevant to their financial needs. This could include general matters such as the consumer's number of dependent and where they live, and potentially more specific matters such as medical needs. A benchmark would then be applied based on those circumstances to create a dollar figure of what the consumer needs to have a modest lifestyle (or, possibly, a mix of a figure created in relation to the 'general matters' with a top-up for specific matters based on the consumer's actual financial needs where they are not covered by the benchmark).

PROPOSAL	YOUR FEEDBACK	
		Such a benchmark is not being used as a verification or validation tool. Instead, it would be used to derive the figure that is used in the actual affordability assessment to test whether the loan was likely to result in substantial hardship to the consumer. For that reason, the benchmark would be targeted at a more basic level than, for example, the HEM figure. The figure would not be income adjusted as it is identifying the amount of funds a person objectively needs to live a modest lifestyle (rather than to continue the lifestyle they have prior to the loan). We are not aware of any licensees currently applying this process and do not believe that such a benchmark currently exists (see our comments in 105). As noted in 127, while this process would arguably provide a more direct way of identifying a consumer's post-loan needs, it would require a reasonably sophisticated responsible lending process. **How licensees currently use benchmarks** Licensees currently focus on making inquiries about a consumer's 'current' living expenses (which is likely to reflect the consumer's pre-loan variable expenditure). In addition to other verification process (e.g. use of transaction data), most lenders will compare the disclosed pre-loan expenditure figure to the HEM benchmark and use the higher of the two as part of the financial capacity assessment. In doing so, the licensee is using the HEM figure for the purposes of the financial capacity assessment, which means that the lender is testing the consumer's post-loan capacity at a level that is potentially higher than what represents a 'modest lifestyle' (i.e. non-discretionary spending at the median and discretionary spending at the 25th percentile). In practice, it could be open to a licensee to assess 'affordability' using a lower benchmark figure, while continuing to use HEM to test whether the loan meets the consumer's requirements and objectives (i.e. whether it requires a significant change in the consumer lifestyle) – where that HEM figure may or may not need to include a 'buffer' depending on the licensee's overall processes (e.g. other buffers that are explicitly or implicitly applied; effectiveness of the licensee's inquiries practices as discussed above etc).
	C3Q2 Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable.	See our comments in 166.

PROPOSAL	YOUR FEEDBACK	
	C3Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	We have not commented on this question.
	C3Q4 What additional business costs would be involved in this approach?	See our comments in 166.
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?	See our comments in 82.
	C4Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	We have not commented on this question.
	C4Q3 What additional business costs would be involved in this approach?	We have not commented on this question.
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.	We have not commented on this question.

PROPOSAL	YOUR FEEDBACK	
	D1Q2 Are there any forms of small business lending where licensees are unsure about whether the responsible lending obligations in the National Credit Act apply? Please describe the situations which give rise to this uncertainty.	We have not commented on this question.
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?	In seeking to comply with their responsible lending obligations, a licensee's focus should be on ensuring that a consumer, who is being upfront and honest, does not enter into an unsuitable loan simply because they have misunderstood the process or questions being asked of them. For a credit provider, there should be consideration as to whether an intermediary has misrepresented the consumer's situation. However, a licensee's responsible lending processes should not be designed with the expectation that they will have to assess every loan contract for a deliberate and determined effort to defraud the licensee (noting that credit providers will maintain their own risk-based fraud prevention practices). Such an approach would be costly, time consuming and invasive for consumers.
	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.	We have not commented on this question.
	D2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	We have not commented on this question.
	D2Q4 What additional business costs would be involved in this approach?	We have not commented on this question.

PROPOSAL	YOUR FEEDBACK	
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 under-stand 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?	Yes. Repayment history information is an indication of whether a consumer has satisfied their minimum payment obligations under the credit contract on a month-by-month basis (over a period of 24 months). Importantly, a record of a 'paid' status is, subject to the concept of a 14 day 'grace period', positive evidence that a consumer is meeting their obligations (as opposed to the previous 'negative only' form of credit reporting). On this basis, the fact that a consumer may have missed a payment in the previous 24 months is not necessarily a 'black mark'. That is, a recent history of repayments that have been satisfied is likely to be more predictive of a consumer's current capacity than a record of an older missed payment. A recent history of good repayments may help a consumer to show a new provider that they are a suitable customer even if the consumer has previously had a 'black mark' default reported. Guidance should provide certainty to a credit provider that they will not be acting against the responsible lending provisions if they form the view that, despite a history of missed payments, the consumer is able to afford the loan, i.e. that the mere fact that there is missed RHI on the consumer's credit history does not mean that the consumer is currently experiencing 'substantial hardship' or that the new loan will put them into 'substantial hardship'. As part of that guidance, it should recognise that the credit provider's own commercial judgment as to the significance of missed payments should be respected. Likewise, the guidance should recognise that a credit provider is not required in every case to make further inquiries about missed RHI before approving the loan. That is, while inquiries may be appropriate in respect of more recent (or current) missed RHI, it is open to a credit provider to assess that inquiries may not be necessary in respect of previous RHI, particularly where those missed payments have been paid. Again, the guidance should recognise the credit provider's commercial judgment in these matters. Finally, the guidance should acknowledge that a credit provider is not <u>required</u> to make further inquiries prior to declining a loan application. In respect to the reference to 'hardship indicator' we assume that this references the potential for such an indicator to be introduced as a result of the Attorney General Department's review of hardship conducted last year. Until we see the results of that review, we are unable to suggest what guidance should be given (other than it will probably reflect similar matters to the guidance in respect of RHI). In practice, we note that the likelihood of a credit provider choosing to lend to a consumer with a hardship indicator, or choosing to make further inquiries, will be influenced by whether the credit provider is able to see whether, and what, payments have been made during the period of hardship.

PROPOSAL	YOUR FEEDBACK	
	D3Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	The guidance should recognise the credit provider's commercial judgment in these matters, including whether it is necessary to make further inquiries prior to approving a consumer for a loan (where the consumer may have a history of missed payments). If not, it is more likely that credit providers will automatically reject such consumers.
	D3Q3 What additional business costs would be involved in this approach?	Provided the guidance provides the flexibility for credit provider to choose when, or when not to, undertake further inquiries, this should not significantly increase business costs. A credit provider will develop models of when it is worth approving a consumer with a history of missed repayments (including where they are required to make further inquiries) and when it is better to simply decline the application. We note that any guidance given by ASIC would need to be applied by AFCA.
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.	**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?	We have not commented on this question.
	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.	We have not commented on this question.
	D4Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	We have not commented on this question.
	D4Q4 What additional business costs would be involved in this approach?	We have not commented on this question.

PROPOSAL	YOUR FEEDBACK	
D5 We propose to provide additional guidance in RG 209 on what information we think should be included in a written assessment.	**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?	We have not commented on this question.
	D5Q2 Please provide any comments on the example set out in Appendix 2.	We have not commented on this question.
	D5Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?	We have not commented on this question.
	D5Q4 What additional business costs would be involved in this approach?	We have not commented on this question.

AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION