

Changes to the Responsible Lending Laws

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What is responsible lending?

Lenders are obliged to comply with the responsible lending obligations specified in the *National Consumer Credit Protection Act 2009* ('National Credit Act'). The National Credit Act enforces certain requirements on lenders to engage in "responsible lending" when providing credit.

The regulation was passed shortly after the Global Financial Crisis in 2008, with the purpose of curtailing the lending practice that left borrowers worldwide in insurmountable debt.

The responsible lending regulation has served to prevent lenders in Australia from encouraging consumers to enter into credit arrangements that are unsuitable for them. This is achieved by requiring lenders to assess each consumer's specific circumstances, and tailoring credit arrangements accordingly.

Responsible lending obligations place the onus on the lender to take reasonable steps to thoroughly assess the consumer's financial situation and their "unsuitability" for entry into a credit arrangement prior to providing a loan or issuing a consumer credit contract.

Changes to Responsible Lending Law

On Friday 25 September 2020, the Morrison government announced that it intends to reform the responsible lending standards in Australia. The change is aimed to come into force in March 2021.

The removal of the responsible lending standards will allow lenders to rely solely on the information provided by borrowers unless there are reasonable grounds to suspect that such information is unreliable. With emphasis now being placed on the consumer's self-responsibility, lenders will no longer be obliged to make further inquiries into the specific needs of the borrower and will also not be appropriately reprimanded in the event borrowers provide misleading information on their loan applications.

According to the Australian Financial Review, the change will preclude the Australian Securities and Investments Commission (**ASIC**) from enforcing responsible lending laws. Accordingly, a significant avenue of inquiry will be stripped away from ASIC, a crucial financial watchdog in Australia.

Treasurer Josh Frydenberg stated on Friday that the changes are designed to "*increase the flow of credit to households and businesses*". Mr Frydenberg further indicated that "*as Australia continues to recover from the COVID-19 pandemic, it is important that there are no unnecessary barriers to the flow of credit to households and small businesses.*"

Effect of the Changes

Responsible lending standards were introduced over a decade ago and were designed to prevent lenders from granting unaffordable loans and products which were unsuited to the consumer's needs. The standards were established to level the playing field between large-scale lenders (such as banks) and consumers, mostly comprising individuals and small businesses.

As noted above, the objective of responsible lending is to impose a strict obligation on lenders to take all reasonable steps to thoroughly assess the consumer's financial situation, thereby preventing them from arbitrarily granting loans without understanding the specific needs and circumstances of the borrower. It requires lenders to know their customer, to inquire into their specific needs, and to tailor their loans accordingly.

The removal of responsible lending obligations removes a safeguard that exists to protect the consumer. After the change is introduced in March 2021, lenders may grant loans without being required to closely assess and completely understand the consumer's circumstances and needs. This will mean that individuals and small businesses in particular may be granted loans that are unsuitable for them and accordingly acquire debt they may not be able to repay.

As consumers discovered during the Global Financial Crisis, weaker lending standards will result in an increase of loans. This includes circumstances where a responsible lender should have refused the loan.

The government's rationale for the proposed changes should also alarm consumers. It is far from apparent that there is a problem with the flow of credit in Australia at the moment, even in the midst of a pandemic. In contrast to Mr Frydenberg's announcement, the Commonwealth Bank of Australia recently said that the flow of credit is above pre-COVID levels and that lending is growing at a strong pace (as noted by the Consumer Action Law Centre's CEO, Gerard Brody).

At the most recent House of Representatives Economics Committee hearings, the big banks did not raise an issue with the current responsible lending laws. Removing responsible lending obligations will free banks to push credit onto their customers. This is a freedom that financial institutions have not enjoyed since 2008. In many situations this could lead consumers to acquire loans which they ultimately cannot afford, and which a responsible lender should have declined. It is also likely to lead to an increase in household debt. This is alarming considering Australian households are already the second most indebted in the world.

In fact, it was noted by Financial Counselling Australia that *"providing people with unaffordable credit will do nothing to hasten the economic recovery from Covid-19. It will only lead to vulnerable people suffering greater harm and distress in the long run. As Australia seeks a way out of the current economic crisis, now is when we should be doubling down on the lessons learned in the GFC and lend responsibly."*

Shifting the onus on the consumer is problematic as credit applications would become increasingly accessible and will encourage consumers to apply for loans as a result of financial hardship.