

Responsible Lending Conduct

Responsible Lending

The NCCR Act requires that all registrants and licensee and their representatives adhere to a range of specific conduct obligations relevant to responsible lending. Broadly, these responsible lending conduct obligations set in place the expected standards of behavior for those engaging in credit activities with consumers.

There are different commencement dates for some obligations dependent upon whether the registrant or licensee is an Authorised Deposit-Taking Institution (ADI).

The objective of the responsible lending obligations is to ensure that a broker or lender or other industry participant does not:

- Enter into credit contract or consumer lease with a consumer
- Suggest a credit contract or consumer lease to a consumer; or
- Assist a consumer to apply for a new credit contract or consumer lease or an increase in an existing credit contract if the credit contract or consumer lease is “unsuitable”

Asic recommend that there are three steps required to meet these responsible lending obligations:

- Making reasonable inquires about the consumers financial situation, requirements and objectives;
- Taking reasonable steps to verify the consumers financial situation; and
- Making preliminary assessment (for credit assistance providers such as brokers) or final assessment (for credit providers such as lenders) as to whether the credit contract or consumer lease is ‘not unsuitable ‘for the consumer based on the information from the first two steps.

These activities must be undertaken before an application for a particular credit product with Paramount (or a particular consumer lease with a particular lessor) is commenced.

To whom do responsible lending obligations apply and from when?

Responsible lending obligations apply to registrants, licensees and their representatives (whether credit providers or credit assistance providers). Registrants and licensees are responsible for ensuring that they and their representatives take appropriate actions to meet these obligations

Asic have recognised in their Regulatory Guide 209: Credit licensing: Responsible lending obligations that the obligations of credit providers (such as lenders) and credit assistance providers (such as brokers or lenders dealing directly with consumers) may at times differ.

For Authorised Deposit - Taking institutions (ADIs) such as banks, the responsible lending obligations apply from 1 January 2011. For non – ADIs, such as brokers, there is a two stage commencement of these obligations – ‘Phase Two’ (disclosure) from 1 January 2011.

For a registrant or licensee that provides credit assistance (such as a broker), the responsible lending obligations apply when they:

- Suggest or assist with, or provide a new credit contract or consumer lease;
- Suggest or assist with or increase the limit on a particular credit contract; or
- Suggest a consumer remain in a particular credit contract or consumer lease.

Making reasonable inquiries – Know your client (fact find)

The responsible lending obligations under the NCCP Act require you to:

- Make reasonable inquiries about the consumer’s financial situation, requirements and objectives;
- Take reasonable steps to verify the consumers financial situation; and
- Make preliminary assessment (for credit assistance providers such as brokers) or a final assessment (for credit providers such as lenders) as to whether the credit contract or consumer lease is ‘not unsuitable’ for the consumer based on the information from the first two steps.

You are not required to undertake every avenue of inquiry to determine a consumer’s financial position – you are only required to make ‘reasonable inquiries’. The level of inquiries required will depend on the particular circumstances and the nature of the services provided to consumers (ASIC calls this ‘scalability’).

To illustrate the scalability of reasonable inquiries, ASIC have suggested that the inquiries expected to be made for a more basic credit contract (for example, a small personal loan) will be less detailed than those required for a mortgage. Further, a greater level of inquiry is necessary for debt consolidation and refinancing.

You should ensure that you have specific processes in place to ensure that the appropriate reasonable inquiries are made and that all information collected is recorded for future reference.

A template Fact Find and assessment document is provided on our web site. This template must be adopted in full, if you do not submit it on one of your own.

Reasonable inquiries about client objectives

Reasonable inquiries must be made about a consumer’s requirements and objectives so that you may match these to the features and benefits of any credit contract you recommended.

Depending upon circumstances, the types of inquiries you may undertake could include:

- The purpose for which the credit is required;
- The amount of credit or maximum amount of credit sought;
- The time frame for which the credit is provided;
- Whether the consumer seeks any particular features or flexibility and understands the costs and risks of those features;
- If the loan is to purchase a specific item, the term of the loan relative to the useful life of the asset.

More inquiries may be necessary where it is evident that;

- The consumer has limited capacity to understand the credit contract;
- The consumer has conflicting objectives;
- The consumer is confused about their objectives
- The consumer has difficulty articulating their objectives;
- There is a mismatch between the consumer's objectives and the product being considered by the consumer.

Reasonable inquiries about the financial situation of the client

Reasonable inquiries must be made about a consumer's financial situation so as to determine their ability to meet all the repayments, fees, charges, and transaction costs associated with the credit contract or consumer lease.

These inquiries could include:

- Amount and source of income (full-time, part-time, casual, etc)
- Consumer's fixed expenses;
- Consumer's variable expenses;
- Credit contracts to be repaid from credit advanced;
- Credit history
- Maximum amount repaid under the loan (including all fees);
- Consumer's particular circumstances (age, number of dependants);
- Consumer's assets (nature and value); and
- Geographical factors (remoteness).

Verification of financial information

A registrant or licensee and their representatives must undertake reasonable steps to verify their client's financial situation.

As with 'reasonable inquiries' what constitutes taking 'reasonable steps to verify' information is scalable, and will depend on the information and resources to which you have access. Generally, this will require you to take some positive steps to verify the information provided by the consumer.

ASIC have stated in Regulatory Guide 202: Credit licensing: Responsible lending conduct that:

In contract to a final assessment made by a credit provider for the purposes of entering a client into a credit contract or consumer lease, the assessment made by a credit assistance provider is considered to be a preliminary assessment based on the information available to the credit assistance provider. This does not diminish their responsibilities with regard to verification; however it recognises that a credit assistance provider may not have access to some information that is available to a credit provider. Credit providers generally have access to a wider range of information than credit assistance providers (e.g. via credit reports, or account information for existing customers).”

ASIC have recognised that as brokers you may not have access to all of the avenues available to a lender to verify financial information, but the obligation to take reasonable steps to remains.

Methods of verification of financial information

The methods of verification you may choose to use will vary, depending upon a number of circumstances, but may include:

- Recent original payroll/payslips to verify the income of a PAYG Client;
- Confirmation of employment with employer;
- Recent income tax returns;
- A statement from the clients accountant to verify the income of a self-employed client;
- Business activity statement to verify the income of a self-employed client;
- Recent original bank statements to verify savings
- Recent original statements for other investments to verify assets.

There will be other ways that you may seek to verify the financial situation of your clients. It is important that you not only take reasonable steps, but that you record what steps were taken.

It is important to remember that the level of verification which should be undertaken will vary depending upon individual circumstances.

Additional verification of financial information

Additional verification may be required if the information gathered is deficient or incomplete. Additional inquiries may need to be made if the information you have:

- Is inconsistent
- Exceeds the standard range for them (for example, their stated income is greater than what may be expected for that type of work);
- Is not current

Another registrant or licensee (such as a lender) may rely on information obtained by you even though the former:

- Is still bound by the responsible lending obligations; and

- Should have process in place to ensure reliability of the information provided to them.

Debtor Obligations

The NCCP Act states that: “a person must not make a false or misleading representation in relation to a matter that is material to entry into a credit contract or a related transaction or in attempting to induce another person to enter into a credit contract or related transaction”.

This means, for example, that a consumer who makes a false or misleading representation to a lender to induce them to provide credit may be liable for any loss suffered.

This is an important obligation on consumers, however, it is still imperative that you take reasonable steps to verify any financial information provided by a consumer.

Assessment

Preliminary Assessment and Final Assessments

Credit assistance providers (such as brokers) must undertake a ‘preliminary assessment’ that a credit contract or consumer lease is ‘not unsuitable’ based on the consumers financial situation, requirements and objectives before recommending the credit contract or consumer lease .

Credit providers (such as lenders) must undertake a final assessment that a credit contract or consumer lease is not unsuitable based on the consumers financial situation, requirements and objectives before entering into that credit contract or consumer lease.

From 1 January 2011, copies of assessments (either preliminary or final) MUST be provided to a consumer if the consumer requests it. The copy of the assessment must then be provided within certain time frames that will be outlined in later training materials.

A credit provider does not need to provide the final assessment if the transaction does not go ahead.

A credit assistance provider does not need to provide the preliminary assessment if they do not provide credit assistance to the consumer.

It is very important that you record the actions you undertake in forming your assessments and the outcomes of the assessments, even now when you are not required to provide a copy of the assessments to consumers. This is so you will be able to demonstrate the actions you have taken to meet your responsible lending obligations if ever called to do so in relation to a particular loan.

Undertaking an Assessment

In order to make an assessment, you should consider two main questions.

- **Will the consumer be able to meet their financial obligations without substantial financial hardship?**

- **Does the credit contract or consumer or consumer lease meet the consumers' requirements and objectives?**

The assessment should be based on the information on hand as a result of the inquiries and verification discussed above. The outcome of the assessment is to ascertain that the proposed credit contract or consumer lease is 'not unsuitable' for the consumer.

Unsuitability

The proposed credit contract or consumer lease will be unsuitable if, at the time of the assessment, it is likely that:

- The consumer will be unable to comply with their financial obligations under the proposed credit contract or consumer lease, or could only comply with substantial hardship; or
- The proposed credit contract or consumer lease will not meet the consumer's requirements or objectives.

Capacity to repay – Meeting Financial Obligations without substantial hardship

Generally, consumers should be able to meet a credit contracts or consumer lease's financial obligations from income rather than equity in an asset. However, there may be circumstances where there is a reasonable position (e.g. bridging loans).

The possible range of factors you may assess when considering a consumers capacity to repay a credit contract or consumer lease could include:

- The consumers current income and expenditure;
- The maximum amount the consumer is likely to have to pay under the credit contract for the credit or consumer lease for the lease;
- The extent to which any existing credit contracts are to be repaid, in full or in part, from the credit advanced; contract or consumer lease;
- The consumer credit history, including any existing or previous defaults in making payments under a credit contract or consumer lease;
- The consumers future prospects, including any significant change in the consumers financial circumstances that is reasonably foreseeable (such as a change in the amount to pay under a credit contract or consumer lease).

There may be matters that will not be able to be known to you at the time of the assessment. This may arise where a consumer does not disclose a matter despite your inquiries, and/or where there was no reasonable way of you verifying the information provided, and/or where there was no way that either you or your consumer could have known what issues may arise in the future.

Meeting Financial Obligations

Consumers should be able to meet a credit contract's or consumer lease's financial requirements from their assessable income. A consumer should not rely upon their equity in an asset to meet this financial obligation.

If a consumer could only comply with a credit contract by selling their principal place of residence, there is a presumption that the consumer can comply only with substantial hardship.

What is “Substantial Hardship”?

“Substantial Hardship” is not defined within the NCCP Act and ASIC has stated that they do not propose to give any definitive formula.

There are however a range of factors you should consider to determine if a credit contract or consumer lease is likely to result in substantial hardship to the consumer, such as consideration of:

- All costs (including fees) of the proposed credit contract or consumer lease;
- Money remaining after deducting living expenses from the consumers after Tax income;
- Consistency and reliability of consumers income;
- Whether the consumers expenses are significantly higher than average;
- Other debt obligations of the consumer;
- How vulnerable the consumer is to interest rate increases or ‘honeymoon’ rates;
- Whether the consumer is likely to have to sell an asset to repay the loan.

What is the consumer cannot currently comply with their existing financial obligations?

Where a consumer cannot currently comply with their existing financial obligations under a credit contract or consumer lease (or only with substantial hardship) a credit licensee may refinance the clients debts if, after refinancing the consumer will be able to comply with the resulting credit contract or consumer lease without substantial hardship.

Meeting Requirements and Objectives

You should only recommend or suggest a credit contract or consumer lease where the parameters of the contract or lease match your client’s requirements and objectives as you have established during your inquiries.

The Assessment

Not Unsuitable

You should consider a particular credit contract or consumer lease not unsuitable if at the time of the assessment and based on the reasonable inquiries and verification you have undertaken:

- The consumer would be able to meet their financial obligations under the credit contract or consumer lease without ‘substantial hardship’ and

- The credit contract or consumer lease meets the consumer's requirements and objectives.

If your assessment reveals that the credit contract or consumer lease is not unsuitable you may:

- Suggest that credit contract or consumer lease , or an increase in it, to that consumer; or
- Assist the consumer to apply for that credit contract or consumer lease.

If a credit provider's assessment reveals that the credit contract or consumer lease is not unsuitable, they may:

- Enter into or increase that credit contract or consumer lease with the consumer; or
- Suggest that credit contract or consumer lease, or an increase in it, to that consumer; or
- Assist the consumer to apply for that credit contract or consumer lease.

Unsuitable

Credit providers and credit assistance providers have an obligation to say 'no' to a consumer who is seeking credit if an assessment indicates the credit contract or consumer lease does not meet the consumers requirements and objectives or that the consumer could only meet their obligations with substantial hardship.

You must **not** suggest or assist a consumer to apply for a credit contract or consumer lease or an increase in credit contract if your assessment indicates unsuitability.

Timing of the Assessment

As credit assistance providers, you must undertake the preliminary assessment within 90 days prior to the day on which you suggest that or assist the consumer to apply for or increase the credit limit of a particular credit contract or consumer lease with a particular credit provider. Your preliminary assessment must cover the period for which it is proposed the consumer will enter into the credit provider. Your preliminary assessment must cover the period for which it is proposed the consumer will enter into the credit contract or consumer lease or increase the credit limit of the credit contract.

Credit providers (such as lenders) must undertake a final assessment within 90 Days prior to entering into or increasing the credit limit of a credit contract or entering into a consumer lease .The final assessment must cover the period for which it is proposed that the consumer will enter into the credit contract or consumer lease or increase the credit limit of the credit contract.

Recording and Communicating the Assessment

Prior to 1 January 2011, the assessment must be completed but there is no requirement to provide a copy to the consumer. Whilst a copy of the assessment may not be required to be provided to the consumer, it is very important that you document the assessment process in each case.

Retention of records demonstrating your consideration of your client's requirements and objectives may however be new for many of you and we encourage you to use the template Fact Find and Assessment

document on our web site to supplement your current processes as required to assist you to meet these new obligations.

From 1 January 2011, a consumer may request a written copy of their assessment from the credit provider or credit assistance provider, and this must be provided within a regulated period of time outlined in subsequent training materials.