



Financial Inclusion, Responsible Lending and Insolvency

An Australian and Global Context

Ros Grady, Senior Financial Sector Specialist :: December, 2013

The Agenda

1

WHAT DO WE MEAN BY “RESPONSIBLE LENDING”?

2

WHY IS RESPONSIBLE LENDING IMPORTANT?

3

HOW IS IT REGULATED IN AUSTRALIA?

4

WHAT ARE THE CHALLENGES?

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What do we mean by “Responsible Lending”?

There are multiple stakeholders who may think about responsible lending from different perspectives:

- The borrower: affordability and product suitability*
- The lender: repayment of facility*
- Other creditors: solvency of the borrower*
- The supervisor: the solvency of the financial institution*
- The macro prudential regulator: stability of the financial system*

What do we mean by “Responsible Lending”?

And the regulatory framework can include rules about:

- *Licensing of credit providers and intermediaries*
- *Credit advertising and offers*
- ***Assessing ability to pay***
- ***Credit lending standards including loan to valuation and debt service ratios***
- *Transparency and disclosure rules*
- *Controls over interest rates and fees and charges*
- *Price comparison tools (e.g. effective interest rates)*
- *Dispute resolution systems*
- *Mandatory use of credit bureaus*
- *Controls over commissions*

Etc. The focus will be on the highlighted points.

1

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Why does Responsible Lending matter?

- *Financial inclusion: the targets are aggressive*
- *Access to finance for SMEs*
- *To avoid systemic crisis such as the Global Financial Crisis, Andhra Pradesh and others*
- *To encourage innovation*

And of course, to minimize the risk of insolvency.

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How is Responsible Lending regulated in Australia?

Key Concept in *National Consumer Credit Protection Act* (Chapter 3: Responsible Lending Conduct):

Credit licensees must 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 credit contract or consumer lease** if the credit contract or consumer lease is unsuitable for the consumer.**

How is Responsible Lending regulated in Australia?

Meeting these obligations requires 3 steps:

1

Make reasonable inquiries about the consumer's financial situation, and their requirements and objectives;

2

Take reasonable steps to verify the consumer's financial situation; and

3

Make a preliminary assessment (if providing credit assistance) or final assessment (if the credit provider or lessor) about whether the credit contract or consumer lease is '**not unsuitable**' for the consumer (based on the inquiries and information obtained in the first two steps).

When is a credit contract / lease considered “not unsuitable”?

A credit contract or consumer lease will be, and must be assessed as, unsuitable where, at the time of the assessment, it is likely that:

- a) The contract does not meet the consumer’s requirements and objectives;*
- b) The consumer will be unable to meet their payment obligations, either at all or only with substantial hardship; or*
- c) Other circumstances prescribed in the regulations apply to the contract.*

AND a contract will be deemed to be “unsuitable” if the borrower could only meet their obligations by selling their principal place of residence and in certain cases involving small amount credit contracts.

How is Responsible Lending regulated in Australia?

The consequences of a breach can be onerous:

- Infringement notice from ASIC: Up to A\$ 8,500 per breach
- Civil penalties: Up to 2,000 penalty units per breach: A\$ 340,000
- Criminal prosecutions: Fines and imprisonment
- Injunctions

- Compensation orders
- Other orders varying or avoiding the contract
- Adverse publicity order
- Enforceable undertaking

- New / varied Australian credit license conditions
- Australian credit license varied or cancelled

And the views from APRA, Australia's prudential regulator

APRA has recently stressed the need for:

- *Clearly documented procedures*
- *Consistent serviceability criteria for all products*
- *Use of an interest rate buffer in stress tests on loan commitments*
- *Use of a long term interest rate floor*
- *Use of a borrowers declared living expenses*
- *Verification of existing debt commitments*
- *Regular exception reporting to management*
- *Independent reviews of serviceability standards*

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What are the challenges?

- *The pressure for financial inclusion*
- *The pressure for SMEs to have access to credit*
- *Aggressive competition environments*

AND to quote Consumers International 2013 Report “Responsible Lending: An International Landscape”:

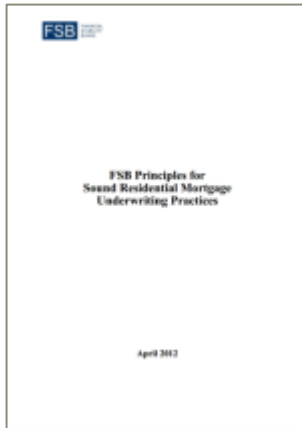
- *“However, the challenge remains in the detail, the content of the measures and whether the will and resources are available to support enforcement...[and how to] say for certain what the benefits for the consumer will be.”*

What is happening globally?

- *Financial Stability Board, Principles for Sound Residential Mortgage Underwriting Practices, April 2012.*
- *European Banking Authority: June 2013 Opinions on good practices for (i) responsible mortgage lending and (ii) for the treatment of borrowers in mortgage payment difficulties*
- *The Smart Campaign: Client Protection Principle No.2: Over-indebtedness*
- *G-20 High Level Principles on Financial Consumer Protection: Principle 6 on Responsible Business Conduct*
- *Basel III regulatory capital reforms*

And of course the Global Survey on Financial Consumer Protection shows that there are many countries which are taking action on responsible lending requirements.

Resources



FSB Principles for Sound Residential Mortgage Underwriting Practices



EBA Good Practices for Responsible Mortgage Lending



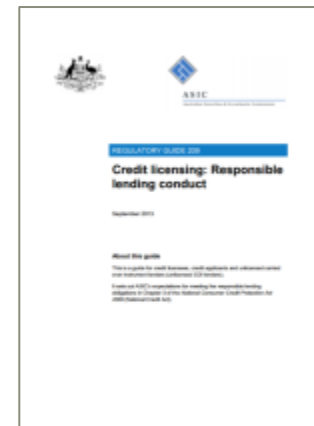
EBA Good Practices for the Treatment of Borrowers in Mortgage Payment Difficulties



The Smart Campaign: The Client Protection Principles



G20 High-Level Principles on Financial Consumer Protection



ASIC Regulatory Guide 209: Credit licensing: Responsible lending conduct

responsiblefinance.worldbank.org
worldbank.org/financialinclusion

LOAN REPAYMENT

Date	No	Exp	Int	Pr
2012/1	20	1160	80	1080
4/12/1	20	1180	80	1100
7-1-1	20	1200	80	1120
1-9-1	20	1220	80	1140
3/9/1	20	1240	80	1160
5/9/1	20	1260	80	1180
6/9/1	20	1280	80	1200
8/9/1	40	1320	80	1240
9/9/1	20	1340	80	1260
10/9/1	20	1360	80	1280
11/9/1	20	1380	80	1300
12/9/1	20	1400	80	1320
13/9/1	20	1420	80	1340
16/9/1	20	1440	80	1360
17/9/1	20	1460	80	1380
18/9/1	20	1480	80	1400
19/9/1	20	1500	80	1420
20/9/1	20	1520	80	1440
21/9/1	20	1540	80	1460
22/9/1	20	1560	80	1480
23/9/1	20	1580	80	1500
24/9/1	20	1600	80	1520
25/9/1	20	1620	80	1540
26/9/1	20	1640	80	1560
27/9/1	20	1660	80	1580
28/9/1	20	1680	80	1600
29/9/1	20	1700	80	1620
30/9/1	20	1720	80	1640
31/9/1	20	1740	80	1660
1/10/1	20	1760	80	1680
2/10/1	20	1780	80	1700
3/10/1	20	1800	80	1720
4/10/1	20	1820	80	1740
5/10/1	20	1840	80	1760
6/10/1	20	1860	80	1780
7/10/1	20	1880	80	1800
8/10/1	20	1900	80	1820
9/10/1	20	1920	80	1840
10/10/1	20	1940	80	1860
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14/10/1	20	2020	80	1940
15/10/1	20	2040	80	1960
16/10/1	20	2060	80	1980
17/10/1	20	2080	80	2000
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19/10/1	20	2120	80	2040
20/10/1	20	2140	80	2060
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22/10/1	20	2180	80	2100
23/10/1	20	2200	80	2120
24/10/1	20	2220	80	2140
25/10/1	20	2240	80	2160
26/10/1	20	2260	80	2180
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2/11/1	20	2400	80	2320
3/11/1	20	2420	80	2340
4/11/1	20	2440	80	2360
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8/11/1	20	2520	80	2440
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15/11/1	20	2660	80	2580
16/11/1	20	2680	80	2600
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23/11/1	20	2820	80	2740
24/11/1	20	2840	80	2760
25/11/1	20	2860	80	2780
26/11/1	20	2880	80	2800
27/11/1	20	2900	80	2820
28/11/1	20	2920	80	2840
29/11/1	20	2940	80	2860
30/11/1	20	2960	80	2880
1/12/1	20	2980	80	2900
2/12/1	20	3000	80	2920
3/12/1	20	3020	80	2940
4/12/1	20	3040	80	2960
5/12/1	20	3060	80	2980
6/12/1	20	3080	80	3000
7/12/1	20	3100	80	3020
8/12/1	20	3120	80	3040
9/12/1	20	3140	80	3060
10/12/1	20	3160	80	3080
11/12/1	20	3180	80	3100
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13/12/1	20	3220	80	3140
14/12/1	20	3240	80	3160
15/12/1	20	3260	80	3180
16/12/1	20	3280	80	3200
17/12/1	20	3300	80	3220
18/12/1	20	3320	80	3240
19/12/1	20	3340	80	3260
20/12/1	20	3360	80	3280
21/12/1	20	3380	80	3300
22/12/1	20	3400	80	3320
23/12/1	20	3420	80	3340
24/12/1	20	3440	80	3360
25/12/1	20	3460	80	3380
26/12/1	20	3480	80	3400
27/12/1	20	3500	80	3420
28/12/1	20	3520	80	3440
29/12/1	20	3540	80	3460
30/12/1	20	3560	80	3480
31/12/1	20	3580	80	3500

***Thank
you!***