

Unintended consequences of responsible lending under the NCCP may reduce the availability of credit to some borrowers

The forthcoming National Consumer Credit Protection (NCCP) Act will come into effect from January 1st 2011. This legislation is, in many ways, just a codification of good lending practice.

One of the key differences between this consumer credit legislation and the previous Consumer Credit Code, is its core commitment to principles of responsible lending. Responsible lending principles are being incorporated into consumer credit legislation around the world to heighten levels of consumer protection and increase the onus on lenders to consider the interests of borrowers when extending credit.

Under the NCCP, mortgage lenders or their representatives, such as mortgage brokers, will be required to fulfil their responsible lending obligations in three steps. First, they will be required to make reasonable inquiries about the consumer's financial situation, requirements and objectives, and second, take reasonable steps to verify the consumer's financial situation. Third, an assessment should be made as to whether the credit contract is 'not unsuitable' for the consumer.

While the first two steps are not dissimilar to current practice, it is this third step that presents some challenge for lenders and could effectively see some borrowers precluded from being granted finance, an outcome which is either good policy or perhaps an unintended consequence.

To assess whether the credit contract is 'not unsuitable', the lender or broker must assess whether the consumer has the capacity to repay the credit contract without 'substantial hardship'. A credit contract will be deemed unsuitable if, at the time of the assessment, it is likely that the consumer will be unable to make repayments or only be able to comply with the contract with 'substantial hardship'.

M E D I A R E L E A S E

'Substantial hardship' is not defined under the NCCP, and in its Regulatory Guide 209 ASIC has stated that "the meaning of 'substantial hardship' will develop and become clearer as cases come before the courts and judgments are handed down."

ASIC has also indicated that consumers should be able to meet a credit contract's obligations from income rather than equity in an asset.

Under the NCCP, it is presumed that, if a consumer has to sell their principal place of residence in order to meet their financial obligations under the credit contract then this constitutes substantial hardship. Consequently, if a consumer establishes that they could only meet the repayments by selling their home, then the onus is on the credit assistance provider to establish that the credit contract is 'not unsuitable'.

Double negatives aside, having to fund a loan out of cash flow may construe a significant impediment for potential borrowers who are relatively close to nominal retirement age. An older borrower who is seeking a 30 year loan in order to keep repayment commitments at the lowest possible level, would arguably need to display capacity to service the loan for the full term in order for it to be deemed 'not unsuitable'. An argument that the property could be sold at a later time when the retiree elects to downsize and thereby repay the loan may not be adequate under responsible lending. Consequently, potential borrowers in their 50s may be precluded from borrowing if they need a loan term of greater than, say 15 years, in order to qualify.

Another area of lending which is sure to change under the responsible lending requirements is access to 'lo doc' loans for the self employed. While in the past an accountant's statement has been accepted by most lenders as sufficient verification of income, that is unlikely to be the case in the future. Under responsible lending, an accountant's statement should not be accepted to verify income unless the lender can attest that the accountant is reputable and has a long standing relationship with the client. Given that most self employed applicants seeking a 'lo doc' loan do so because they do not have a demonstrable financial history, such potential borrowers may find access to a mortgage loan no longer possible. Consequently responsible lending will preclude such applicants from gaining credit for home loans, an outcome which it could be argued is in the spirit of the legislation as it protects borrowers on shaky financial grounds.

The final area where there may well be issues to address is with respect to reverse mortgages.

Under the definition of responsible lending in the NCCP, reverse mortgages - where no repayments are made - may be outcast. For retired people who are asset rich and income poor, reverse mortgages present one of the few mechanisms that allows them to access the equity value of their homes to support their quality of life in their later years. With the recent setback in superannuation returns, many self-funded retirees are struggling to make ends meet and may soon need to access some of their home equity - without this product they can't. While reverse mortgages are yet to be addressed in phase 2 of the new consumer credit laws, responsible lending provisions put this type of product in jeopardy.

As the 1st January rapidly approaches, these issues under the NCCP are about to hit home. While responsible lending principles are generally to be commended, there may well be some unintended consequences of the legislation as currently proposed. Older borrowers, the self employed seeking lo doc loans and retirees looking to access a reverse mortgage, may find their access to credit reduced.

Professor Deborah Ralston

Director, Australian Centre for Financial Studies

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Media contact details:

Prof Deborah Ralston
Director
+61 3 9666 1010
+61 419 650 318
Deborah.Ralston@australiancentre.com.au

www.australiancentre.com.au