Australian Banking Association

20 May 2019

Ms Fleur Grey
Senior Specialist
Credit, Retail Banking and Payments
Financial Services
Australian Securities and Investments Commission
responsible.lending@asic.gov.au

Dear Ms Grey

ABA response to ASIC Consultation Paper 309: Update to RG 209 Credit Licensing: Responsible lending conduct

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

Australia's banks play a significant role to support the economy and community by providing access to timely and appropriate credit to customers and small businesses. Australia's banks take their responsible lending obligations seriously. Their approach to responsible lending must comply with the law, balance consumer protection, competition and financial stability, while enabling innovation and meeting changing customer preferences. These are economy wide issues that will have a tangible impact on the needs of everyday Australians so it is vital that we get the policy and regulatory settings right.

Growth in credit to households is slowing. Loans to owner occupiers and housing investors have slowed with APRA's limits on lending and reduced confidence in the economy. Other personal credit, such as credit cards, personal loans and car loans has dipped significantly, while there is demonstrated growth in other personal lending and lending like products such as pay day loans (both NCCP Act and non NCCP Act regulated) and 'buy now, pay later' services.

The ABA believes it is essential that both the regulatory framework and regulatory guidance on responsible lending is 'future proof'. This will allow industry to innovate based on changes in technology and available data, to meet customers demand for more online banking experience, and the changing nature of work and employment, such as the growth of the 'gig' economy. A 'future proof' framework will improve access to timely and appropriate credit and meet customer demands for online and speedy credit decisions.

Customers are best served by regulatory guidance that:

- Maintains a principles-based approach
- Promotes consideration of the customer's entire financial situation and reflects the principles of good credit assessment: character, capacity and collateral
- Allows scalability of arrangements, including investigation and verification of a customer's financial situation, and
- Provides for the appropriate use of benchmarks and statistical measures, in particular as these measures improve over time.

The ABA is concerned that a move away from a principles based approach that embeds appropriate flexibility will negatively affect competition by:

- impacting on smaller players: will disadvantage smaller ADIs or new entrants with less sophisticated systems as their ability to invest in updated or new technology may be limited and typically have less access to readily available transaction account data
- discouraging switching: deter consumers from switching products or financial institutions over time, if they perceive the application process to be overly burdensome or prolonged
- advantaging unregulated providers: provide incentives for consumers to access credit like products from providers that are not regulated under the National Consumer Credit Protection Act (NCCP).

While the review of RG209 is welcome, the broader economic and regulatory environment impacts the speed and availability of credit for consumers and should be considered as part of the review of RG209. The ABA has set out these considerations in part 1 of this submission.

The ABA looks forward to working with ASIC through this consultation process. Please contact me on 0400 681 407 or at justin.mining@ausbanking.org.au if you have any questions or require anything else.

Yours sincerely

Justin Mining
Policy Director

Australian Banking Association

ABA Response to ASIC Consultation Paper 309:

Update to RG 209 Credit licensing: Responsible lending conduct

20 May 2019

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1. Introduction

Australia’s banks play a significant role to support the economy and community by providing timely and appropriate credit to customers and small businesses. Australia’s banks take their responsible lending obligations seriously. Their approach to responsible lending must comply with the law, balance consumer protection, competition and financial stability, while enabling innovation and meeting changing customer preferences.

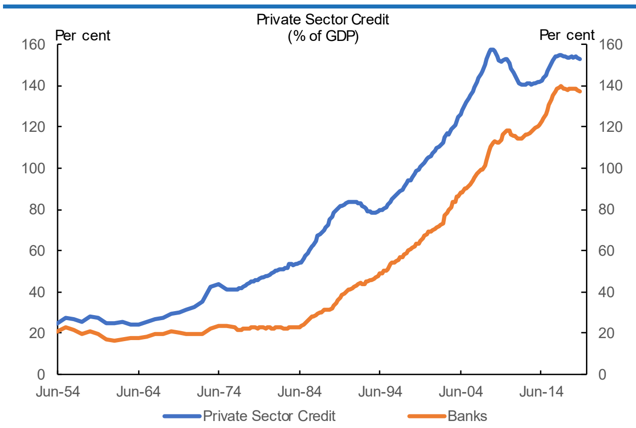
While the review and update of RG 209 is welcome, the broader economic and regulatory environment has an impact on the speed and availability of credit for customers. In conjunction with the RG 209 review, additional factors should be considered when assessing the effectiveness, impact and potential net benefits of changes to regulatory guidance.

While this submission specifically contemplates the review and update of RG 209, the ABA has provided additional commentary on a range of broader factors in the regulatory and credit environment and their effect on the provision of credit to customers and small businesses.

1.1 Trends in consumer lending

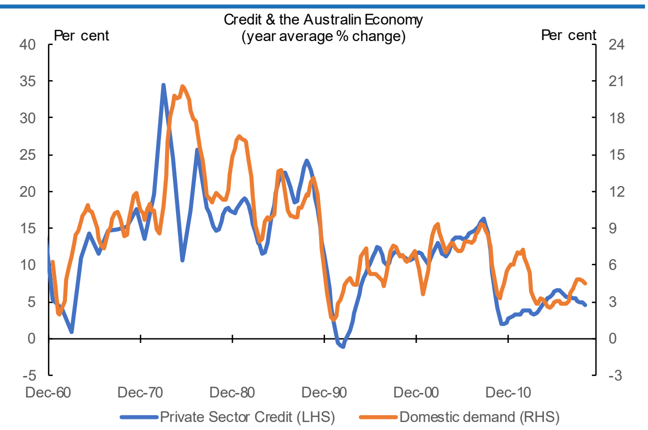
The flow of credit into the economy has slowed. Over the year to March 2019 total private sector credit has grown by just 3.9%. Credit extended to the private sector has grown at a slower pace than the overall economy since the end of 2016, resulting in the first decline in credit as a % of GDP outside of a recession or major downturn. The decline in credit over the past 2 years relative to the overall GDP has been the most persistent since the 1960s credit crunch.

Figure 1: Credit and lending by banks



Source: RBA, ABS, ABA calculations

Figure 2: Demand growth and credit flow



Source: RBA, ABS, ABA calculations

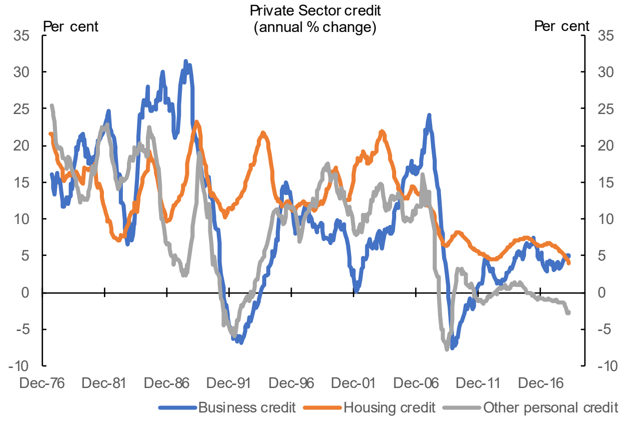
However, the severity and impact of these changes differs across lending segments and customer cohorts.

1.1.1 Owner-occupied and Investor Housing

The slowing in credit growth has been driven by the household sector. Growth in housing credit has slowed to the weakest pace reported in the 42-year history of the monthly RBA credit aggregates. Other personal credit is contracting at its fastest pace outside of a major recession or downturn (i.e. GFC).

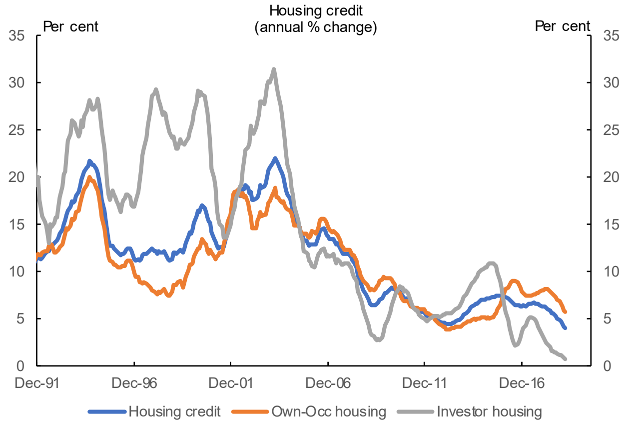
The slowing in housing credit growth has been driven initially by investor housing credit, which peaked in mid-2015 and has since declined following the introduction of macro prudential constraints such as the 10% per annum speed limit on investor lending growth, and later changes in loan assessment and volume constraints on interest-only lending. Growth in the stock of credit for investor housing has been flat since the end of 2018.

Figure 3: Credit growth by type



Source: RBA, ABS, ABA calculations

Figure 4: Housing credit trends



Source: RBA, ABS, ABA calculations

1.1.2 Other personal finance – declining at recessionary rates

Other personal credit (comprising of credit cards, personal loans, margin loans and leases) continues to decline, however the pace of decline has accelerated over the past 6 months. Other personal credit shrunk by 2.8% over the year to March 2019, the fastest pace outside of a recession or the GFC. There have been significant declines in credit card debt, with almost 1 million credit cards closed since May 2017 (a 5.7% fall), and a 2.3% decline in the total credit limit. The flow of new lending commitments for motor vehicles, travel and household goods has slumped over the past 6-12 months while new and increased limits for revolving credit facilities (e.g. credit cards) has also slumped over the past six months.

These changes in other personal finance are accompanied by growth in payday lending. Since April 2016 to June 2018, just over 3 million discrete payday loans have been written, worth in total around $1.85 billion by around 1.6 million households.

1.1.3 Reverse mortgages, low doc loans, loans outside serviceability and other non-standard loans

Reverse Mortgages small and in decline

The number of reverse mortgages is small and peaked in December 2012 at 29,500 according to APRA data. The decline in the number of reverse mortgages accelerated over the 18 months to December 2018, declining 22% from 27,800 to 21,600. Over this period the value of outstanding loans declined 17% to $2.3 billion, and the average balance of reverse mortgages rose 6.8% from $101,100 to $108,000.

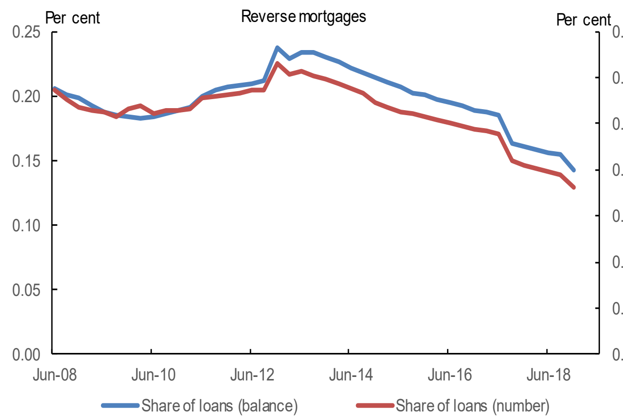
Seniors groups have advised the ABA the there is a strong but unmet demand for home equity products, that are sought to be used for home modifications, in-home care and significant health expenses.

Low documentation loans are dying out

The current stock of low document loans outstanding has fallen to $16.9bn (1% of outstanding loans), from $60.2bn in December 2010 (6.6% of outstanding loans). At their peak there were more than 305,000 loans, now there are less than 90,000. The flow of new low doc loans approved was a meagre $842mn in 2018, representing just 0.2% of new loans approved in the year. Similar trends, though of a different scale, are evident in non-standard loans.

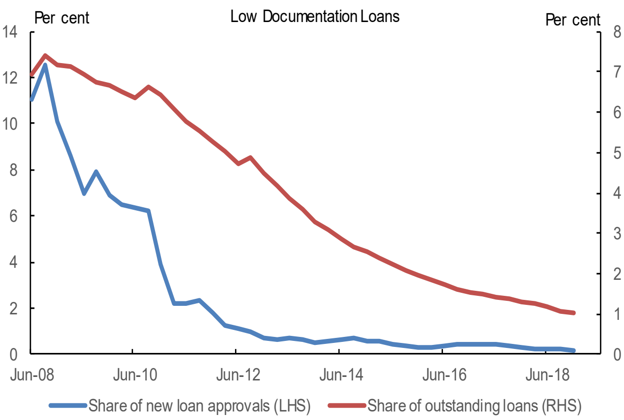
These figures represent a change in the way lenders are (and are not) meeting the needs of borrowers who are self-employed, gig economy participants or small business owners and don't have access to the documents required to obtain a traditional mortgage.

Figure 5: Reverse Mortgages



Source: APRA, ABA calculations

Figure 6: Low documentation loans



Source: APRA, ABA calculations

1.1.4 Small business lending trends

Small business lending did grow in 2018, with an additional $2.3bn of credit extended to businesses in facilities <$2mn, which would generally be considered to be small and medium business loans.

However, the increase in credit outstanding to small business was meagre at only 0.8% - this is the slowest annual growth since 2009. Growth in small business credit outstanding was dominated by larger loans in the $500k to <$2mn segment, with the pool of credit outstanding in loan facilities <$500k actually declining.

Loans in the $0-$500K range tend to be offered to small business, where there is the greatest risk of comingling business and domestic requirements, objectives and financial situation.

Table 1: Business Credit Outstanding

Business Credit Outstanding ($bn)

	as at		change	
	Dec-17	Dec-18	$bn	%
<100k	32.7	33.1	0.4	1.3
100k - <500k	99.6	99.1	-0.5	-0.5
500k - <$2mn	149.0	151.5	2.4	1.6
Total <$2mn	281.4	283.7	2.3	0.8
$2mn+	669.0	710.2	41.3	6.2
Total	950.3	993.9	43.6	4.6

Source: RBA Statistical Table D7.3

Source: APRA, ABA calculations

Table 2: New business credit approvals

New Business Credit approvals ($bn)

			change	
	2017	2018	$bn	%
<100k	12.1	10.4	-1.7	-13.9
100k - <500k	25.5	23.6	-1.9	-7.5
500k - <$2mn	42.1	39.7	-2.3	-5.6
Total <$2mn	79.7	73.7	-5.9	-7.5
$2mn+	266.3	299.8	33.5	12.6
Total	346.0	373.5	27.5	8.0

Source: RBA Statistical Table D7.4

Source: APRA, ABA calculations

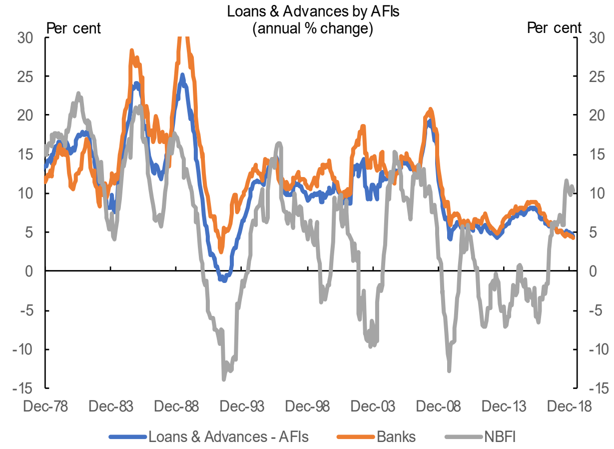
1.1.5 Growth of non-bank lenders

According to RBA data, lending by Banks rose 4.2% ($106.4bn) over the year to March 2019. This was outpaced by the rate of growth in lending by Non-Bank Financial Institutions (**NBFI**). NBFI lending rose by 10.4% ($15.1bn) over the year to March 2019. Whilst NBFI represented 5.7% of total loans and advances in March 2019, NBFI accounted for 12.5% of total loan growth over the year.

That is 1 out of every 8 dollars of additional lending into the economy over the 12 months to 31 March 2019 was from a non-bank financial institution.

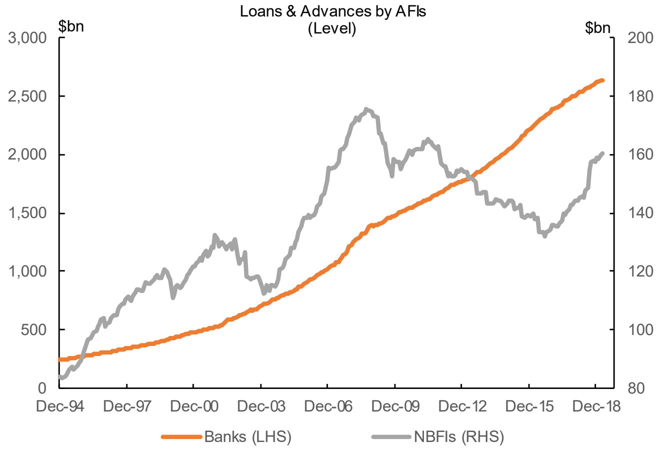
Analysis of RBA securitisation data highlights that non-banks are most competitive from an interest rate perspective in investor lending. For owner-occupiers, there may be a degree of less robust application of regulatory guidance. The recent consultation from APRA regarding additional data from linked wholesale loan warehouse facilities or securitised mortgage pools.

Figure 7: Growth in lending by originator



Source: RBA, APRA, ABA calculations

Figure 8: Stock of outstanding loans



Source: RBA, APRA, ABA calculations

1.1.6 Causes for the slow down

These changes and the slowing in total private sector credit, led by a contraction in consumer credit offered through mortgages and credit cards and other forms of non-housing personal credit are suggested to be attributed to a range of factors:

- Prevailing economic conditions and consumer confidence
- Reductions in house and property prices, and equity market volatility
- Impacts of changes in prudential requirements and macro-prudential interventions, and
- Stronger supervision of loan serviceability rules by regulators, including ASIC and APRA, and a shift in understanding across documenting requirements and objectives, collection and verification of income and expenses.

The ABA has begun a detailed data analysis intended to establish the extent to which the slowing in overall credit is demand or supply driven, and whether particular dips correspond with macro interventions and statements from regulators (for example ASIC publication of the Interest Only loan reviews). The ABA will provide ASIC with the results of this analysis in the coming weeks.

Challenges with the origination of credit are multifaceted and relate to a number of issues. Prevailing economic conditions, investment in technology and systems and a bank's credit and risk appetites all play a role. However, across the sector, law and regulation play a significant and encompassing role in determining, if credit is provided, how much, on what terms and to whom.

1.2 Role of regulation

It is useful to consider why regulation is needed in consumer credit. Well-designed regulation should also balance consumer protection, competition and financial stability, while enabling innovation and meeting changing community expectations and customer preferences.

Market failures are present in credit markets which can reduce the amount of lending for customers.

Well targeted and efficient government intervention in the form of both conduct and prudential regulation can help mitigate some the negative impacts of market failures in credit markets that cannot be addressed by banks alone. Targeted conduct regulation that addresses market failures could:

- improve the access to credit for suitable borrowers
- restrict unsuitable lending to borrowers
- ensure terms of lending are fair and reasonable for both lender and borrower, and
- product features are responsive to consumer needs.

The ABA submits that well targeted regulation should not seek to remove all risks for borrowers.

As noted by RBA Governor Lowe "*Even when banks lend responsibly, a percentage of borrowers will end up in financial strife and be unable to meet their obligations. We need banks to be prepared to make loans in the full expectation that some borrowers will not be able to pay them back. Banks need to take risk and manage that risk well. If they become afraid to lend simply because of the consequences of making a loan that goes bad, our economy will suffer. So a balance needs to be struck here.[1]*"

1.3 Consumer protection

Responsible lending requirements are one example of a range of regulatory requirements in place to restrict lending to unsuitable borrowers. ASIC and APRA have found that some banks have previously not consistently implemented these requirements and have taken appropriate monitoring and enforcement action in these cases. This was also highlighted in the Royal Commission's hearings that highlighted that some banks in historical cases had not made good lending decisions leading to poor outcomes for individual borrowers.

We note however that some banks have also taken recent steps to improve their practices, as acknowledged by ASIC and noted by APRA in its recent information paper[2]. In terms of the adequacy of the current regulation, the Royal Commission considered whether further changes were needed to improve consumer outcomes. It concluded that current regulation, when implemented properly, would be adequate to ensure the risk of poor lending decisions. It did not recommend further changes as part of its comprehensive review of the sector.

Given this, it raises the question of what the additional benefit to borrowers will be from tightening regulatory guidance by implementing the requirements proposed in the ASIC consultation paper. The ABA is concerned that limiting flexibility, scalability and mandating in prescriptive detail certain steps that must be taken in making credit assessments will:

- negatively affect competition across the sector
- impede innovation and the use of technology, open data and artificial intelligence, and
- and leave banks unable to respond to changing consumer preferences.

Each of these issues is explored further below.

1.4 Competition

A competitive credit sector delivers a range of benefits to customers including lower pricing, improved service and innovation in products and technology. Digital innovation in the sector is now driving even more competition in the credit market as ADIs now compete with financial technology start-ups and the growing presence of large technology firms.

There has been significant growth in competition in the consumer credit market and other financial products, particularly in sectors such as home loans, credit cards, small value credit products and 'buy now, pay later' (**BNPL**) schemes. More than ever there is a need for competitively neutral regulation

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[1] *https://www.rba.gov.au/speeches/2018/sp-gov-2018-11-20.html*
[2] https://www.apra.gov.au/sites/default/files/review_of_apras_prudential_measures_for_residential_mortgage_lending_risks_-_january_2019.pdf

The benefits of this competitive tension need to be considered closely as we are concerned that ASIC's proposal to take a more prescriptive approach to some aspects of RG 209 may negatively impact competition by:

- **impacting on smaller players:** will disadvantage smaller ADIs or new entrants with less sophisticated systems as their ability to invest in updated or new technology may be limited and typically have less access to readily available transaction account data
- **discourage switching:** deter customers from switching products or financial institutions over time, if they perceive the application process to be overly burdensome or prolonged
- **advantage unregulated players:** provide incentives for customers to access credit like products from providers that are not regulated under the National Consumer Credit Protection Act (**NCCP**).

1.5 Emerging issues

The ABA believes there are a number of emerging issues that will affect the framework of credit regulation. These issues relate to changes in consumer preferences, the economy, and a shifting technological and data environment. Future regulatory guidance should embed the flexibility for the industry to responsibly adapt to these emerging issues and continue to meet the needs of the community.

1.5.1 Consumer preferences

What customers want from a loan has changed. Marketing research suggests that a cheaper interest rate is not the main factor why a customer chooses a loan. Customers are looking for online and mobile management for lending, flexibility to access small amounts of credit and fast credit decisions.

These preferences are demonstrated through the fast and significant uptake of BNPL services, the growth in small loans available online (both NCCP Act and non-NCCP Act regulated) and a move away from traditional forms of consumer credit such as credit cards and car loans.

1.5.2 Changes in the economy and patterns of work

Changes in patterns of work such as contracting, the gig economy, labour hire and casualisation mean that more people, including medium and high-income earners are more likely to earn irregular income. Overtime, there may be a lower proportion of PAYG salary earners, with fixed and predictable incomes. The responsible lending settings need to flexible enough to adapt to these changing patterns in work and income. In particular, a balance needs to be struck around requirements for income verification and the flexibility of a lender to assess the ability to repay where the customers income is lumpy and irregular.

1.5.3 Changes in technology and data

Changes in technology, data and statistical measures are specifically discussed in part 2. The ABA notes that the technology and data environment is evolving at a rate and in a way that was not predicted in 2009. Regulatory settings and regulatory expectations need to enable utilisation of new technology and data sets, to underpin efficiency and better customer outcomes.

2. Key issues in RG 209

2.1 Maintaining a principles-based approach

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

While the ABA believes that a principles-based approach should remain the general underlying basis of an updated RG 209, at the same time, we do support ASIC providing some further guidance in some specific areas. This includes the treatment of new financial services products such as BNPL arrangements in the context of serviceability assessments and giving credit providers comfort to apply the intention of the NCCP Act that these obligations do not apply to credit that is not for a business purpose. This will help to ensure credit providers are consistently meeting regulatory expectations and customers are afforded the right protections on these issues.

In the current version of RG 209, ASIC sets out a broad set of principles of conduct that it believes will assist credit providers to meet their responsible lending obligations and outlines its expectations for compliance. These principles form the basis for how credit providers decide how to most appropriately implement them in order to deliver the outcomes that ASIC requires as well as best fit the needs of their customers and business.

CP309 acknowledges how ASIC decided against taking a more prescriptive approach to guidance when RG 209 was being developed on the following grounds:

- "setting minimum standards would be relatively inflexible, and not allow industry to tailor their responsible lending processes in a way that is appropriate for their business and customers"
- it would involve "greater compliance costs and may not be the most efficient approach for businesses", and
- it could result in some licensees only carrying out the inquiries specified by ASIC, which would allow "less scrupulous licensees to ignore other relevant issues that fall outside the factors set by ASIC and hide behind technical compliance".

The ABA believes that these same issues not only exist now but are even more relevant in a credit industry that is subject to significant changes through technology and innovation and consumer needs. Further, the maintenance of this principles-based approach in RG 209 will be of significant benefit to customers by:

- **net benefit for customers:** a principles-based approach focuses regulated entities on developing their own approaches to achieve compliance with responsible lending obligations and shifts their regulatory focus from process to outcomes. Overall, a shift to compliance with a set of minimum rules may effectively be seen as a form of "safe harbour" by some licensees. This may not permit credit providers the flexibility to manage risks relating to the customer's circumstances. **We believe a prescriptive approach will not provide a net benefit to customers**
- **recognising changing credit industry landscape**: the credit industry is rapidly changing with a diverse range of business models and their different characteristics in terms of source of funding, distribution channels, use of technology and access/use of data. These business models are evolving to meet consumer needs and are taking advantage of innovations in data and technology
- **fostering a more innovative credit industry**: a principles-based guidance approach will provide flexibility for banks to take advantage of a range of future innovations that will be effective in meeting consumer needs and minimising defaults, such as:
    - technology to assist with data inquiry and verification

- Artificial Intelligence systems, such as chatbots, process automation as well as transaction and review systems that can help prevent fraud and assist with responsible lending compliance
    - development of new and more accurate statistical measures of a customer's financial situation, and
    - increased availability of individual and community data through reforms such as open banking and Comprehensive Credit Reporting (**CCR**).
- **evolving consumer expectations:** consumer expectations in relation to credit are constantly evolving as can be seen with recent developments such as the migration towards BNPL products while the uptake of traditional credit cards is on the decline. A principles-based approach will allow licensees to continue to change existing, and to develop new, credit products and services to meet the requirements and objectives of their target markets.

2.2 'Reasonable inquiries and verification'

2.2.1 Customer's financial situation

The National Consumer Credit Protection Act (**NCCP**) requires the credit provider to take reasonable steps to inquire into and verify the customer's financial situation. The customer's financial situation has traditionally reflected the principles of good credit assessment: character (e.g., past repayment history), capacity and collateral.

In assessing a credit application, income and expenses as well as any shortfall are essential considerations and are central to a customer's capacity to re-pay. Banks may also consider other indicators of capacity such as debt servicing ratios or debt-to-income ratios, which have proven to be useful predictors for the likelihood of financial difficulty.[3]

Banks will also consider a customer's character and evidence of meeting current and past liabilities as well as the quality of the collateral being used to secure the credit.

A focus only on inquiring and verifying income and expenses presents the following difficulties for customers:

- income and expenses (and any shortfall) is a point in time assessment and we believe that many customers reduce their discretionary expenses when taking on new liabilities
- income and expenses is a point-in-time assessment that does not, and cannot, predict the significant triggers for financial difficulty such as illness, divorce, loss of employment or death, and
- applying significant resources to verifying income and expenses can divert from other robust predictors such as debt servicing ratios and debt-to-income ratios.

2.2.2 Scalability

In this context, the ABA supports the retention of a scalable approach in RG 209 to what reasonable inquiries and verification a licensee needs to take prior to making a suitability assessment under the NCCP Act. This means that a licensees approach to inquiries and verification would be dependent on an assessment of the circumstances and risks faced by the customer.

We submit that it would not be in the interests of customers for ASIC to take a highly prescriptive approach to setting minimum standards in terms of inquiries and verifications on many grounds:

- **no 'one size fits all' approach:** a reasonable set of minimum inquiry and verification requirements needed to assess the suitability of a credit product is dependent on the circumstances of and risks faced by the customer. An attempt to impose a "one size fits

[3] See Financial Conduct Authority, *Occasional Paper 20: Can we predict which consumer credit users will suffer financial distress?,* 2016, available at: https://www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-20

all" minimum approach is not appropriate – there is a danger this becomes a "check list" approach

- **'check list' compliance:** it would be impossible for ASIC to define a set of minimum inquiry and verification requirements for each and every product or customer type in RG 209 – licensees may feel compelled to take an overly cautious approach to satisfying the "check list" of requirements before extending credit to otherwise eligible customers, particularly at a time of increased scrutiny faced by the credit sector
- **delays in processing:** customers would experience delays in licensees processing their credit applications due to licensees having to adhere to an inflexible set of minimum requirements – this is at a time when customers are increasingly expecting more efficient decision-making processes and are proven to be taking advantage of the speed offered through BNPL services and online small loans providers
- **impact on switching:** licensees would inevitably request more information directly from customers including more documentation and manual follow up. This will discourage customers looking to switch to other credit providers, favours the incumbent provider and potentially disadvantages alternative credit providers who have no access to the customer's financial history
- **increase cost of credit origination:** a prescriptive approach would likely increase costs within the credit market to assess credit application reviews and set up facilities – this includes the cost of licensees amending or developing systems, requiring more manual processing with less ability to use automated processes and need for further staff training, and
- **alternative credit sources:** the changes may push customers towards alternative credit products that often come at a much higher cost to customers, such as short-term loan providers.

The ABA submits that **RG 209 should continue to enable licensees to consider the circumstances and risks faced by each consumer at the time of each credit application and to determine the appropriate level of due diligence required in relation to inquiry and verification.** Further, we agree with ASIC's view that licensees should be able to undertake a lower level of inquiries and verification steps for particular types of customers. We suggest that an example of these types of customers that would fall into this category should include:

- customers with a demonstrated financial position showing a positive repayment history and their declared information is in line with expectations for their profile and they are not "on the margins" in terms of ability to service the new facility, and
- customers making minor financial adjustments (such as refinancing or restructuring existing facilities) who have been making their repayments and are not significantly changing their debt position.

This reasonable, scaled approach would promote licensees providing appropriate and timely access to credit to customers where it is deemed 'not unsuitable' and meet the demonstrated consumer preference for speedier and less complex credit assessment processes.

Our response to ASIC's specific questions on its proposed approach to additional guidance on reasonable inquiries and steps is contained in Appendix 1.

2.3 Verification of consumer's financial situation

As noted above, the assessment of a customer's financial situation can take into account factors other than income and expenses. **To the extent that a bank is considering income and expenses, ASIC's guidance on verification should focus primarily on income, existing debts/liabilities as well as fixed and recurring expenses with a lesser focus on variable and discretionary expenses.**

As outlined in our responses at Appendix 1, we are supportive of ASIC's general approach to guidance on verification of income and existing debts. However, we are concerned that ASIC is not appearing to differentiate significantly between fixed/essential and variable/discretionary living expenses, and it is unclear how the level of verification should differ between the categories.

In the ABA's view, ASIC should adopt an alternative approach to guidance on verification of variable, living expenses. Many of the concerns outlined above in relation to taking a highly prescriptive approach generally also apply to the risk of setting mandatory, minimum verification standards on variable, discretionary expenses.

We also submit that a move to a verification process involving more manual processing of a consumer's variable, discretionary expenses in a credit application is out of step with consumer demand for more digital credit process solutions. A potential line-by-line examination of financial history will necessarily help deliver improved outcomes for customers.

In the same respect, the ABA is also concerned about the proposed "if not, why not" approach as it is inconsistent with the requirement for licensees to meet the standard of "reasonable verification" under the NCCP Act and undermines scalability of inquiries and verification. We are concerned that it may require credit providers to go beyond "reasonable steps" by requiring reference to a range of further sources when financial information has already been adequately verified. We believe a better approach would be to require licensees to be able to demonstrate why they used certain sources as the "reasonable steps" for verification and not to focus on why they did not use other sources.

2.4 Use of benchmarks and statistical measures

The ABA believes that it is good public policy that benchmarks and statistical measures can be used as an element of making reasonable inquiries into and verification of a customer's financial situation. The ABA submits that the use of quality benchmarks and statistical measures can play a role beyond the obligation to take reasonable steps to verify the consumer's financial situation than 'determin(ing) whether information provided by the consumer is plausible'.

The industry anticipates that over time, new and more comprehensive benchmarks and statistical measures will be developed based on large data sets that ensure accuracy and better predict risks of financial difficulty and default. It is possible that over time such benchmarks and statistical measures may provide a more accurate way of verifying a consumer's financial situation than relying on self-declared customer information and manual verification checks.

The ABA believes that it is against the interest of customers to set policy and regulatory guidance that would unreasonably constrain the ability to use benchmarks and statistical measures to satisfy responsible lending requirements.

However, in maintaining flexibility to appropriately use benchmarks and statistical measures, credit providers must take responsibility for the appropriate use, quality and accuracy of such measures. The ABA supports ASIC's proposals at C3 to require that additional steps should be taken to ensure that benchmarks are realistic and to periodically review their use across the portfolio. The ABA believes these kinds of reasonable steps should be applied to future statistical benchmarks and measures.

2.5 Interaction with prudential regulation

APRA will also be considering the role and appropriate use of HEM in its proposed update to APS220. We note that this prudential standard only applies to residential mortgages and that APRA as the prudential regulator may set particular standards relating to benchmarks to promote financial system stability.

The ABA encourages ASIC and APRA to develop a joint position on the use of benchmarks in relation to residential mortgage lending. The industry needs certainty on the approach of regulators in order to develop appropriate systems and the development of improved benchmarks.

2.6 Changes in industry practice

ASIC has highlighted the impending industry developments of open banking and comprehensive credit reporting (**CCR**) as critical to various aspects of their proposed changes to RG 209, including customer inquiries and verification, and use of repayment history information.

The ABA acknowledges that these have the potential to enhance the capacity of the credit industry to meet their responsible lending obligations in a more efficient manner. However, we do caution that there is much to be done to implement these into the credit system and it will require significant consumer, industry and government support to bring the benefits to fruition.

2.6.1 Changes in industry practice and regulatory guidance

Open banking, CCR and data aggregation services will require changes to industry practice, as the industry would need to consider information that has not historically been available. It is important that RG 209 guidance preserves the opportunity for the industry to deliver these benefits to customers.

The ABA suggests that changes to RG 209 be guided by the following principles:

- **Flexibility:** the future availability of new customer data sets will mean all banks can adopt different approaches in their responsible lending systems and processes, which will be positive for customers and further enhance competition.
- **Enabling technology:** digitisation and automation will be both key benefits and drivers of these processes and should act to enable credit assessments to be made more quickly and accurately than a manual review of data. This will also help to promote more consistent decision making. Banks need to ensure systems are well designed and audited regularly to ensure they are delivering the desired outcomes.
- **Future-minded**: Constant advances in technology underpin the modern banking environment and can further improve responsible lending processes and compliance and requires a technology neutral approach from regulators.
- **Respecting privacy and customer choice**: An overarching requirement of open banking's CDR is that customers should remain in control of their data, so the reform is dependent on a customer electing to share their information with a new credit provider. Regulatory guidance should not set obligations that a licensee can only meet through accessing open banking data.

2.6.2 Open banking

Open banking has the potential to enhance the responsible lending process as it may assist banks to make reasonable inquiries about the customers financial situation by including income and expense data passed from a customer's other financial institutions, helping to overcome some of the challenges faced under existing processes.

While there is significant potential for this to deliver benefits, the ABA submits that open banking should not be regarded as a "silver bullet" to the complex issues that can often inhibit access to reliable and detailed data.

The regulatory framework remains uncertain as the rules and standards that will drive the detailed functioning of open banking remains under development, including draft rules of the Consumer Data Right (**CDR**), accreditation and registration of data recipients by the ACCC, Treasury's Privacy Impact Assessment of the CDR, consent rules on joint or multiple account holders. We believe that it will take some time for the industry to start utilising the open banking system, understand its full potential and embed it into credit decision making processes.

ASIC appears to have adopted an approach in its proposed changes to RG 209 that most customers will provide consent for their data to be used and this runs contrary to the CDR, which will give customers the right to elect whether they share the data or not. We recommend ASIC work with APRA, Treasury and the ACCC to resolve this concern.

In this context, the ABA would recommend caution on ASIC framing its RG 209 in the context that open banking will be a key part of banks fulfilling their responsible lending or regulatory obligations.

2.6.3 Comprehensive Credit Reporting

In the event that it is implemented industry wide, CCR may allow banks to have a much broader insight into a customer's financial situation, including their liabilities with other banks, and their past behaviour in meeting their credit obligations. This may enable a credit licensee to make a more informed credit assessment of a loan applicant and their suitability for credit.

However, similarly to open banking, there is much to be done before the benefits of the reform can be realised. The CCR legislation has now lapsed with the proroguing of the last Parliament due to a lack of consensus around customers in hardship arrangements and how they should be reported. It is unclear what will be the approach of the new government.

While the major banks and some other banks are participating in credit reporting and sharing positive data with credit bureaus, it is unclear when or if other entitles will participate. The industry also anticipates that there may be implementation challenges as the information obtained from bureaus will likely need to be refined over time.

With these challenges in mind over the status of both reforms, the ABA submits that RG 209 should be drafted with the flexibility so that these can be utilised in the future when they have been shown to be an effective tool in responsible lending processes but the guidance still needs to be fit-for-purpose for current industry practice.

2.7 Areas where responsible lending does not apply

The ABA supports the intention of the NCCP Act, that lending to business, including small business is not captured by the responsible lending obligations set out to primarily apply to customers. The 2019 Banking Code of Practice builds on the protections in the 2013 code and introduces further obligations for banks to small business customers (including farmers). This includes the responsibility to act as a prudent and diligent banker in respect of loans to small businesses (cl 49), apply special conditions and protections in small business loans (Part 6) and work with a small business customer in financial difficulty (chapters 39-42).

The Banking Code was recognised in the Royal Commission final report as the chief protection for small business borrowers. The Commissioner did not recommend expansion of the NCCP Act to cover small business (recommendation 1.9).

The ABA is concerned that issues in relation to the interpretation and application of the NCCP Act and associated regulatory frameworks, including RG 209, are impacting on the provision of credit to small business.

We believe that there are a number of key aspects of this impact on small business including:

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

The ABA suggests that whilst the law under the NCCP Act may appear to be clear in not strictly applying to business lending, the complicated financial situation of those customers in small business is often unclear. This has meant that some banks take a more conservative approach to applying the NCCP Act to loans applied for by small business owners.

The ABA looks forward to discussing this issue with ASIC as part of the RG 209 consultation process.

2.8 Costs of compliance and credit origination

ASIC has invited the industry to provide feedback on costs associated with its proposals. The ABA has provided feedback on potential costs, both incurred by the bank and by customers. However, as a general principle, the industry accepts that increased costs are appropriate when there are net benefits to customers and a tangible overall improvement in consumer protections.

2.9 ASIC consultation process

The ABA acknowledges the constructive and thorough approach from ASIC in consulting on RG 209. The objectives of this consultation would be furthered by an industry roundtable to discuss ASIC's proposals and emerging issues in the credit landscape more generally. The ABA would be pleased to assist in arranging this roundtable or any other appropriate process to assist ASIC further.

The industry would appreciate the opportunity for further consultation process on the next proposed version of RG 209.

Appendix 1 – Response to specific questions

The ABA's responses to ASIC's specific proposals and questions are contained below.

ASIC Proposal B1

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

Question	Feedback
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?	The ABA believes that ASIC guidance in RG 209 on what inquiries and verification steps need to be taken by a credit licensee prior to making a suitability assessment under the NCCP Act needs to remain scalable. This means that what a licensee needs to do to meet these obligations in relation to a particular consumer will vary depending on the circumstances and risks faced by the customer. A scalable approach is in line with the original legislative intention of a principles-based approach in section 130 of the NCCP Act requiring credit providers to "(1)(b) make reasonable inquiries about the consumer's financial situation" and "(1)(c) take reasonable steps to verify the consumer's financial situation". ASIC's guidance should continue to allow credit providers to take a reasonable, scalable approach based on the circumstances presented by the customer. In the event that ASIC provides a minimum level of inquiry and verification that needs to be carried out, there is a danger that some credit providers would regard them as a form of safe harbour. In the alternative, it would be impossible for ASIC to define an appropriate level of inquiry and verification suitable for each type of product or customer.
B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.	The ABA submits that RG 209 should continue to enable credit providers to consider the circumstances in each credit application and to determine the appropriate level of inquiries and verification steps required to be undertaken. There are a number of key elements of current industry practice that should be reflected in updated guidance: • **financial situation:** the customer's financial situation has traditionally reflected the principles of good credit assessment: character, capacity and collateral. In assessing a credit

	application, income and expenses as well as any shortfall are essential considerations and are central to a customer's capacity to re-pay. Banks may also consider other indicators of capacity such as debt servicing ratios or debt-to-income ratios, which have proven to be useful predictors for the likelihood of financial difficulty. Banks will also consider a customer's character and evidence of meeting current and past liabilities as well as the quality of the collateral being used to secure the credit. • **digitisation and automation of process:** credit providers have invested significantly in advanced digital solutions and customers now expect a seamless and more efficient credit assessment process for credit applicants. • **rapid expansion of competition:** there has been significant growth in competition in the consumer credit market and other financial products, particularly in sectors such as home loans, credit cards, small value credit products and 'BNPL schemes so more than ever there is a need for competitively neutral regulation • **industry initiatives on living expenses:** through LIXI Limited[4], many of the key participants in the Australian residential mortgage lending industry have coordinated a number of industry-led initiatives to better support credit providers meet regulator expectations. • **APRA guidance:** following a targeted review, APRA has worked with a range of small and large ADIs to make improvements to their lending practices, including to how they more accurately assess borrower income and living expenses and establish improved controls to check for information on borrowers' pre-existing debts.
B1Q3 Are there any kinds of credit products, customers or circumstances for which you consider it may be reasonable to undertake fewer inquiries and verification steps? Please identify the kinds of products, customers and circumstances and particular features you think are relevant.	The ABA agrees with ASIC's view that the RG 209 guidance should "continue to make it clear that credit providers are not prevented from determining that for a particular consumer it would reasonable to undertake a lower level of inquiries and verification steps".

[4] LIXI is an Australian, member-based not-for-profit company that develops data standards for the Australian mortgage processing industry, which has been essential in the move to digitisation of the lending industry and standardising information to allow electronic application lodgement of loan processes. LIXI members can be viewed here: https://lixi.org.au/lixi-standards-community/lixi-members-licensees/

	It would be reasonable for a credit licensee to undertake fewer inquiries and verification steps based on the circumstances, such as: • customers with a demonstrated financial position showing a positive repayment history and their declared information is in line with expectations for their profile and they are not "on the margins" in terms of ability to service the new facility, and • customers making minor financial adjustments (such as refinancing or restructuring existing facilities) who have been making their repayments and are not significantly changing their debt position.
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 ABA believes that the following aspects of a consumer's financial situation need to be inquired about in all circumstances: • income • existing debts and liabilities (credit cards / personal loans etc.), and • fixed living expenses – fixed or recurring expenses (housing rent / insurance) Inquiry into variable and discretionary living expenses (e.g., entertainment or holiday costs) should be scalable and a credit licensee should be able to limit inquiries for certain customers, such as those identified in the response to B1Q3. The industry also requests guidance from ASIC on treatment of new financial services products such as BNPL arrangements in the context of serviceability assessments. Should credit providers consider these as 'expenses' or 'liabilities'?
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 ABA believes that the following aspects of a consumer's financial situation need to be verified in all circumstances: • income • existing debts and liabilities (credit cards / personal loans etc.), and • fixed living expenses (housing rent / insurance). Verification of a customer's variable and discretionary living expenses can often be difficult for a credit licensee due to the difficulties in identification and categorisation of transactions in a customer's

	financial profile. Complexities in verifying these expenses are typically due to the following issues: • estimating a consumer's future expenses can be difficult based on past bank statement and transaction data • some expenses are practically difficult to verify as one-off or ongoing expenses without forensic investigation by a licensee (e.g., medical expenses) • the nature of some expenses makes it difficult to verify with certainty (e.g., average holiday spend can fluctuate significantly based on destination, location, and time of year), and • customers may alter their variable living expenses, both in the lead up to and after applying for credit to ensure they can service their liabilities going forward. As such, these types of expenses may not be considered central to determining unsuitability.
B1Q6 What would be the effect on customers of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for customers?	The ABA believes that overly prescriptive guidance on necessary inquiries and verification steps without any scalability poses a risk of leading to an extended and more complicated credit assessment process for customers, which may: • delay credit application decisions at a time when customers are expecting more efficient decision-making processes • increase the cost of credit due to additional costs for credit providers in conducting credit application reviews and setting up facilities • limiting customers to remaining with their current credit providers due to increased processing demands required to switch to other credit providers, and • pushing customers to higher cost credit products or to providers not regulated under the NCCP Act such as BNPL services.
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.	The ABA believes that business and compliance costs for credit providers would increase depending on the level of prescriptiveness of the inquiries and verification steps. These increased costs would be

	related to changes to systems, process and resourcing required due to: • consumer inquiries requiring a detailed financial forensic analysis and more direct interaction with a customer • training costs for staff and other representatives to meet the new requirements • greater level of manual intervention in the credit assessment process, where this may currently be automated, and • re-designing compliance and assurance reviews. We believe that these additional costs would not necessarily result in any benefits to customers or in a reduction in credit impairment.
B1Q8 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.	The ABA believes there may be some other potential competitive impacts of the proposal: • advantage providers not regulated under the NCCP Act, including BNPL services and other small loan providers due to their ability to provide quicker credit decisions and maintain lower origination costs, and • smaller ADIs with less sophisticated systems may be disadvantaged as their ability to invest in updated or new technology may be limited and typically have less access to readily available transaction account data.

ASIC Proposal C1

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

(a) clarify our guidance on kinds of information that could be used for verification of the consumer's financial situation, and provide a list of forms of verification that we consider is readily available in common circumstances; and

(b) clearly state that views on what are 'reasonable steps' will change over time, as different forms or sources of verifying information become available. For example, developments in open banking and data aggregation services will assist licensees to efficiently confirm the financial situation of a consumer (including allowing simultaneous inquiry about and verification of some information).

Question	Feedback

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?	The ABA submits that ASIC's guidance on verification should focus on income, existing debts/liabilities, some types of fixed and recurring living expenses. The guidance should adopt an alternative approach to variable/ discretionary expenses. Mandating verification of these expenses, which can and often are varied by customers, may significantly impact credit assessments. At a minimum, customers should have the opportunity to demonstrate if they have plans in place to reduce discretionary living expenses and a credit licensee should be able to take this into account in the credit assessment if deemed plausible. The ABA would welcome guidance enabling credit providers to take such statements into account in assessing a credit application. If ASIC elects to take a more prescriptive approach in RG 209, it also needs to provide guidance to industry on what constitutes a reasonable period of inquiry.
C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?	**Income** ABA broadly supports the approach to proposed forms of verification relating to income. However, as far as possible, we suggest that credit providers should be able to rely on the most efficient verification method unless a risk factor is identified (e.g., income identified as being regularly deposited into a transaction account should not also require third party verification such as contacting the employer). **Existing debts** We also broadly support ASIC's proposed approach in Appendix 1 for credit providers to verify existing debts/ liabilities through credit reports. **Expenses** The ABA requests that ASIC consider providing further specific guidance in relation to the use of bank statements for verification, particularly in relation to expenses. The industry would be concerned if the expectation is that credit providers are expected to undertake a line by line examination of a customer's bank statement. For example, it can be very difficult at this point in time to categorise many transactions in a bank statement, particularly for customers from another institution.

	In relation to living expenses, the ABA is concerned that Tables 3 and 4 in Appendix 2 do not differentiate between fixed and variable expenses and it is unclear how the level of verification differs between these categories.
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?	The ABA has some significant concerns in relation to the use of data aggregation services: • **Data security issues:** ASIC and credit providers/providers should not be encouraging or requiring customers to use data aggregation services. These services typically require a consumer to provide their banking log in details, including their password, to the aggregation provider. The service then logs in using the consumer's personal details to access their account information. This exposes the consumer to a risk of fraud if their data is misused or subject to a data breach. • **Potential loss for customers:** the ABA urges caution in ASIC suggesting that financial institutions or customers use these services as this may give the impression that these services are safe and secure. This is not the case. By using these services customers breach the terms and conditions of their account and invalidate their protections under the ePayments Code. If ASIC intends to support the use of these services, we suggest it consider a suitable framework for protecting customers from any resulting harm. • **Data quality in credit assessments:** it is not clear whether use of a data aggregation service would enable a licensee to meet their obligation to undertake reasonable verification. If this is the case, then the licensee should not be found to be in breach of its responsible lending obligations if it extends credit based on incorrect information provided by a service. • **Income and expense categorisation:** aggregator services may have different approaches to categorising data from a transaction feed and this may not be able to be transmitted directly to a licensee due to privacy restrictions. This could undermine the reliability of the information in making a credit assessment. • **Unreliability of processes:** the ABA has concerns about the reliability of 'black box' algorithms that are used by data

	aggregators. These algorithms are used to determine income, expense and liability payments and, if leveraged without a clear understanding of how they are developed, could shift accountability for verifying an individual's financial situation away from the licensee to aggregators, despite the licensee being responsible for meeting regulatory standards. As such, would not support guidance that mandates reliance on data aggregation services' data as reliable sources of verification.

ASIC Proposal C2

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

(a) more clearly stating that it is not sufficient merely to obtain verifying information but not have regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects of the consumer's financial situation; and

(b) including an 'if not, why not?' approach— that is, if a licensee decides not to obtain or refer to forms of verifying information that are readily available, they should be able to explain why it was not reasonable to obtain or refer to those forms of verification in the circumstances of the particular consumer involved.

Question	Feedback
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?	The ABA is concerned that the proposed clarification is inconsistent with the requirement for credit providers to take 'reasonable steps' to verify information. We do not believe it is within the intent of the "not unsuitable" test established under the NCCP Act for a licensee to be required to use all possible sources to verify every aspect of a consumer's financial situation. The requirement is for the licensee to take 'reasonable steps' to verify the consumer's financial situation to ensure that the consumer can meet their income without substantial hardship. This is reflected in 3.146 of the Explanatory Memorandum to the NCCP Act that stated that credit providers "must make such efforts to verify the information provided by the client as would normally be undertaken by a reasonable and prudent lender" in the relevant circumstances. This reflects the inherent difference in a licensee obtaining information and asking a credit applicant about their living expenses, and the requirement to verify them. Verifying all elements of a customer's

	living expenses with certainty is difficult and may not be possible to do at all. The ABA suggests that there are some specific circumstances where it would be useful for ASIC to provide some guidance of what reasonable steps a licensee should consider taking in a scalable approach to verification of an applicant's financial situation, including: • joint accounts and liabilities • income derived from indirect sources (e.g., money given by a parent to their child), and • where there are foreseeable changes to a customer's circumstances.
C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?	The ABA has a number of concerns about the proposed 'if not, why not' approach, including: • it undermines the legislative requirements to take "reasonable steps" to verify a customer's financial situation • it is not necessary to meet the statutory requirement for 'reasonable' verification • it risks introducing inefficiencies to the provision of services to customers associated costs, and • it risks introducing a "tick the box" compliance process with limited value to protecting customers. This is particularly an issue in the context of today's competitive environment where customers have grown to expect seamless engagement with financial institutions and rapid credit decisioning. This approach may introduce subjectivity into the credit assessment process, which could embed further inconsistency in the way credit decisions are made across industry. The ABA's preferred approach in the guidance for credit providers to meet the statutory test for verification would be to require them to be able to demonstrate the sources used as reasonable steps and not to have reasons why other potential sources were not used.
C2Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	A requirement to seek, have regard to, and judge inconsistencies between, multiple sources of information about a customer's financial circumstances, will place a higher administrative burden on customers and increase the costs of originating credit.

	Under the proposed approach, customers will be asked for more information when applying for credit, which they may find intrusive. Credit providers are likely to take longer to make credit decisions due to the resource intensive nature of what would be required. This will be of concern to most customers who have come to expect efficient processing of their applications. It will most impact customers seeking credit urgently (e.g., for motor vehicle repairs or to replace broken appliances).
C2Q4 What additional business costs would be involved in this approach?	The ABA notes that the same business costs outlined in our response to B1Q7 would apply to this approach.
C2Q5 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.	The ABA is concerned this approach may have a number of potential competitive impacts: • provide incentives for customers to access credit through providers that are not regulated under the NCCP Act • smaller or new entrant credit providers with less sophisticated systems may be disadvantaged, depending on their ability to make necessary changes and invest in technology to take advantage of digitised and shared data • intermediaries (e.g., mortgage brokers) and customers may gravitate towards those credit providers that are able to provide the most seamless and efficient application and verification processes to the detriment of customers, and • deter customers from switching products or financial institutions over time, if they perceive the application process to be overly burdensome or prolonged.

ASIC Proposal C3

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

(a) A benchmark figure does not provide any positive confirmation of what a particular consumer's income and expenses actually are. However, we consider that benchmarks can be a useful tool to help determine whether information provided by the consumer is plausible (i.e. whether it is more or less likely to be true and able to be relied upon).

(b) If a benchmark figure is used to test expense information, licensees should generally take the following kinds of steps:

(i) ensure that the benchmark figure that is being used is a realistic figure, that is adjusted for variables such as different income ranges, dependants and geographic location, and that is not merely reflective of 'low budget' spending;

(ii) if the benchmark figure being referred to is more reflective of 'low budget' spending (such as the Household Expenditure Measure), apply a reasonable buffer amount that reflects the likelihood that many customers 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 customers 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.

Question	Feedback
C3Q1 Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?	The ABA submits that benchmarks and statistical measures can and should be used by credit providers in taking reasonable steps to verify a consumer's financial situation. The ABA supports ASIC's proposals in C3 to require credit providers to take steps to ensure that benchmarks are accurate and realistic and are reviewed appropriately. The industry anticipates that over time, benchmarks and statistical measures will be further developed based on large data sets to a greater degree of accuracy and be even better at indicating risks of financial default.
C3Q2 Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable.	The ABA believes that over time, the need for buffers may become less relevant as benchmarks and statistical measures are developed that are more accurate. In the meantime, we consider that banks need to be appropriately developing and applying a reasonable buffer to their benchmarks that reflects ASIC's guidance.
C3Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	The ABA believes that it would be against the interest of customers for ASIC to set guidance in RG 209 that would unreasonably constrain the ability of banks to use benchmarks and statistical measures to satisfy responsible lending requirements.
C3Q4 What additional business costs would be involved in this approach?	In the long term, the industry has the potential to use benchmarks that are more accurate based on larger data sets to significantly decrease costs across the credit process.

ASIC Proposal C4

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

Question	Feedback
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?	Sections 116 and 128 of the NCCP Act require a credit licensee to assess whether a proposed credit contract will be 'not unsuitable' for a consumer. As part of this, the licensee needs to make reasonable inquiries on a customer's requirements and objectives and then assess whether the particular product meets them. The reference to 'not unsuitable' makes it clear that the obligation is not to ensure that the product is the best or most appropriate product for that consumer. This is the test that was recently upheld following close examination by the Royal Commission, which recommended against any change. Industry supports the current standard of 'not unsuitable' embedded in the NCCP Act and believes that this test provides adequate and appropriate protection for customers having regard to the types of credit products that the bank offers. The ABA is concerned that ASIC's proposed clarification of guidance on understanding a consumer's requirements and objectives implicitly shifts this to a 'suitability' test and introduces an element of subjectivity that could be characterised as akin to a standard required for providing financial advice. The introduction of this element of subjectivity changes the public policy position that has underpinned the responsible lending requirements in the NCCP Act since 2009. This "do no harm" approach was endorsed by the Royal Commission. Any ASIC guidance should align with the current public policy settings and the observations of the Royal Commission.
C4Q2 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	Based on the experience of customers in financial advice, it is possible that the process will become more complex and costs of origination will increase.
C4Q3 What additional business costs would be involved in this approach?	There may be additional business costs involved with: • system and process changes to accommodate a more detailed and manual interaction with customers in the majority of all credit applications • initial and ongoing training costs for staff on new requirements • ongoing monitoring of compliance.

ASIC Proposal D1

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

Question	Feedback
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.	The ABA is concerned that issues in relation to the interpretation and application of the NCCP Act and associated regulatory frameworks, including RG 209, are impacting on the provision of credit to small business. We believe that there are a number of key aspects of this impact on small business including: • in many small business lending applications instances, homes or other personal assets are being used as security over business lending; • small business customers frequently comingle their business and personal cashflows and often do not distinguish between their personal and business borrowings – this often means their requirements and objectives across these, and their capacity to repay loans are intrinsically linked; • where the funds required for business purposes are less than 50% of the total customer lending requirement, the National Credit Code (**NCC**) applies; and • customer documentation and verification requirements are more complex for a small business customer than for a standard PAYG customer. The ABA suggests that whilst the law under the NCCP Act is clear in not strictly applying to business lending, the complicated financial situation of those customers in small business is often unclear. The objective of this guidance should be to give credit providers comfort to apply the intention of the NCCP Act that these obligations do not apply to credit that is not for a business purpose.
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.	The ABA believes that there is some confusion in relation to consumer lending for purchasing property that may have a commercial or investment component but should not usually fall under the NCCP Act, such as:

	• where an individual is purchasing a property, they will reside in but also contains a commercial component (e.g., a boarding house or motel) • when a commercial property is used as security to borrow funds to purchase a new home to live in, and • whether there is a limit on how many investment properties an individual can buy before falling out of the NCCP Act regime. ASIC could provide further guidance to industry to ensure that it is not extending the NCCP Act to lending that should not be covered.

ASIC Proposal D2

We propose to include new guidance in RG 209 on:
(a) the role of the responsible lending obligations, and in particular the obligation to take reasonable steps to verify information provided about the consumer's financial situation, in mitigating risks involved in loan fraud; and
(b) risk factors that might indicate that additional verification steps should be taken.

Question	Feedback
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 customers entering unsuitable credit contracts as a result of fraud? Why or why not?	The ABA provides our general support for ASIC providing more specific guidance to help better identify fraud and reduce the risk of customers entering unsuitable credit contracts. We believe more specific guidance on processes that licensees should have in place to identify false or unreliable information provided by a third party would be helpful. We also support further guidance on some reasonable steps a licensee could take in these circumstances. We do not believe there is sufficient clarity in what ASIC is proposing to consider how much of an impact this will have on fraud levels, particularly in addition to the current industry work already under way, as highlighted in the recent inquiry into loan application fraud. We note that credit fraud is often undertaken in order to obtain a level of credit that is in accordance with a consumer's stated requirements and objectives and is often very sophisticated (carried out by experienced third parties such as dealerships) and hard to detect. Therefore, it is important to ensure that any ASIC guidance does not

	serve to highlight ways to better carry out fraud in the system for those intent on doing so. The ABA also submits that the guidance should reflect the fact that all parties to a credit contract, including customers, have an obligation under section 154 of the National Credit Code to act honestly in providing financial information.
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.	The ABA supports the risk factors and additional verifying steps outlined by ASIC, particularly on the basis that the licensee can undertake measures that are reasonable in the circumstances. In terms of some specific aspects of credit fraud, we suggest that ASIC acknowledge that it can often be difficult to verify information in certain circumstances. For example, in relation to forged or doctored bank statements used for fraud, it may not be easy to verify these electronically (e.g., if a customer does not have an existing relationship with the credit licensee) or manually with a third party (e.g., an employer not verifying pay due to privacy restrictions). Therefore, we submit licensees should be able to rely on their 'reasonable' further steps to verify if this is conducted in good faith.
D2Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	Appropriately developed guidance for industry that does reduce credit fraud levels will have significant benefits for customers through reducing the costs ultimately borne to recover funds involving fraudulent applications. Changes in technology and industry practice through open banking and comprehensive credit reporting should assist in the credit industry reducing fraud. However, we need to ensure that any guidance does not act to unnecessarily restrict access to credit for customers where appropriate due diligence has been conducted but further verification is not possible. This is particularly relevant to small loans applied for by customers that do not have extensive financial records, such as newly arrived migrants, young people and people leaving family violence circumstances. It is important that a licensee is not required to take further steps unless there are clear reasons to doubt the reliability of information

	provided by the consumer and/or a third party involved in the application. An extended credit assessment process (e.g., requiring more manual processing of inquiry and verification) inevitably impacts on customers by making the process lengthier and more difficult for them. This move back towards more manual processing in many instances comes at a time when customers are expecting quicker decision-making processes and seamless experiences in financial services.
D2Q4 What additional business costs would be involved in this approach?	This proposal has the potential to significantly increase business costs through: • significant changes to licensee systems being required • greater level of manual intervention in the credit decision process, where this may be currently automated • training and education costs for staff, and • upgrading systems and processes to ensure privacy and data protection rights are maintained.

ASIC Proposal D3

We propose to include guidance in RG 209 to clarify how repayment history information may be used, including that:
(a) the occurrence of repayment difficulties on one product will not necessarily mean that a new credit product will in all cases be unsuitable for that consumer; and
(b) this information should instead trigger the licensee to make more inquiries to enable it to understand those repayment difficulties, and the likelihood that the circumstances of the consumer leading to those difficulties will mean that the consumer would also be unable to meet financial obligations under the new product being considered.

Question	Feedback
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?	The ABA appreciates the objective of ASIC in potentially providing guidance to discourage licensees from treating hardship indicators as a trigger for automatic refusal. However, we submit that decision making for the provision of credit for customers with a negative repayment history should be primarily the responsibility of the credit licensee. Any relevant regulatory guidance should maintain a licensee's ability to set its own credit risk levels and policies.

	The ABA submits that a licensee should not be required to conduct mandatory additional inquiries for customers with certain negative repayment history information or prevented from extending credit to them where appropriate.
D3Q2 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	Any change to the guidance on how payment history information may be used will have an impact on customers, particularly if it limits the flexibility of licensees to make their own credit risk decisions. As with many other aspects of these proposed changes, additional costs for the provision of credit would result from the significant system and process changes required to facilitate additional inquiries.
D3Q3 What additional business costs would be involved in this approach?	Depending on the nature of the guidance provided, this may impose increased costs for industry. It is difficult to envisage how a licensee can conduct additional inquiries suggested in the proposal with a much greater level of manual processing, including direct follow up contact with customers.

ASIC Proposal D4
We propose to include new guidance in RG 209 about maintaining records of the inquiries made and verification steps taken by the licensee, reflecting our findings and recommendations on good recording practices included in REP 493.

Question	Feedback
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?	The ABA supports ASIC providing new guidance in RG 209 as to what it considers good practice for licensees to record in order to demonstrate compliance with responsible lending obligations. We suggest that this should be for guidance only and not be overly prescriptive as ABA member banks have developed their own policies to appropriately record credit application determinations. These are retained for internal or external review as well as for dispute resolution purposes.
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.	Any guidance on 'best practice' should be reflective of the fact that licensees have developed their own individual means of preparing and maintaining records. It should also be flexible enough to allow future innovation in how licensees do so.

	The ABA suggests that the credit application form is usually the most appropriate means of recording the completed inquiry and verification steps. ASIC should stipulate the minimum types of key information that it expects licensees to record in such documentation (e.g., product type, employment status, living situation etc.).
D4Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	This approach, if appropriately drafted, will help to better confirm the financial circumstances disclosed by the consumer and how the licensee has appropriately assessed their credit application. It will also assist in the review of any suggested cases of maladministration of credit and in dispute resolution matters.
D4Q4 What additional business costs would be involved in this approach?	The ABA believes that there may be costs for business if ASIC's guidance requires significant systems changes. ABA member banks have devoted considerable time and resources to developing their own credit filing and recording systems and procedures.

ASIC Proposal D5
We propose to provide additional guidance in RG 209 on what information we think should be included in a written assessment.

Question	Feedback
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?	The industry recognises that practices in relation to written assessments have been inadequate and inconsistent. That is why ABA member banks over the past few years have spent considerable time and resources in developing assessments that: • meet the needs of their customers and are often subject to ongoing customer testing • have been designed in a particular format within their bank's systems and processes, and • are well understood by the bank's representatives and staff. We therefore submit that any guidance from ASIC on the development of assessment should not be mandatory. Moreover, the ABA suggests that any prescription of disclosures for customers should be appropriately tested with customers before ever being set in the regulatory guidance to ensure that it meets customers' expectations and will be in fact, a valuable enhancement to the credit application process for them.

D5Q2 Please provide any comments on the example set out in Appendix 2.	Paragraph 209.141 of the current RG 209 states that the written assessment should be "concise and easy for customers to understand". We are concerned that ASIC's proposed change moves away from this important principle as the Appendix 2 written assessment is too lengthy and prescribes a level of detail and form above the critical aspects that a customer needs to understand the outcome of a credit decision. ASIC's example generally replicates the application form. We submit that the form should also not require information on the further inquiries and verification conducted of third-party financial support to be provided to the customer due to privacy concerns.
D5Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?	While there may be some benefit to those customers who request a copy of the written assessment in better understanding how the credit decision was made under the Appendix 2 example, there are also significant concerns with the approach, including: • additional costs for the provision of credit due to significant systems changes being required by licensees and increases in necessary resourcing • the prescribed level of information in the assessment may impose a higher level of fraud risk as the requirements for a customer to obtain credit are provided in great detail • the significant increase in granular information provided to customers may be confusing, and • possible risks arising from obligations under the AML/CTF legislation. We also note that customers are able to access their credit information at any time through an appropriate national credit reporting body.
D5Q4 What additional business costs would be involved in this approach?	A written assessment in this form, involving a shift from customer declared to verified data, would necessitate significant changes to the licensees' current systems, processes and frontline training. This would be disproportionate to the value added for customers given they will have already entered into a credit arrangement by this point. For certain products, ABA member banks currently do provide a detailed summary to customers prior to submitting their application. However, changing the approach from customer declared data to verified data would be a significant change and may cause customer confusion in situations where we utilise additional verification data form

	our internal assets (e.g., CCR data, lower income verification) that would not be aligned to customer declared data. The ABA suggests that any mandated changes should only be considered in a phased way and allow an appropriate time for transition to minimise costs and difficulty of implementation.

About the ABA

With the active participation of 23 member banks in Australia, the Australian Banking Association provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services.

The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.