

## Responsible Lending Changes

The Treasurer's plan to scrap the Responsible Lending Obligations (RLOs) of banks and other lenders, (introduced in 2009) warrants detailed examination. It is hard to see that the claimed motives for the change have much substance, and the timing is strange.

RLOs – if well designed (something considered below) - should be largely irrelevant for socially responsible organisations, that would naturally adhere to the principles involved. Their merit lies in constraining the behavior of “bad apples” and preventing others from letting loan standards slip or from lax management allowing bad practices.

The Hayne Royal Commission chastised banks and others for misconduct (including lending) and argued for better alignment of incentives and accountability of their employees and agents to prevent that. The banks argue that they have listened and implemented better in-house practices to achieve better customer outcomes. Probably so, but this would suggest that well-designed RLOs, as a “minimum standard” become largely irrelevant to them.

But one of the Hayne recommendations relating to conflicted remuneration arrangements for mortgage brokers, who handle around half of mortgage applications, was rejected by the Government in favour of a “best interests” obligation which is likely to be difficult to police! Without a change in remuneration arrangements, RLOs may be a better way of avoiding future poor lending advice, assessment, and approval practices.

The timing of the change is also hard to justify. ASIC spent much of 2019 consulting on a review of its guidance on RLOs and released a new version of its guide (RG209) in December 2019. And it then lost the “Wagyu and Shiraz” case against Westpac in which its attempt to hold banks to a higher standard of borrower expense verification than comparison against “benchmarks” was defeated.

If anything, that should have somewhat settled bank concerns about the RLOs involving a “gray line” between compliance and non-compliance and resulting risks. Checking past expenditure levels (relative to income) of applicants is no longer as critical as assessing whether there is some reasonable level of required future expenditure for applicants which is consistent with meeting loan repayment obligations.

Identifying whether an applicant is willing to forgo discretionary expenditures (eg private school fees) to obtain the loan size required for buying the, otherwise unaffordable, house of their dreams, should be a clear focus of lender assessment of the borrower's capability. Emphasizing such tradeoffs can also put some of the onus of assessing loan suitability back on the borrower, which many would argue was lost with the primarily *caveat vendor* focus of RLOs.

Now it may be that the RLOs impose excessive loan assessment costs on the banks. The extra work for applicants to provide required information may also be a disincentive to apply.

But with the recent introduction of open banking, enabling easier access and use of customer data, and fintechs developing products to cost-effectively apply that data, it would seem likely that loan assessment costs (including meeting RLOs) are likely to decline. So, if costs are the issue, why change the rules (abolishing RLOs) when a cost-reducing revolution is in progress?

Another argument has been that abolishing RLOs will facilitate growth in lending. Maybe – but not without less suitable lending occurring. RLOs may have slowed the loan approval process but can have impeded the ongoing level of loans only if one or both of two factors apply.

Either the information supply requirements (gathering of which should help applicants understand their borrowing capacity) have dissuaded potential applicants. Removing RLOs to get more poorly informed borrowers to take out loans does not seem like a good outcome.

Alternatively, the RLOs have led to banks approving fewer (or lower value) unsuitable loans to borrowers. That is hardly a bad outcome. Absent these undesirable increases in ongoing loan approvals, any shortening of the loan approval process will only lead to a once-off spike in loans, but no longer run increase in volume.

Finally, the argument that APRA can police and enforce good lending behavior ignores the fact that APRA's remit relates to credit risk and safety of the banks. It does require lenders to assess how credit risk of loans might change if interest rates increase. But it has no mandate (nor expertise) for considering whether borrowers will be put into financial hardship to meet loan obligations.

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