Responsible Lending Conduct

Phase One

Learning Guide

Version: June 2010

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Introduction

LEARNING GUIDE

This Learning Guide has been developed to assist Mortgage Managers to meet their responsible lending obligations from 1 July 2010 under the National Consumer Credit Protection Act (NCCP) Act.

Additional responsible lending obligations which come into effect for Mortgage Managers from 1 January 2011 will be covered in future guides.

This Learning Guide provides information about the obligations which, for Mortgage Managers (and some others), come into effect on 1 July 2010. It also includes examples to assist you to meet those obligations.

There are activities and review questions to help you in your learning process.

This Learning Guide is not legal advice and we suggest that if you require further information or clarification about your obligations, you should seek independent professional advice.

TERMINOLOGY AND DEFINITIONS

It is important that you are aware of terms and phrases used specifically in this guide of which some have been taken directly from the NCCP Act. Please note that some of these terms have been summarised so as to relate to the activities a Mortgage Manager will perform in the normal course of their business. Full definitions can be found within the NCCP Act.

ACL	See **Australian Credit Licence**.
ASIC	Australian Securities and Investments Commission.
Australian Credit Licence (ACL)	A licence that authorises the licensee to engage in particular Credit Activities.
Consumer Credit	Consumer credit applies to the provision of credit if: (a) the debtor is a natural person or a strata corporation; and (b) the credit is provided or intended to be provided wholly or predominantly: (i) for personal, domestic or household purposes; or (ii) to purchase, renovate or improve residential property for investment purposes; or (iii) to refinance credit that has been provided wholly or predominantly to purchase, renovate or improve residential property for investment purposes; and (c) a charge is or may be made for providing the credit; and (d) the credit provider provides the credit in the course of a business of providing credit carried on in this jurisdiction or as part of or incidentally to any other business of the credit provider carried on in this jurisdiction. The predominant purpose for which credit is provided is: (a) the purpose for which more than half of the credit is intended to be used; or (b) if the credit is intended to be used to obtain goods or services for use for different purposes, the purpose for which the goods or services are intended to be most used.
Consumer Credit Regime	The consumer credit regime which will apply under the National Consumer Credit Protection Act, the National Credit Code (NCC), and associated regulations.
Consumer Lease	For the purposes of the NCC, a consumer lease is a contract for the hire of goods by a natural person or strata corporation under which that person or corporation does not have a right or obligation to purchase the goods.
Credit Activities	These include: • Providing credit under a credit contract or consumer lease; • Securing obligations under a credit contract or consumer lease by way of mortgages or related guarantees; • Benefiting from mortgages or guarantees of obligations under a credit contract or consumer lease; • Providing credit services in connection with a credit contract or consumer lease; and • Other activities prescribed in the regulations. A person cannot engage in credit activities unless they are registered, licensed or a representative of a person or entity registered or licensed with ASIC to engage in credit activities.

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Credit Assistance	Suggesting or assisting a consumer to remain in, apply for or increase a particular credit contract or consumer lease. It doesn't matter whether credit assistance is provided on your own behalf or on behalf of another person.
Credit Assistance Provider	The person who provides **Credit Assistance**.
Credit Contract	A 'credit contract' (**National Credit Code** - regulated Credit Contract [Consumer Credit]) is a contract where: • the debtor is a natural person or a strata corporation; and • the credit is provided wholly or predominantly for: - personal, domestic or household purposes; or - to purchase, renovate, improve or refinance a residential investment property; and • a charge is made for the credit.
Credit Licensed Person/Entity	A person or entity licensed with ASIC to engage in credit activities – that is, the person or entity holds an Australian Credit Licence (ACL).
Credit Provider	A person or entity that provides credit e.g. lenders such as banks and credit unions. Includes a prospective credit provider.
Credit Registered Person/Entity	A person or entity registered with ASIC to engage in credit activities.
Credit Representative	A **registrant** or **licensee** may give a person or corporate entity a written authority to engage in specified credit activities on behalf of the registrant or licensee. An authorised person is a credit representative, and an authorised corporate entity is a corporate credit representative. The **registrant** or **licensee** is responsible for the actions of their credit representatives.
Credit Services	Providing **credit assistance** to a consumer or acting as an **intermediary** between a lender and a consumer are credit services.
Employees	Any employee of a **registrant** or **licensee** is a "representative" for NCCP Act purposes. Registrants and licensees may have their own rules for who can or can't engage in particular types of credit activities, as they must ensure that the relevant employees have appropriate training. For instance, a **registrant** or **licensee** may require that only employees with certain training and designations can provide credit assistance.
Intermediary	You are an intermediary if, in the course of, as part of, or incidentally to, a business, you: (a) act as an intermediary (whether directly or indirectly) between a credit provider and a consumer wholly or partly for the purposes of securing a provision of credit for the consumer under a credit contract for the consumer with the credit provider; or (b) act as an intermediary (whether directly or indirectly) between a lessor and a consumer wholly or partly for the purposes of securing a consumer lease for the consumer with the lessor. It doesn't matter whether you act as an intermediary on your own behalf or on behalf of another person.
Licensee	See **Credit Licensed Person/Entity**.

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National Credit Code	The National Credit Code (NCC) replacing the State based Uniform Consumer Credit Code. The NCC is a schedule to the NCCP Act
NCC	The **National Credit Code**.
NCCP Act	The **National Consumer Credit Protection Act**.
Non-Employees	A **registrant** or **licensee** can appoint non-employees as "**credit representatives**". (This is a concept similar to "authorised representatives" under the Australian Financial Services License (AFSL) regime.) There are certain additional practical requirements for appointing "credit representatives". These include: • written notice to the credit representative authorising them to engage in specified credit activities on behalf of the credit registered or credit licensed entity/person; and • individual membership of an ASIC approved external dispute resolution scheme such as the Credit Ombudsman Service Limited (COSL) or Financial Ombudsman Service (FOS).
Registrant	See **Credit Registered Person/Entity**.
Representative	(a) an employee or director of a **registrant** or **licensee**; or (b) an employee or director of a related body corporate of the registrant or licensee; or (c) a credit representative of the registrant or licensee.

Section 1 – The Consumer Credit Regime

WHY HAS A NEW NATIONAL REGIME BEEN INTRODUCED?

Historically there has been concern over a range of undesirable market and business practices experienced by some consumers, including:

- Provision of inappropriate advice to consumers;
- Misinformation or lack of information provided to consumers about the credit products recommended or offered to them;
- Potential that consumers may suffer if the businesses offering credit or credit advice are not soundly run;
- Advice provided to consumers by insufficiently experienced, skilled and qualified professionals;
- Consumers being disadvantaged by conflicts of interest experienced by those engaging in credit activities.

The Consumer Credit Regime has been established to protect consumers by introducing a comprehensive national licensing regime for businesses and people who engage in credit activities.

The Consumer Credit Regime and its associated requirements have been identified and legislated through the National Consumer Credit Protection (NCCP) Act and the National Credit Code (NCC).

THE NATIONAL CONSUMER CREDIT PROTECTION ACT (NCCP ACT)

The National Consumer Credit Protection Act has been introduced to provide a national set of rules and regulation for the consumer credit industry.

The NCCP Act is the legislative response to recommendations made by the Council of Australian Governments (COAG) to give the Federal Government responsibility for the regulation of credit activities.

The NCCP Act implements new compliance obligations for businesses and people who engage in credit activities and includes:

- registering with ASIC (or operating as a representative of a registrant) by 1 July 2010 to engage in credit activities;
- applying for or holding an Australian Credit Licence (or operating as a representative of a licensee) by 1 January 2011, and satisfying general conduct obligations;
- an obligation to engage in 'responsible lending';
- being a member of an external dispute resolution scheme; and
- complying with the new National Credit Code.

To engage in credit assistance without a licence is a serious offence punishable by a fine of up to $220,000 or two years imprisonment, or both.

NATIONAL CREDIT CODE (NCC)

Another element of the NCCP Act is the replacement of the Uniform Consumer Credit Code (UCCC) with the new National Credit Code (NCC) from 1 July 2010. The NCC is a schedule to the NCCP Act. The NCC incorporates many of the obligations and requirements of the UCCC but with some important modifications.

Business purposes declaration

A business purpose declaration will be ineffective if a credit provider or credit assistance provider (such as a Mortgage Manager) knew, suspected or had reason to know, if they had made reasonable inquiries about the purpose of the credit, the declaration was inappropriate. This means that a credit provider or credit assistance provider will need to ensure that they undertake reasonable inquiries about loan purposes rather than relying only on the business purpose declaration made by a consumer on the declaration form.

By declaring that the purpose for which the credit being applied for is wholly or predominantly business related, a consumer may lose the protection afforded under the NCC as the loan may be considered a non-regulated or non-coded loan. Protection under the NCC is afforded only to regulated or coded loans.

We suggest that if a consumer has signed a declaration that the credit for which they are applying is wholly or predominantly for business purposes, a Mortgage Manager should clarify the loan purpose with that consumer and explain to the consumer the protection applicable to a regulated loan. The Mortgage Manager should also document their actions and communication with the consumer. If you believe that the business purpose declaration is false (for whatever reason) you should ensure the lender is made aware of your belief that the loan should be considered regulated.

Residential investment

The application of the NCC has been expanded to include credit provided wholly or predominantly to finance the purchase, renovation or improvement, or to refinance an existing credit contract entered into for the purchase, renovations or improvements of residential property for investment purposes.

THE INTRODUCTION OF NATIONAL LICENSING

The new credit regime also introduces national licensing for those engaged in 'credit activities'. This includes credit providers (or lenders such as banks, building societies and credit unions) and credit assistance providers (such as Mortgage Managers). This is different from the current regulation of financial services under the *Corporations Act 2001* (Corporations Act) as it is tailored to meet the issues arising from the receipt of credit which consumers must repay.

THE REGULATOR OF THE NEW REGIME

The Australian Securities and Investments Commission (ASIC) is the regulator of the new regime. ASIC have developed and published Regulatory Guides to assist our industry participants to meet their obligations under the NCCP Act. These are available on the ASIC website (www.asic.gov.au) in the Credit section.

Not only does ASIC have the task of assessing Australian Credit Licence (ACL) applications and granting licenses, it also has the power to suspend or cancel a credit registration or an ACL, or to ban individuals from engaging in credit activities. ASIC can take action as it considers appropriate in a broad range of circumstances to protect consumers from the risk of financial harm and to maintain the integrity of the credit regime.

As the NCCP Act is a Federal Act, a person who is banned or disqualified by ASIC will be unable to legally engage in credit activities anywhere in Australia.

COMPLIANCE WITH OBLIGATIONS

Registrants and their representatives must comply with certain obligations of the NCCP Act from 1 July 2010.
These general conduct obligations are discussed further in Section 3 and are detailed within ASIC *Regulatory Guide 202: Credit registration and transition*. These obligations are not as extensive as those which apply under the licensing regime.

Credit licence applicants must be able to demonstrate in their licence application that they can comply with all of their obligations under the NCCP Act from the time their ACL is granted and on an ongoing basis. These obligations range from training and competency to maintaining appropriate compensation arrangements.

ASIC have issued the following Regulatory Guides to provide assistance to a licensee on how they may seek to meet their obligations:

- *Regulatory Guide 205: Credit licensing: General conduct obligations*
- *Regulatory Guide 206:Credit licensing: Competence and training*
- *Regulatory Guide 207: Credit licensing: Financial requirements*
- *Regulatory Guide 209: Credit licensing: Responsible lending conduct*
- *Regulatory Guide 210: Compensation and insurance arrangements for credit licensees*

This course is intended to provide guidance for Mortgage Managers in relation to their obligations from 1 July 2010.

Where these obligations apply equally to Mortgage Managers both during the registration period and licensing period, this will be specified. However please note that further training and guidance will be provided in the future in relation to the particular obligations which apply from the date a licence is granted.

PRE-EXISTING STATE/TERRITORY LEGISLATION

Western Australia, New South Wales, Victoria and the Australian Capital Territory all have existing legislation relating to finance broking and/or credit provision. While most state based legislation will be replaced by the incoming National Credit Regime, the transition will occur slightly differently.

Mortgage Managers and brokers dealing with consumers domiciled in NSW, will need to continue to use the Finance Broking Contract (in its current format) until 1 January 2011. **This means that Mortgage Managers should ensure they continue to enter into Finance Broking Contracts with consumers located in New South Wales even after 1 July 2010.**

Not all States/Territories have declared their intention with regard to finance broking contracts. We will endeavour to keep you informed.

Activity 1: National Consumer Credit Protection Act

a) Identify the four central obligations that businesses and individuals must meet under the National Consumer Credit Protection Act if they wish to engage in credit activities.

b) What are the penalties for engaging in credit activities without a licence?

Activity 2: Consumer Credit Activities

Identify the characteristics of credit regulated by the NCCP Act and the NCC (consumer credit).

Section 2 – Registrants, Licensees and their Representatives

CREDIT REGISTERED PERSONS/ENTITIES (REGISTRANTS) AND CREDIT LICENSED PERSONS/ENTITIES (LICENSEES)

Any natural persons, partnerships, corporate entities and multiple trustees can apply for a credit registration and credit licence.

A registrant or licensee is responsible for the actions of its directors and employees (representatives – see below) and persons/entities that the registrant or licensee has authorised to engage in credit activities on its behalf (credit representatives – see below).

REPRESENTATIVES

Depending on the type, representatives may require written authorisation (credit representatives – see below) or may be considered representatives by virtue of their role with a registrant or licensee (representative – see below).

A director of a registrant or licensee that is a corporate entity is a representative of that registrant or licensee.

Example:
The directors of ABC Pty Ltd are John Smith and Mary Jones. If ABC Pty Ltd is credit registered with ASIC, then both Mr Smith and Ms Jones as directors are considered representatives of ABC Pty Ltd.

An employee of a registrant or licensee is a representative of that registrant or licensee.

Example:
A Mortgage Manager, James Brown, has registered with ASIC as a natural person. He employs Darcy Taylor as a full-time loan writer and pays Mr Taylor a regular salary. Mr Taylor as an employee is considered a representative of James Brown.

Representatives are not required to register with ASIC directly or to seek their own independent credit licence on their own behalf.

The registrant or licensee is responsible for the credit activity conduct of its representatives.

CREDIT REPRESENTATIVES

Credit representatives are a special type of representative.

A registrant or licensee can authorise non-employees to engage in credit activities on their behalf. The authorisation must be in writing and must specify the credit activities in which the credit representative is authorised to engage.

A template letter is provided in Section 9.

Example:
James Brown also has three sub-contractors working in his business as brokers. Mr Brown may elect to authorise those sub-contractors in writing to provide credit assistance to consumers on his behalf. Each of those sub-contractors would be credit representatives operating under the authority of Mr Brown in his capacity as registrant.

The registrant or licensee must ensure that each credit representative:

- is a member of an approved external dispute resolution scheme (eg COSL or FOS); and
- has not been banned or disqualified from engaging in credit activities (under Federal, State or Territory laws); and has not been convicted, within the last 10 years, of serious fraud;

otherwise, the authorisation may have no effect.

The registrant or licensee must also notify ASIC of the authorisation of a credit representative within 15 business days of the authorisation. Please note that the requirement to notify ASIC of the authorisation of a credit representative commences on 1 July 2010, and the online form to provide notification to ASIC may not be available until this date.

Credit representatives are not required to register with ASIC directly or to seek their own independent credit licence. A credit representative is not permitted to also hold their own credit licence to engage in the same credit activity/ies, otherwise the credit representative authorisation will be ineffective.

The registrant or licensee is responsible for the credit activity conduct of its credit representatives.

CREDIT REPRESENTATIVES OF TWO OR MORE REGISTRANTS OR LICENSEES

A credit representative can be a credit representative of two or more registrants licensees provided that each registrant licensee consents.

The registrants or licensees may be jointly and severally responsible for the credit activities of jointly authorised credit representatives.

Example:
Jenny Jones works part-time for two different and unrelated companies, ABC Pty Ltd and DEF Pty Ltd, both of which are credit registered. Ms Jones is not an employee of either company. ABC Pty Ltd and DEF Pty Ltd are aware of Ms Jones's working relationship with each company and both have knowingly authorised Ms Jones to provide credit assistance to their respective clients. Both companies will be jointly and severally responsible for Ms Jones's credit assistance conduct, and may be called upon to provide compensation to consumers if her conduct proves to breach the NCCP Act and result in loss to consumers.

Further details regarding responsibilities of credit representatives of more than one credit registered or licensed person/entity can be found in Section 76 of the NCCP Act.

MAINTAINING COMPETENCY

Registrants and licensees must ensure that they and their representatives maintain competency to engage in credit activities.

Minimum Education

ASIC have set minimum required educational qualifications for registrants and licencees who are required to hold a Certificate IV in Financial Services (Finance/Mortgage Broking) by 30 June 2014.

Continuing Professional Development

Licensees must also ensure that they and their representatives engage in a suitable number of hours of continuing professional development activities each year to suit their role within the credit industry. For registrants and licencees, ASIC will require the completion of a minimum of 20 hours of continuing professional development activities. For all other participants, the licensee is required to decide the minimum number of hours of professional development activities after consideration of the participants role and responsibilities, but ASIC expect that the amount should be somewhere between 10 and 30 hours. Licensees should maintain records of the completion of professional development activities as they will be required to certify the maintenance of their and their representatives' competency annually.

Activity 3: Representatives

a) Explain and define the types of representatives.

b) What must a credit representative obtain and from whom to legally engage in credit activities on behalf of a credit registered or licensed person/entity?

c) What is a credit representative required to have in order for their authorisation to be of effect?

Section 3 – General conduct obligations

The NCCP Act identifies general conduct obligations with which a licensee must comply from the time their licence is granted and on an ongoing basis. These general conduct obligations are extensive and detailed. *Regulatory Guide 205: Credit Licensing: General Conduct Obligations* provides detail on ASIC's expectations of a licensee with regards to these obligations.

This learning guide focuses on the general conduct obligations which a registrant must comply with from 1 July 2010.

GENERAL CONDUCT OBLIGATIONS UNDER REGISTRATION

A registered Mortgage Manager's general obligations from 1 July 2010 include:

- being a member of an ASIC approved external dispute resolution scheme (eg COSL or FOS);
- engaging in credit activities efficiently, honestly and fairly;
- complying with any registration conditions;
- complying with the credit legislation;
- having adequate arrangements to ensure that their representatives comply with credit legislation;
- taking reasonable steps to ensure consumers are not disadvantaged by any conflict of interest that may arise in relation to the credit assistance engaged in;
- compliance with any other obligations prescribed by regulations.

CONFLICTS OF INTEREST

During and beyond the registration period, you have an important obligation to take reasonable steps to ensure that your clients are not disadvantaged by any conflicts of interest that may arise wholly or partly in relation to credit activities in which you engage.

Where your interest conflicts with a legal obligation that is owed to your client, the conflict must be managed and monitored to ensure that your client is not disadvantaged.

An example of how a conflict may occur is where you will receive an increased commission percentage for achieving certain volume targets with a particular lender. You must ensure that you do not favour the achievement of such volume targets over the interests of your clients.

It is therefore important that you have processes in place to adequately identify any conflicts of interest and correctly assess the suitability of particular credit contracts (see Responsible Lending Conduct below) so as to ensure your clients are not disadvantaged. It is also critical that you maintain records of your identification of any conflicts and your assessment including all relevant supporting information (see Responsible Lending Conduct below).

Example:
A Mortgage Manager holds accreditation with a number of lenders whose products are representative of the market in which the Mortgage Manager operates. The Mortgage Manager has recommended to a consumer that they apply for a home loan with a particular lender. As a result of this application, the Mortgage Manager's loan application volumes this quarter with that lender will be sufficient for the Mortgage Manager to avoid suspension of his accreditation with that lender and having to attend a retraining session with that lender at a financial cost to the Mortgage Manager.

There is a conflict of interest present between the obligation to suggest a loan that is not unsuitable and the requirement to achieve volume targets.

The Mortgage Manager must take steps to ensure that the credit contract suggested or recommended is not unsuitable for the consumer's financial situation, requirements and objectives, and that the Mortgage Manager has not favoured the achievement of his volume targets over the interests of the consumer. The Mortgage Manager should also keep records of his identification of the conflict and his assessment of suitability (see Responsible Lending Conduct below). Disclosing the conflict may form part of the Mortgage Manager's consideration.

Example:
A registrant has appointed a credit representative and has entered into an agreement under which the level of remuneration increases if the credit representative arranges 30 loans in a month. The credit representative needs to arrange two more loans to achieve this target, and does so by placing borrowers in credit contracts that are unsuitable. By being placed in unsuitable credit contracts, these clients have been disadvantaged by the credit representative's conflict of interest in receiving the higher remuneration.

ASSESSING CONFLICTS OF INTEREST – WHEN DO THEY ARISE?

Conflicts may arise as a result of a number of scenarios, for example:

- **Commissions / incentives** paid by lenders which are not disclosed and which may bias your advice or recommendation towards lenders and / or products which offer higher incentives.
- **Volume targets** – lenders may give you a higher rate of commission for achieving a certain volume of settlements.
- **Other non-monetary incentives** which may bias your recommendations.
- Customers not being offered an **adequate selection of products**.

A consumer may be disadvantaged by such conflicts if as a result of the bias, they are directed to a specific product / loan which is unsuitable for them.

MITIGATING AND MANAGING CONFLICTS OF INTEREST

ASIC considers that the obligation includes the obligation to **manage** and monitor any conflicts that arise in relation to any credit activities in which you engage. This might include:

- **disclosure** (for example, in a product comparison schedule);
- **discussion** with the customer;
- **assessment** to ensure the customer is not disadvantaged by the conflict of interest.

To ensure that such conflicts are managed and customers are not disadvantaged, you **may**:

- Have a suitably comprehensive and competitive product list which should be thoroughly researched and reasonably representative of the products available on the market;
- Match product features to the customer's objectives;
- Disclose commissions associated with the products;
- Undertake a product comparison (features, costs, fees, commissions) and demonstrate how they meet the customers requirements, objectives and financial situation;
- Allow the customer to make the choice of which credit products to apply for, regardless of your recommendation;
- Outline how the benefits of the product to the clients' circumstances will outweigh the potential conflict which led to the recommendation (not unsuitable);
- Request the customer acknowledge that you have done this (via the assessment).

Activity 4: General Conduct Obligations

List the general conduct obligations that come into effect on 1 July 2010.

Section 4 – Responsible Lending Conduct

The NCCP Act requires that all registrants and licensees 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 behaviour 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 Mortgage Manager or lender or other industry participant does not:

- enter into a 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 contact 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 inquiries about the consumer's financial situation, requirements and objectives;
- Taking reasonable steps to verify the consumer's financial situation; and
- Making a preliminary assessment (for credit assistance providers such as Mortgage Managers) 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.

These activities must be undertaken **before** an application for a particular credit product with a particular lender (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 Mortgage Managers 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 Mortgage Managers, there is a two stage commencement of these obligations – 'Phase One' (unsuitability assessment) from 1 July 2010 and 'Phase Two' (disclosure) from 1 January 2011.

This training course is provided for the guidance of Mortgage Managers and focuses on the 'Phase One' obligations. Further training will be provided prior to the commencement of 'Phase Two' obligations (which include disclosure documents such as credit guides, quotes and credit proposal disclosure documents).

For a registrant or licensee that provides credit assistance (such as a Mortgage Manager), 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.

Activity 5: Responsible Lending Obligations

a) What three steps do ASIC recommend to meet the responsible lending obligations that come into effect for non-ADIs from 1 July 2010?

b) Who is obligated to meet the responsible lending obligations that come into effect from 1 July 2010?

c) Who is obligated to meet the responsible lending obligations that come into effect from 1 January 2011?

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 consumer's financial situation; and
- Make a preliminary assessment (for credit assistance providers such as Mortgage Managers) 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 appropriate reasonable inquiries are made and that all information collected is recorded for future reference.

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 recommend.

Depending upon the 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 timeframe 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.

Example:
A consumer seeks a loan of $250,000. The Mortgage Manager providing credit assistance makes reasonable inquiries to establish that $200,000 will be used to refinance the consumer's existing home loan, but makes no inquiries into the purpose of the remaining $50,000 of loan funds, and therefore has failed to meet the criteria for making reasonable inquiries.

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 dependents);
- 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 contrast 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 Mortgage Managers 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 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 client's 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.

Example:
A client supplied pay slips to their Mortgage Manager as a form of evidence of their income. The pay slips were computer generated and generic in nature. The client also provided original bank statements.

The Mortgage Manager was able to verify the payment of salary as detailed on the payslips to the bank account by using the original bank statements. Alternatively, the Mortgage Manager may have chosen to contact the client's employer to confirm their income and employment status, or may have made that contact in addition to verifying the client's income to their bank statements.

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 processes in place to ensure reliability of the information provided to them.

Example:
Note: While this example relates to a credit provider, the principles also apply to you as credit assistance providers.

In order to obtain a credit card with a $3,000 limit, a consumer claimed that she had an income of $50,000 and had one personal loan valued at $5,000. She provided payslips dated 3 and 4 months' prior to her application.

In fact, the consumer only had an income of $18,000 and also had additional undeclared debt with other credit providers. The lender she approached offered her the credit card.

The lender relied on the information provided by the consumer and took minimal steps to verify her financial circumstances in order to provide the credit. The lender made no effort to seek more recent payslips and did not contact her noted employer.

It is unlikely that the credit provider would be considered to have taken reasonable steps to verify her income.

Debtor obligations

The NCCP Act states that: “a person must not a 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.

Example:
If we further consider the example immediately above, the consumer could be considered to have made false or misleading representations to the lender regarding the amount of their income.

Even with the borrower failing to meet her obligations, it is still likely that the credit provider will also be considered not to have taken reasonable steps to verify the consumer’s income.

Activity 6: Inquiries and Verification

a) Identify some of the ways you could undertake reasonable steps to verify the income of a PAYG client?

b) Identify some of the ways you could undertake reasonable steps to verify the income of a self-employed client?

Section 5 – Assessment

PRELIMINARY ASSESSMENTS AND FINAL ASSESSMENTS

Credit assistance providers (such as Mortgage Managers) must undertake a 'preliminary assessment' that a credit contract or consumer lease is 'not unsuitable' based on the consumer's 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 consumer's 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 guides.

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 upon 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 lease meet the consumer's requirements and objectives?

The assessment should be based on the information to 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 contract's or consumer lease's financial obligations from income rather than equity in an asset. However, there may be circumstances where this is a reasonable position (e.g. bridging loans).

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

- the consumer's 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;
- the consumer's credit history, including any existing or previous defaults in making payments under a credit contract or consumer lease;
- the consumer's future prospects, including any significant change in the consumer's financial circumstances that is reasonably foreseeable (such as a change in the amount to pay under a credit contract or consumer lease).

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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 consumer's after-tax income;
- consistency and reliability of consumer's income;
- whether the consumer's 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 if 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 client's 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.

Example:
A consumer wishes to purchase a residential property in which they intend to live for 12 to 18 months while they renovate it. They then intend to sell the property. The property under purchase will be used to secure the loan, and the consumer wishes to make additional payments on the loan without penalty.

Their Mortgage Manager recommends the consumer consider a loan that has no early repayment penalties or deferred establishment costs and has a variable interest rate on the basis that this will enable the consumer to payout the loan with minimum costs when they sell the property, and make additional payments if they wish.

Assuming that the preliminary assessment indicated that the consumer would be able to meet their financial obligations, the Mortgage Manager has taken appropriate steps to meet the responsible lending obligations. The Mortgage Manager should also document their inquiries, verification and 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 consumer's 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 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.

The template Fact Find and Assessment document will be provided for recording details of the steps taken to assess the unsuitability of a credit contract or consumer lease. We encourage you to use the Fact Find and Assessment document 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 provided within a regulated period of time.

Activity 7: Assessment

a) What are the characteristics which may indicate that a credit contract or consumer lease is 'not unsuitable' for a consumer?

b) If an assessment indicates that a credit contract or consumer lease does not meet the consumer's requirements and objectives, then what actions should a lender or Mortgage Manager undertake?

Section 6 – Conclusion

In this guide you have learned about the responsible lending obligations of the NCCP Act which come into effect on 1 July 2010 and what you may do to meet those obligations.

Congratulations, you should now be able to understand:

- the background to the NCCP Act;
- the impact of the general conduct obligations which come into effect on 1 July 2010;
- the impact of the responsible lending obligations which come into effect on 1 July 2010;
- what "consumer credit" is;
- what may be reasonable inquiries about your clients' financial situations, and their requirements and objectives;
- what steps you may take to verify your clients' financial situations; and
- how to make a preliminary assessment about whether a particular credit contract or consumer lease is 'not unsuitable' for your client.

Section 7 – Activity Answers

Activity 1	a) • Being licensed, including complying with the General Conduct Obligations; • Engaging in responsible lending; • Being a member of an external dispute resolution scheme; and • Complying with the new National Credit Code. b) Engage in credit assistance without a licence is punishable by a fine of up to $220,000 or two years imprisonment, or both.
Activity 2	The characteristics of credit regulated by the NCCP Act and the NCC include: • the debtor is a natural person or a strata corporation; and • the credit is provided or intended to be provided wholly or predominantly: - for personal, domestic or household purposes; or - to purchase, renovate, improve or refinance a residential investment property; and • a charge is made for the provision of the credit.
Activity 3	a) Representatives by virtue of being a director of a credit registered or licensed entity. Representatives by virtue of being an employee of a credit registered or licensed person/entity. Credit representatives who are authorised to engage in credit activities on behalf of a credit registered or licensed person/entity. b) Written authority from the credit registered or licensed person/entity specifying the credit activities in which they are authorised to engage. c) Be individual members of an external dispute resolution provider.
Activity 4	The obligations which are effective for a credit registered person/entity from 1 July 2010 include: • being a member of an ASIC approved external dispute resolution scheme (eg COSL or FOS) • engaging in credit activities efficiently, honestly and fairly • complying with registration conditions • complying with credit legislation • taking reasonable steps to ensure that representatives comply • taking reasonable steps to ensure clients are not disadvantaged by any conflict of interest that may arise in relation to credit assistance engaged in • comply with any other obligations prescribed by regulations.
Activity 5	a) • Making reasonable inquiries about the consumer's financial situation, requirements and objectives; • Taking reasonable steps to verify the consumer's financial situation; and • Making a preliminary assessment (for credit assistance providers such as Mortgage Managers) 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. b) • Credit Service Providers (eg. Mortgage Managers) • Credit Providers who are non-ADIs (eg. lenders) c) All credit providers and credit service providers.

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Activity 6	Some examples of the types of information that may be used when verifying income are: a) For PAYG consumers: • recent payroll/payslips; • confirmation of employment with employer. b) For self-employed consumers: • recent income tax returns; • a statement from the consumer's accountant; • business Activity Statements.
Activity 7	a) A not unsuitable assessment would find that: • the consumer was able to comply with their financial obligations under the credit contract or consumer lease; • the consumer could comply with the credit contract or consumer lease without 'substantial hardship'; and • the credit contract or consumer lease meets the consumer's requirements or objectives. b) The provider of credit or credit services has 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 consumer's requirements and objectives. In such circumstance, a credit provider or credit assistance provider must not: • enter into or increase that credit contract or consumer lease with eat consumer; • suggest that credit contract or consumer lease, or an increase in it, to that consumer; or • recommend or assist the consumer to apply for that credit contract or consumer lease.

Section 8 – NCCP Act References

The **National Consumer Credit Protection Act and Regulations** can be accessed via the "Legislation" section of the Australian Government's Consumer Credit website:

http://www.treasury.gov.au/consumercredit

The **ASIC Regulatory Guides and Information Sheets** can be accessed via the "Guidance" option under the "Credit" section of the ASIC website:

http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/ASIC%20guidance%20on%20credit