

8 April 2019

Fleur Grey
Senior Specialist
Credit, Retail Banking and Payments
Financial Services
Australian Securities and Investments Commission

By email: responsible.lending@asic.gov.au

Dear Ms Grey

SME Committee, Business Law Section, Law Council of Australia – Comments on ASIC Consultation Paper 309 ‘Update to RG 209: Credit licensing: Responsible lending conduct’ (RG209).

Introduction

Thank you for the opportunity to provide comments on ASIC Consultation Paper 309 dated February 2019 entitled ‘Update to RG 209: Credit licensing: Responsible lending conduct’ (**Consultation Paper**).

RG 209 sets out ASIC’s guidance on responsible lending for consumer credit under the NCCP. It is designed to assist holders of an Australian Credit Licence (ACL) to understand their responsible lending obligations. The SME Committee recognises that the Consultation Paper is considering appropriate updates to RG209¹ as a consequence of case law, ASIC enforcement and review themes, legislation, technology and, of course, the findings of the Royal Commission².

The Law Council of Australia (**Law Council**) is the peak national body representing the legal profession in Australia. The Small and Medium Enterprise Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) wishes to provide comments on the Consultation Paper. The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SME’s. Please note that the SME Committee’s submission may differ from those made by other Committees of the Law Council because of our Committee members’ perspectives and experiences as advisers to SMEs.

¹ RG09 originally issued in 2010 and last revised in 2014.

² Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry established under Letters Patent issued 14 December 2017

Response

Rather than provide responses to each of the questions listed in the Consultation Paper, the SME Committee wishes to provide a general comment on responsible lending, and then raise serious application issues for some Australian Credit Licence holders, particularly large Authorised Deposit-taking Institutions (**ADIs**).

The SME Committee reiterates the response of the Law Council³ to the Royal Commission's Interim Report⁴ on the subject of responsible lending. The Law Council noted, and the SME Committee concurs, that the *'premise that lenders are a better judge of otherwise competent individuals' best interests than the individuals themselves deserves re-examination*⁵. The Law Council also noted that such re-examination of the current approach to underlying responsible lending obligations of banks could benefit from developments in behavioural psychology which could be instructive in enabling banks to receive from potential borrowers reliable relevant information, particularly on expenditure, given the wide variety of household circumstances of borrowers.

The SME Committee is concerned at what will be viewed as unnecessary constraints on the availability of loans and credit to SMEs and unnecessary assessments and constraints on the continuing position of borrowers who have not entered into any new loans or increased the available credit under loans in existence before the 1 January 2011, being the date responsible lending obligations commenced under the *National Consumer Credit Protection Act 2009* (**NCCP**).

Inappropriate application of RG 209 requirements to SMEs

The SME Committee notes that the NCCP and RG 209 apply to loans or credit provided to consumers and are not drafted to apply to SMEs. Aside from the legislative provisions that have extended unfair contract terms law to SMEs (that prohibit unconscionable, and misleading and deceptive conduct, and that imply 'due care and skill' and 'reasonably fit for purpose' warranties in loan agreements), there is currently no equivalent SME responsible lending regime to that of NCCP for consumers. The main protection for SMEs is contained in the Banking Code of Conduct⁶ (**Code**) (which is effectively legally binding on banks), which prescribes that the lending bank must 'exercise the care and skill of a diligent and prudent banker' when looking at making loans, including loans to SMEs.

There are currently no guidelines from ASIC on responsible lending practices applicable to SME customers. In the aftermath of the Royal Commission, the SME Committee has observed the current practice of ADIs (particularly the major banks) is often to seek to apply the responsible lending guidelines set out in RG 209 to SME customers. The SME Committee recognises that the basis for this developing practice may be due to the crossover that can occur between the business assets and activities of SMEs and the private affairs of the owners of SMEs, who would ordinarily in their private capacity be consumers to which the NCCP and RG 209 would apply, particularly where an SME owner's home taken as security for a loan to the SME.

³ Law Council of Australia (submission) on Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; 31 October 2018 (accessed at <https://www.lawcouncil.asn.au/resources/submissions/interim-report-of-the-royal-commission-into-misconduct-in-the-banking-superannuation-and-financial-services-industry>) ("LCA Submission")

⁴ Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; 28 September 2018

⁵ LCA Submission: paragraph 31

⁶ From 1 July 2019 to be the Banking Code of Practice, approved by ASIC in accordance with RG183

Despite this crossover, the SME Committee is strongly of the view that the responsible lending guidelines for consumers set out in RG 209 are not in any way appropriate to be applied when an ADI assesses the ability of an SME to service debt or repay any loan or credit, and any security for a loan/credit provided by a third party should be assessed accordingly.

In its response to Chapter 4 (Small and Medium Enterprises) of the Interim Report, the Law Council noted that currently the Code requires a lender to 'consider any appropriate circumstances known'⁷ to it when assessing whether an SME can repay a loan by looking at the SME's financial position (being its bank account balance with that lender) or (not 'and') the SME's conduct (being how it has conducted its bank account including deposits, account balance, overdrafts etc), and, where reasonable, allows access to third party resources such as personal guarantees and security to the lender by way of a mortgage over property owned by a third party.

The Law Council suggested⁸, and the SME Committee reiterates, that it would be more appropriate for a lender to assess an SME's ability to service a loan and repay a debt when due by looking at an SME's business plan and cash flow forecasts, which are tailored to best reflect the circumstances of the SME's current and anticipated financial position in the industry in which it operates.

Unnecessary application of RG 209 requirements to loans existing pre NCCP

Likewise, the SME Committee notes that the NCCP, and thereby the responsible lending obligations of ACL holders and ADIs under RG 209, only applies to new loans issued from 1 January 2011, or to extensions of credit under loans existing as at 1 January 2011. The SME Committee is aware that it is currently the practice of ADIs, particularly the major banks, to seek to apply their responsible lending obligations under RG 209 to customer loans existing as at 1 January 2011, even where no new loan or extension of credit has been applied for since 1 January 2011 under those pre-existing loans.

The SME Committee understands that these ADIs are incorrectly advising customers that any change to existing loan terms, not just a new loan application or an extension of credit under an existing loan, requires the application of responsible lending obligations under RG 209 including the assessment of serviceability and repayment of principal, albeit the existing loan is being adequately serviced and the basis for repayment of principal was originally acceptable to the ADI when the loan was originally issued.

Changed ADI internal credit risk assessment for reporting to APRA

The SME Committee appreciates that in relation to both SMEs and customers with pre-existing loans, the Australian Prudential Regulation Authority (**APRA**) has in recent years required ADIs to strengthen reporting to APRA in relation to understanding of their internal credit risk being taken and APRA has, in its prudential guidelines on credit risk assessment, referred to RG 209 as providing guidance for responsible lending that ADIs could utilise to assist them in assessing their internal credit risk. It appears that ADIs are justifying their inappropriate or unnecessary application of RG 209 obligations to both SMEs and pre-existing loan customers on this basis.

The SME Committee considers that the responsible lending obligations set out in RG 209 are not appropriate for the assessment of the credit risk to the lender of loans and credit provided to SMEs. ADIs should assess, and should already have been assessing, their internal credit risk on loans and credit to SMEs based upon the credit assessment information relevant to a particular SME, for example, by looking at a SME's business plan and cash flow forecasts,

⁷ LCA Submission: paragraph 118

⁸ LCA Submission: paragraphs 121 to 126

which are tailored to reflect the circumstances of the SME's current and anticipated financial position in the industry in which it operates, and which can vary considerably due to the differences in circumstances between SMEs.

The SME Committee further considers that RG 209 obligations should not be applied by ADIs for their own internal credit risk assessment of customers with pre-existing loans unless the customer has applied for an increase in credit under that loan. The SME Committee recognises particularly that customers with loans pre-existing 1 January 2011 are already in the ADI's credit risk profile and, unless additional credit is provided, the risk assessment under that profile should not change.

Request for ASIC clarification

The SME Committee therefore calls on ASIC, as a matter of urgency, to clarify to ADIs that the responsible lending obligations in RG 209:

- are not appropriate to apply, and should not be applied, by ADIs to assess applications for loans or credit from SME customers;
- should not be applied to customers with loans pre-existing 1 January 2011, unless a new loan or an extension of credit under pre-existing loans is applied for; and
- should not be applied by ADIs to assess their own internal credit risk for the purposes of reporting to APRA with regard to loans to or credit sought by -
 - SME customers, or
 - customers with loans pre-existing 1 January 2011, unless a new loan or an extension of credit under pre-existing loans is applied for.

The SME Committee also submits that ASIC should seek to have the current provisions of the Code that apply to the assessment of loans or credit to SMEs altered to appropriately require a lender to assess an SME's ability to service a loan and repay a debt when due by looking at the SME's business plan and cash flow forecasts that better illustrate an SME's current and anticipated financial position.

Further discussion

The SME Committee would be happy to discuss any aspect of these comments. Please contact Coralie Kenny, member of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully,



Greg Rodgers
Deputy Chair, Business Law Section