AUSTRALIAN
RETAIL
CREDIT
ASSOCIATION

3 February 2021

National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020

Thank you for the opportunity to provide a submission on the *National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020* (the Bill).

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include credit providers, credit reporting bodies and, through our associate Members, many other types of related businesses providing services to the industry. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

ARCA's Members operate across all segments of the retail credit industry, and include large banks, mutuals, finance companies and fintechs. As a result, within our Membership there will be both large and smaller credit providers that are subject to the prudential requirements and the oversight of APRA, and others that will be subject to the new non-ADI framework overseen by ASIC.

It is important to note that, given the broad nature of ARCA's Membership, the differential nature of the reforms and the lack of certainty regarding elements of the reforms, there is a diversity of views across Members in respect of the reforms proposed under the Bill. However, there is a common view that there is a need to address the specific issues relating to verification, living expenses and foreseeable changes (described below).

Submission

ARCA welcomes the overall policy intent of the reforms to improve "the flow of credit by reducing the time that it takes consumer and business to access credit".[1] As described in our submission to Treasury in relation to the exposure draft of the Bill[2], there are elements of the current responsible lending regime that result in uncertainty for lenders and create inefficiencies in the lending process. In our earlier submission, we describe these as the:

- Verification issue
- Living expense issue
- Foreseeable change issue

To improve lending to Australian consumers – particularly as the economy recovers from the pandemic – these issues need to be addressed.

However, we consider that the regulatory framework implemented under the Bill may not provide sufficient clarity to lenders in respect of those issues and will also reduce the relevance of the recent ASIC v WBC decision which in some areas gave greater clarity to lenders regarding their responsible lending obligations.

Further, the Bill creates two parallel systems[3] that will inevitably impact the competitive landscape, though the significance of this is impossible to determine in advance.[4]

Likewise, the parallel regimes established by the Bill means the legal requirements protecting a consumer will depend on the status of the lender (i.e. ADI v non-ADI). While responsible lending laws tell a lender what the lender needs to do, they also tell a consumer what they should expect of a lender. However, while it is common for consumers to consider products from both ADI and non-ADI lenders, it would be unusual for a consumer to consider the regulatory status of a lender when they make their choice. The risk under the proposed parallel regimes is that, should the consumer find themselves in dispute with their lender, they may then be told that the outcome of the dispute depends on the regulatory status of the lender (rather than the simple facts of what the lender did or didn't do). This is likely to cause confusion and frustration for consumers who find themselves in that situation.

While we welcome the policy intent behind the proposed legislation, we believe an alternative approach should be considered that delivers the desired outcomes but also maintains a more unified system of regulation which reduces the risk of unintended

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[1] *Explanatory Memorandum to the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020.*

[2] Attached as Annexure A. See section B, *Key Issues of verification, living expenses and foreseeable changes*.

[3] As an example of the parallel systems, we note that APRA is consulting on adding a "substantial hardship" element to APS 220 to "ensure appropriate alignment with the non-ADI lenders' regime". However, the proposed changes *do not* align the regimes as the prudential regime requires ADIs to merely "assess" whether the borrower would experience substantial hardship, while the non-ADI regime would prohibit a non-ADI from entering into a credit contract if the borrower is likely to experience substantial hardship – while also setting out very specific circumstances for when a borrower is deemed to experience substantial hardship (which have no equivalent in the prudential standard).

[4] We note that the significance of the competitive distortion will depend on many factors, including the final non-ADI credit standards set out in the Ministerial determination, any changes to the prudential standards developed by APRA, and how those requirements are applied by APRA, ASIC, AFCA and the courts.

consequences. For example, the *National Consumer Credit Protection Act* permits the regulations to prescribe what steps must be taken – or do not need to be taken – in respect of the inquiries and verification stage.[5] Regulations could be made to provide clarity in respect of the verification, living expense and foreseeable change issues.[6]

In terms of the Bill in its current form, our earlier submission to Treasury (attached as Annexure A) included detailed suggestions on changes that might better achieve the policy intent, and also reduce the risk of unintended consequences. If the policy approach proposed under the Bill is to be followed, the key changes we identified involved ensuring that:

1. The Ministerial determination that establishes the Non-ADI credit standards provides sufficient clarity to non-ADI lenders and does not impose additional barriers to lending.[7]

   For example:
   i. Consideration should be given to fundamentally changing the approach adopted under the exposure draft Determination, as the current proposal, by including the 'substantial hardship test', effectively reintroduces the existing NCCP responsible lending obligations (while also removing the clarity provided by the ASIC v WBC decision);
   ii. The final Determination needs to provide additional clarity and certainty in relation to the issues of verification/borrower responsibility, living expenses and foreseeable changes which gives effect to a risk-based (i.e. scalable) approach; noting that the attempts in the exposure draft Determination to provide for such an approach are poorly executed; and
2. The prudential obligations applying to ADIs are reviewed and, where appropriate, changes incorporated into APS220 to help ensure a level playing field (including to reflect the changes recommended under (1) in respect of the non-ADI credit standards).[8]

Further, we suggest that Treasury maintain a taskforce to oversee the implementation and operation of the reforms on an ongoing basis over the next 18 – 24 months to ensure the reforms are meeting the Government's objectives.

[5] See, for example, section 130(2) NCCP. We note that the regulation impact statement within the Explanatory Memorandum to the Bill discusses maintaining the 'status quo' (i.e. the current responsible lending framework within the NCCP for all lenders), however does not contemplate the potential for refining and clarifying the obligations through regulation.
[6] For example, the regulations could further refine and confirm the approach taken by the court in the ASIC v WBC decision in relation to the relevance of 'living expenses' in the assessment of 'substantial hardship'.
[7] We note that we raised a number of concerns regarding the exposure draft of the *National Consumer Credit Protection (Non-ADI Credit Standards) Determination 2020* in our submission to Treasury. A further draft of that determination has not been released and so we do not know whether our suggestions have been adopted.
[8] It is also important to ensure that AFCA, when applying the prudential standards, recognises that those standards are designed to ensure the overall health of the ADI's portfolio and should not be applied in a way that creates inflexible obligations on individual loans.

Yours sincerely,

Mike Laing
Chief Executive Officer
Australian Retail Credit Association

Annexure A – ARCA submission to Treasury on exposure draft Bill

Ms Claire McKay
Banking and Access to Finance Unit
Treasury
Langton Cres
Parkes ACT 2600

20 November 2020

By email: creditreforms@treasury.gov.au

Dear Ms McKay

Consumer Credit Reforms

Thank you for the opportunity to provide a submission in response to the package of reforms that will give effect to the Government's announced changes to the consumer credit framework.

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include credit providers, credit reporting bodies and, through our associate Members, many other types of related businesses providing services to the industry. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

Importantly, ARCA's credit provider Members represent nearly all segments of the retail credit industry, including large banks, mutuals, finance companies and fintechs. As a result, within our Membership there will be large and smaller credit providers that are subject to the prudential requirements and the oversight of APRA, and others that will be subject to the new non-ADI framework overseen by ASIC.

Summary

ARCA agrees that there are elements of the existing responsible lending framework that could be improved, particularly as they relate to the expectation to verify a borrower's

financial situation, to understand the borrower's 'living expenses' and to predict changes to the borrower's financial situation (see section B, below), and that appropriate regulatory reform is necessary. Any reform must also ensure that – as far as possible and appropriate – the competitive "playing field" for lenders is not inadvertently altered.

We note that the Government has already announced the overall policy approach to the reforms, which will see:

- the removal of responsible lending obligations from ADIs, so that they will be subject to APRA's lending standards; and
- non-ADIs being subject to a 'risk-based regime' for credit assessments administered by ASIC (and appropriately adopting key elements of APRA's ADI lending standards).

Recognising the policy drivers of the Government's decision, our submission is underpinned by two overarching objectives:

- seeking to improve the operation of the proposed changes to better enable them to achieve the Government's stated policy intent (as extracted below); and
- seeking to ensure the competitive positions/dynamics in the market are not unduly affected by having different approaches to credit risk regulation for ADIs and non-ADIs, and large credit providers and small credit providers.

As an overall observation, we note that the Government's policy intent is a significant and potentially positive change to the regulatory framework that has shaped lending in Australia for more than a decade. However, the manner in which the policy intent is being implemented does not necessarily remove much of the uncertainty surrounding the application of the current responsible lending obligations. Unless the uncertainties we have identified are addressed prior to the effective date for their implementation, there is a risk that the Government's concerns around an "increasingly risk adverse and overly conservative" approach to lending may not resolved.

In the following sections, we discuss:

- risks that the Government's policy intent is not achieved due to the design of the draft Determination,
- the impact of the reforms on the issues of verification/borrower responsibility, living expenses and foreseeable changes (which many of our Members suggest are the key issues that are currently impacting their ability to lend efficiently and confidently),
- how AFCA's interpretation and application of the reforms may impact the effectiveness of the reforms, and
- how the reforms may impact the competitive positions/dynamics in the market.

We discuss the detail of the draft Determination in Appendix A.

While we make additional specific recommendations in Appendix A, we make the following broader recommendations which we consider will help give effect to the Government's policy intent and to minimise the potential impact of the reforms on the competitive dynamics in the credit industry:

> **Recommendation 1:** Treasury to maintain a taskforce to oversee the implementation and operation of the reforms over the next 18 – 24 months to ensure they are meeting the Government's objectives.

Recommendation 2: As part of that taskforce, Treasury accept and act upon real time feedback from stakeholders (including lenders and consumer advocates) regarding the effectiveness of the reforms, and any unforeseen consequences.

Recommendation 3: Treasury (with ASIC and APRA) to work closely with AFCA to ensure that AFCA understands the expectations that are required of lenders under the new regulatory framework, so that it gives effect to those expectations through its complaint handling. This could involve ensuring that AFCA only applies the specific regime that applies to the relevant lender (i.e. non-ADI framework to non-ADIs and ADI framework to ADIs) and does not impose obligations under codes of conduct to non-signatories.

Recommendation 4: The Determination to provide additional clarity and certainty in relation to the issues of verification/borrower responsibility, living expenses and foreseeable changes which gives effect to a risk-based (i.e. scalable) approach – as these are the key issues that many of our Members consider act as obstacles to lending efficiently (noting also recommendation 7).

Recommendation 5: ASIC and APRA to be specifically tasked to ensure their respective regulatory oversight of the relevant regimes is, as far as possible and appropriate, consistent.

Recommendation 6: Consideration should be given to an alternative approach to that taken in the draft Determination, as the current proposal, through the inclusion of the 'substantial hardship test', effectively reintroduces the existing NCCP responsible lending obligations. Recommendation 9 in Appendix A provides detail on how ARCA considers this could be done.

Recommendation 7: To the extent that changes are made to the Determination (including in relation to the issues of verification/borrower responsibility, living expenses and foreseeable changes) consideration should be given to whether those changes should also be incorporated into APS220, to help ensure a level playing field and to apply those changes to ADIs which account for the majority of credit to consumers.

Given the broad nature of ARCA's Membership, the differential nature of the reforms[9] and the lack of certainty regarding elements of the reforms[10], there is a diversity of views across Members in respect of the reform, however we do note that the need to address the specific issues described in section B is common to Members.

A. Is the stated policy intent given effect to?

In essence, the approach taken to the reforms involves the application of the prudential obligations in paragraph 44 of the redrafted and not-yet operative, *APS220 Credit Risk Management* to all credit providers – both ADIs and non-ADIs, while at the same time

[9] In addition to the differences in regulation between ADI and non-ADI, we note that there will also be differences based on whether a lender is a signatory to a relevant code of conduct which (subject to *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020*), may soon also constitute obligations under the law.

[10] We note, in particular, the proposed changes to APS220 to incorporate a 'substantial hardship' test will be of relevance to both ADIs and, for the purposes of assessing the competitive effects, non-ADIs.

retaining the 'substantial hardship' test under the *National Consumer Credit Protection Act* (NCCP) for non-ADIs and adding a new 'substantial hardship' test to the obligations under APS220 for ADIs. In doing so, the reforms are suggested as giving effect to the Government's policy intent of "simplifying Australia's credit framework to ensure consumers … can get timely access to credit, particularly as the economy recovers following the COVID crisis".[11]

We are concerned that, by assuming the APRA prudential framework is less limiting than the current NCCP legislative framework, the reforms may not meet the stated policy intent of the Government. Based on the plain wording of the obligations in the APRA prudential standard (and proposed to be mirrored in the non-ADI framework), those obligations are, in many respects, more prescriptive and less flexible than the current NCCP legislative provisions. Importantly, they are often also no less ambiguous than the current NCCP legislative provisions.

Whether the reforms give full effect to the policy intent may depend on lenders' risk tolerance, how the obligations are enforced by ASIC or APRA, and how they are applied by AFCA.

In addition, we note that the non-ADI framework set out in the draft Determination imposes certain obligations on lenders that the recent ASIC v Westpac decision confirmed did *not* apply under the current NCCP legislative regime (see Appendix A).

B. Key issues of verification, living expenses and foreseeable changes

The NCCP responsible lending obligations were originally drafted to be a principles-based framework that was designed to ensure that unsuitable credit is not provided to consumers. The principles-based approach allows for – and requires – a level of sophistication of licensees to design and maintain processes and systems that are appropriate to their business structure and product-range. We consider that this approach is appropriate and must be retained to allow for competition and innovation to occur in the credit industry.

However, that principles-based approach – and the absence of a 'check-list' approach to compliance – invariably increases the potential for differences in opinion to arise between stakeholders as to the meaning of the responsible lending obligations and their application to specific lending tasks.

Nevertheless, the feedback from our Members suggests that there are a small number of core issues that, if addressed, would resolve a significant amount of uncertainty under the responsible lending obligations – and potentially help improve the flow of credit to Australian consumers. The three most significant issues are:

- The level of verification required of a borrower's financial situation and the absence of a 'borrower responsibility' concept that would place a reasonable degree of responsibility on the borrower to provide accurate and complete information to the lender (**'verification issue'**); and
- The expectation placed on lenders to undertake a forensic examination of a borrower's historical 'living expenses' – both inquiries and verification - to predict their future needs in order to assess whether the borrower would be likely to experience "substantial hardship" as a result of the loan ('**living expense issue**').

[11] See p.1, *Consumer Credit Reforms Fact Sheet*, Australian Government.

- The expectation placed on lenders to predict future changes to the borrower's circumstances ('**foreseeable changes issue**').

It is important to note that the above issues are not the direct result of the responsible lending framework as set out in the current NCCP. Rather, the issues largely arise from how the obligations in the NCCP have been interpreted by ASIC and AFCA (see below for a further discussion of how AFCA may interpret and apply the changes).

In fact, in finding that it was open to the lender to use an expense benchmark to assess whether the borrower was likely to experience substantial hardship, the recent ASIC v Westpac decision confirmed the meaning of the law contained in the NCCP and arguably went a significant distance to resolving the living expense issue. While not explicitly addressed in the case, we consider that the overall practical and sensible approach taken by the court also suggests a sensible approach would be taken by the court to the foreseeable change issue (noting, in particular, the judicial approaches taken in the case in respect of a borrower's "future" living expenses and assessing a borrower's ability to meet principal and interest payments after an interest only period ends).

The verification issue is largely the result of ASIC and AFCA imposing a verification approach based on what verification "could" be undertaken (and then enforced as a 'must'), rather than what verification it is "reasonable" to take (as provided for under the law).

To give effect to the Government's stated policy intent, the reforms must address these three specific issues.

The draft Determination – through subparagraphs (8)(2)(d) and (e) – appears to be attempting to provide clarity and certainty to lenders in relation to the verification and living expense issues.

However, overall, we do not consider that these specific issues are adequately addressed in the reforms (particularly when considering how the reforms may be interpreted and applied by AFCA) due to the limited, vague and unclear nature of those paragraphs. In relation to the living expense issue, we consider that by changing the legal framework and removing the relevance of the ASIC v Westpac caselaw, the reforms may reintroduce uncertainty and compliance risk for lenders.

The draft Determination does not attempt to address the foreseeable change issue and specifically goes against the findings of the court in the ASIC v Westpac case in relation to the assessment of loans with an interest only period (see paragraph 7(2)(e)). The Determination otherwise provides no clarity or limitation on the obligation to predict "foreseeable changes".

We discuss this issue in more detail in the context of the draft Determination in Appendix A.

C. Interpretation and application of the changes by AFCA

Many of our Members have noted that the obstacles to lending resulting from the NCCP responsible lending obligations arise from AFCA's interpretation and application of the law, in addition to ASIC's interpretation and enforcement of those obligations. This has been particularly noted amongst smaller Members (both ADI and non-ADI) which have significantly less ability to absorb the costs and process disruption resulting from AFCA complaints.

At times, the concern of our Members reflects a fundamental difference in view of the requirements of the NCCP responsible lending obligations between AFCA and lenders – noting that our Members report that it is not uncommon for AFCA to extrapolate beyond the guidance within ASIC's RG209.

Of course, as noted above, the principles-based approach taken under the NCCP does create the potential for differences in opinion to arise between stakeholders. Given AFCA is charged with ensuring consumers are treated fairly and in accordance with the law, it is not surprising that they may, at times, take a more expansive view of what is required of lenders under the NCCP's responsible lending obligations (particularly in the context of "good industry practice"). [12]

The concept of lending "responsibly" or "prudently" is complex and, in order to ensure that inappropriate obstacles to lending are removed, it is imperative that AFCA be given clear guidance as to what is required of lenders (and, possibly more importantly, what is *not* required).

We do not consider that the proposed reforms will do this.

Overall, we note that AFCA will now be tasked with applying separate legal regimes to different classes of lenders; APS220 applying to ADIs and the NCCP non-ADI framework applying to non-ADIs.[13] One of those regimes (i.e. APS220), will be supported by additional guidance (i.e. APG220 (draft) and APG220) and one will not.

In addition, some lenders may be subject to additional, voluntary obligations contained in relevant codes of conduct (i.e. Code of Banking Practice and Customer Owned Banking Code of Practice).

AFCA will also need to interpret and apply additional relevant legislative reforms – particularly the new Design and Distribution obligations.

This is a complex and difficult task.

The draft Determination, which sets out the details of the non-ADI framework, does little to provide clarity and certainty to AFCA (or, in fact, lenders subject to that Determination). As noted above, even where the non-ADI framework seeks to provide certainty to lenders in relation to the verification and living expense issues, that clarity is undermined by limiting and vague drafting which will require a significant degree of interpretation by AFCA (see, for example, the references to "reasonable grounds" in subparagraph (8)(2) and "reasonable estimates" in subparagraph 8(2)(2)(e)).

There are, in total, ten references to "reasonable-ness" in the Determination[14], each of which will require AFCA to interpret and apply their judgment.

Paragraphs 7(1)(b) and 11 – which seek to imbed the "risk-based" approach to the obligations – will cause significant additional complexity for AFCA to interpret and apply as

[12] As an example, a non-ADI Member notes that AFCA applied APRA's prudential guidance in APG223 relating to the use of the specific 2% buffer and floor rates (as APG223 required at the relevant time). This was done on the basis that AFCA considered those prudential expectations as 'good industry practice'.

[13] In addition, they will have to apply the existing responsible lending obligations in relation to small amount credit contracts and consumer leases.

[14] That is, references to "reasonable" or "reasonably".

they must tailor their expectations based on the "nature, type and size of the credit" and the "nature, scale and complexity" of the non-ADI's business.

In practice, without additional direction given to AFCA, we consider that this is a significant task to ask of the dispute resolution scheme and, based on industry's previous experience with the way AFCA has interpreted the existing laws, may impede the ability of the reforms to give effect to the Government's stated policy intent.

D. Impact on competitive positions/dynamics in the credit market

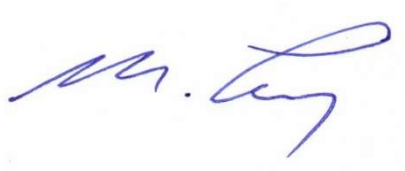
There is a real risk that without consistent treatment by APRA and ASIC the reforms may impact the competitive dynamics in the credit industry.

Given ADIs and non-ADIs provide credit to the same customers, differences in credit risk standards applying to ADIs versus non-ADIs should only reflect the nature of their status as an ADI or non-ADI. For example, it may be appropriate for APRA to establish more prescriptive or limiting obligations for ADIs if it considers that it is necessary to maintain the prudential strength of the organisation or the integrity of the financial system (e.g. the use of specific interest rate buffers so as to reduce the risk of widespread defaults should there be a sudden significant increase in rates[15]).

We note that a Regulatory Impact Statement that includes consideration of the competition impacts of the reform would be an invaluable tool to help stakeholders understand the predicted impact of the reforms on the competitive positions/dynamics in the credit market.

If you have any questions about this submission, please feel free to contact me on 0414 446 240 or at mlaing@arca.asn.au, or Michael Blyth on 0409 435 830 or at mblyth@arca.asn.au.

Yours sincerely,



Mike Laing
Chief Executive Officer
Australian Retail Credit Association

[15] This is not to suggest that a non-ADI acting prudently (i.e. 'professionally') wouldn't use their own form of buffer; it just does not necessarily require the same one as required by APRA.

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Appendix A – ARCA feedback on draft Determination

Paragraph	Comments	Recommendations
Implementation date – 1 March 2021	The implementation date of 1 March 2021 is unrealistic for non-ADIs. This date assumes that the obligations established under the draft Bill and Determination are no more onerous, or different, to those under the existing NCCP responsible lending obligations. The requirements are prescriptive and, potentially, not consistent with the NCCP and/or ASIC guidance in RG209 (which, as described below, includes some facilitative guidance which is not included in the Determination and which may no longer be able to be relied upon to support existing processes). Such a significant change to the regulatory framework will require each and every non-ADI to undertake a complete review of their "systems, policies and processes" to ensure compliance with the legal requirements; this is the case even if the non-ADI is confident their processes are compliant with the existing laws. Even if minimal changes are ultimately required, this will take up significant resources at a time when lenders are still dealing with the impacts of COVID-19.	**Recommendation 8:** The Bill to allow for a transition period of no less than 18 months from 1 March 2021 for non-ADIs (during which the non-ADI may act in accordance with either the existing NCCP responsible lending obligations or the new obligations – or, where the non-ADI is in the process of taking reasonable steps to implement the new obligations, a combination of the two regimes).

	Further, the requirement in s133EB(1)(b)(ii) is a significant new obligation to be placed upon non-ADIs. The "written plan" is not the same as any other documents that the non-ADI is likely to already maintain (including the risk appetite statements that is maintained by most prudent lenders). In effect, the written plan will require non-ADIs to map and justify their end-to-end lending assessment process.	
General	The Determination does not give effect to the Government's announcement to "mirror" APRA's lending standards. By retaining the "substantial hardship" test (which is not currently in APS220) and all the matters in paragraphs 7 – 10, the Determination simply replicates the existing NCCP responsible lending framework (however, in a more prescriptive and less flexible manner). This will make it harder for non-ADIs to comply and place them at a competitive disadvantage compared to ADIs. To give effect to the Government's announcement, and to simplify lending by non-ADIs, the Determination should remove the substantial hardship test and better reflect the relevant risk-based provisions of the prudential standard.	**Recommendation 9:** Redraft the Determination by (i) removing the concept of "substantial hardship" from the Determination; (ii) requiring the non-ADIs to have systems, policies and processes of a 'prudent lender' (i.e. where 'prudent' refers to the concept of a 'professional' lender, rather than a prudentially regulated one); and (iii) incorporating more of the 'risk-based' elements of APS220, such as those relating to credit risk appetite statements (APS220.19) and which are necessary to provide context to the non-ADI's 'systems, policies and procedures'.
7(1) and 9	In retaining the 'substantial hardship' test from the existing NCCP responsible lending obligations, without making any real attempt to define that concept, the reforms simply reproduce the significant confusion that the test currently causes. The uncertainty caused by the substantial hardship test is best illustrated by the living expense issue described above (in Section B). Despite requests (during the 2019 review of RG209) by ARCA and other stakeholders to provide a better description or definition of the substantial hardship	**Recommendation 10:** If the substantial hardship test is to be retained, better clarity on the meaning of that concept must be provided.

	test, ASIC did not do so. Further, through their prosecution of the ASIC v Westpac case, they showed, in ARCA's view, a clear misunderstanding of the meaning of "substantial hardship" (i.e. they considered that it would cause hardship to a borrower if the borrower was required to reduce their pre-loan expenditure, even if the borrower still had enough excess funds to afford a moderate level of spending allowed for under the relevant benchmark). It is arguable that, implicit in ASIC's approach to 'living expenses' is the belief that a borrower who is, for example, required to give up their pay TV account would be considered to be experiencing substantial hardship (see RG209, Table 4). Assuming the substantial hardship test is retained, there must be clearer guidance in the Determination as to what is – and *isn't* – substantial hardship. Such clarity would then assist lenders to apply the requirement to understand the borrower's "obligations" (in paragraph 7(2)(b)(ii)) and give context to the requirement to understand the borrower's reasonably foreseeable expenses (in paragraph 7(2)(g)). We consider that appropriate guidance on the meaning of "substantial hardship" would involve looking at whether the borrower is likely to be unable to afford: • their material non-discretionary expenses (i.e. existing and proposed loan contracts, rent, child support, unusual medical expenses etc); and • their material quasi non-discretionary expenses unless the borrower agrees to give up those expenses (e.g. private school fees).	

	Such guidance would allow non-ADIs to focus on the expenses that genuinely impact whether a customer is likely to experience *substantial* hardship – and less time on less significant expenses (even if they may have an element of "obligation", such as a pay TV account).	
7(2), as expanded upon in 8(2)	We note that the list of factors in subparagraph 7(2) is significantly more prescriptive than the existing NCCP responsible lending obligations, which require consideration of the borrower's overall "financial situation" rather than the individual elements of that financial situation (e.g. income, expense, commitments etc). Importantly, the prescriptive nature of the obligations within the draft Determination may result in those requirements being less flexible and not supporting innovative methods of lending responsibly (even compared to the existing NCCP responsible lending obligations). While 8(2)(a) notes that a licensee is required to obtain "adequate information" to undertake the assessment, the Determination does not clearly recognise that, in some cases, it may not be necessary to collect all the information referred to under 7(2) to make the assessment. For example, for a small credit limit increase, a non-ADI may consider that it is unnecessary to collect all the information referred to in 7(2) as the borrower's repayment history shows a clear ability to service that additional limit increase. A further example could involve a non-ADI considering the borrower's savings history without looking at the specific elements of income and expenses. Such an approach is currently recognised in RG209, Example 15.	**Recommendation 11:** The Determination to recognise indirect means of understanding a borrower's financial situation, such as through the use of savings history as a proxy. **Recommendation 12:** The Determination explicitly recognise that the non-ADI may determine that it is not necessary to collect all the information referred to in 7(2) in every case. That is, it is only required to collect the information that it considers is relevant to the assessment. **Recommendation 13:** In the first instance, the reform package should be sufficiently flexible to accommodate innovation and, secondly, it should establish a process for non-ADIs to engage with the Minister (taking advice from ASIC and other relevant bodies) in relation to the implementation of innovative systems, policies and processes that may not strictly be consistent with the wording of the Determination where the innovations are otherwise consistent with the overall policy intent of the law.

	In respect of the second example, we note that APS220.44(a) requires a similar level of inquiry regarding the specific element of "sources of repayment", however APRA has provided additional guidance in the draft APG223 that savings history may (in a similar way to ASIC's RG209) be used as a proxy for separate inquiries into income and expenses. This issue also illustrates a number of concerns we have with the form of the Determination: • In treating RG209 as redundant, elements of the guidance which facilitate the better provision of credit by lenders will no longer be available to support lender's processes. • The Determination, once set by the Minister, applies strictly to all non-ADIs. There is no apparent ability for an individual non-ADI to engage with the Minister, Treasury or ASIC to seek permission to implement processes that are not compliant with the strict wording of the Determination (such as the use of savings history as a proxy for income and expenses). Compared to non-ADIs, we consider that there is more scope for ADIs to seek the input or permission of APRA to undertake such innovation (which places non-ADIs at a competitive disadvantage).	
7(2)(d)(ii)	See our discussion in relation to the 'substantial hardship' test. The expectation to understand a borrower's obligations should be limited to those 'material' obligations which are relevant to whether the borrower would experience substantial hardship.	**Recommendation 14:** In addition to providing clarity on the meaning of "substantial hardship", the paragraph 7(2)(d)(ii) of the Determination be amended to refer to "material obligations".

	In its current form, the Determination would require overly invasive and onerous obligations to understand immaterial 'obligations' such as a borrower's pay TV account.	
7(2)(e)	This is a retrograde step and will impose obligations in relation to interest-only loans that the ASIC v Westpac case confirmed do not exist when assessing whether the eventual move from interest only payments to principal payments are likely to cause substantial hardship to the borrower – and where the court noted the clear logic of why they *shouldn't* apply (although, we note that there may be prudential implications which would be a reason a similar expectation is included under APS220 – but that does not mean the expectation should automatically apply to non-ADIs). The Determination otherwise provides no clarity or limitation on the obligation to predict "foreseeable changes". In doing so, the Determination does not provide any further certainty to non-ADIs in relation to one of the key issues that many of our Members have identified as being an obstacle to the provision of credit.	**Recommendation 15:** The specific examples in (i) and (ii) of subparagraph 7(2)(e) should be removed. **Recommendation 16:** Additional clarity, including limits, on the need to predict "foreseeable changes" should be given.
7(f), including as expanded upon in 8(2)(e)	We believe that subparagraph 8(2)(e) may be intended to provide a clearer basis for the use of 'benchmarks' by non-ADIs (which would help deal with the 'living expense' issue above (in Section B)). However, the provision is overly complex and difficult to interpret. For example, the requirement to make "reasonable inquiries about the consumer's expenses" while referring to "making reasonable estimates" appears to be contradictory. Is the paragraph attempting to suggest that the "inquiries" may be made of the relevant benchmark, rather than of the borrower? If that is the case, then the provision should	**Recommendation 17:** Simplify the drafting of subparagraph 8(2)(e) to clarify the ability of a non-ADI to rely on benchmarks to provide the estimate of the borrower's foreseeable living expenses (other than material fixed and quasi-fixed expenses, as described above).

	simply state that the prediction of the borrower's "reasonably foreseeable expenses" (under subparagraph 7(2)(g) may be made based on the non-ADI's "reasonable estimate, including using an appropriate benchmark. There is no need to refer to "inquiries" as that reference simply confuses the meaning of the provision. (Importantly, we note our recommendations in relation to the "substantial hardship" test and the need to understand "obligations" would focus non-ADIs' attention on the *material* obligations that cannot be easily adjusted by the borrower and would cause substantial hardship if the borrower is unable to afford them following the loan.)	
8(2)(d)	We welcome the intent to introduce an element of "borrower responsibility" within the Determination. A properly formed concept of borrower responsibility will largely address the verification issue, described above. However, we are concerned that the drafting of subparagraph 8(2)(d) is problematic and, as applied by ASIC and AFCA, there may be little difference between the requirement to undertake "reasonable verification" under the existing NCCP responsible lending obligations and no verification "unless there are reasonable grounds" under the new law. We are also concerned that the borrower responsibility has a very limited application. It appears to only apply to information about the borrower's 'reasonably foreseeable expenses' (i.e. living expenses) and the 'purpose of the credit' (which is similar to the concept of 'requirements and objectives' under the existing law – which was never subject to a verification requirement in any case).	**Recommendation 18:** Additional clarity should be provided as to the meaning of "reasonable grounds" that allows for an appropriate level of borrower responsibility to be applied by non-ADIs. **Recommendation 19:** The requirement to undertake 'reasonable steps' to verify the borrower's sources of income and current risk profile must recognise that this can be done using a risk-based approach, which may not involve any such verification for a particular loan. **Recommendation 20:** Further to recommendations 18 and 19, a lender must not be held accountable for the provision of a falsified document given to the lender by or on behalf of the borrower, unless the lender was recklessly indifferent to the falsity of that document.

	The Government's stated policy intent was to allow: *"lenders to rely on the information provided by borrowers, unless there are reasonable grounds to suspect it is unreliable. Borrowers will be made more accountable for providing accurate information to inform lending decisions, replacing the current practice of 'lender beware' with a 'borrower responsibility' principle."* [16] There is no suggestion in the Government's announcement to exclude information relating to sources of repayment (e.g. income) and the borrower's current risk profile (i.e. total indebtedness and obligations) from that borrower responsibility concept. In fact, the proposed change would arguably not remedy the problem described in the "Risk-adverse lender" example in the Government's announcement. A 'prudent' (i.e. professional) lender will, of course, take the steps that it considers are necessary in relation to a specific loan to verify the borrower's sources of repayment and current risk profile. However, what the lender considers is 'reasonable' may, for a specific credit application, be nothing. This may either be because of the nature of the credit application (e.g. a small credit limit increase on a loan that is performing well) or through another risk-based approach. To give effect to the Government's policy, this must be reflected in the Determination.	

[16] See p.3, *Consumer Credit Reforms Fact Sheet*, Australian Government.

	Further, we note that under the current regime, lenders have even been held responsible for relying on falsified documents given to them by or on behalf of the borrower. It is a peculiar situation for a lender, which itself is the victim of the fraud, to be considered in breach of the law. If there is to be a genuine concept of 'borrower responsibility', the Determination must make it clear that an innocent lender is not liable because of such fraud being perpetrated on them.	
8(2)(f)	We note that this provision will place a higher obligation on non-ADIs to verify information received from agents of the borrower, compared to information received from the borrower themselves. On a 'principles' basis, information received from a third party should not be considered inherently less trustworthy than information received directly from a borrower (particularly as many of those third parties will be licensed, or a representative of a licensee, and subject to all the requirements of the NCCP, including the general conduct obligations and best interest duty). We note also that the drafting of the paragraph is vague and would potentially capture all sources of information, including credit reporting bodies, and government and other public information sources.	**Recommendation 21:** Paragraph 8(2)(f) should be reviewed to allow for a more principles-based approach to verifying information received from third parties. **Recommendation 22:** Clarity should be provided that recognises that one way to verify information from third parties is to provide that information directly to the customer and obtain their direct affirmation. **Recommendation 23:** Paragraph 8(2)(f) should be clarified to confirm that it does not apply to third party sources of information, such as credit reporting bodies, and government and other public information sources.
9(2)	Subparagraph 9(2)(b) establishes an impractical requirement to evidence a borrower's "intent" to sell their property. At the time of borrowing money to purchase a house, a 55-year-old will recognise that they "may" need to sell when they retire but will not necessary have formed the intention. More relevantly, is the question of whether the borrower recognises that they *may* need to sell.	**Recommendation 24:** Noting our recommendation to provide better clarity as to the meaning of "substantial hardship", paragraph 9(2) should be removed. This would also apply to paragraph 9(3). **Recommendation 25:** Otherwise, paragraph 9(2) should be redrafted to apply only to situations in which the sale of the residential property is the direct result of the loan (and

	However, even that requirement imposes a prescriptive and inflexible obligation on lenders, and requires an additional 'tick-the-box' approach to lending under which every 55-year-old is asked the same question. This is unnecessary and simply adds red-tape. We note also that ADIs are not currently subject to any of the requirements in paragraph 9.	not the result of the borrower subsequently changing their financial situation, such as by retiring).
9(3)	Subparagraph 9(3) is highly prescriptive and inflexible, and fails to recognise the practicality that a borrower may choose to cease paying rent in order to obtain credit. For example, younger borrowers (millennials) may choose to move back to parent's residence to enable them to afford the credit.	**Recommendation 25:** Paragraph 9(3) should be redrafted to recognise and give effect to a borrower's choice to cease paying rent in order to obtain credit; whether this is a firm choice at the time of entering into the credit contract or an option that the borrower may later exercise (see also recommendation 22).
9(4)	Subparagraph 9(4) reimposes the specific obligations created under the current NCCP responsible lending provisions in respect of credit cards. This is not consistent with the Government's intent to simplify the credit industry, move back to a principles-based framework and reduce the "prescriptive, complex, costly, one-size-fits-all" credit regime that has developed under the current responsible lending regime. Nor does it recognise the significant developments and work that credit card providers have undertaken to ensure credit card products are offered responsibly to borrowers, or the additional work that lenders will be required to do under the design and distribution obligations. Further, we note that this legislative obligation will apply only to non-ADIs.	**Recommendation 26:** Subparagraph 9(4) should be removed.