

The Future of Responsible Lending

ASIC's latest responsible lending conduct guide (RG 209), issued in December 2019, sets the course for the future of responsible consumer lending in Australia.

Rich Data Corp has teamed up with Nigel Butler, a 30 year credit risk expert and independent risk management consultant, to highlight some of the challenges lenders may face in adopting and implementing the guidelines, and the opportunities that can be achieved in doing so.

This paper will also touch on advances in data driven technology and AI techniques that are enablers for change towards best case consumer outcomes under the direction of the guidelines.

The importance of responsible lending

Given the special place banks hold within an economy, they are obligated to act in a responsible manner towards their customers.

Consumers come in all shapes and sizes, with a wide range of financial circumstances, experiences, and sophistication. Banks must be able to understand this and provide appropriate assessment and support to ensure a consumer understands the implications of any financial contract they enter into.

RG 209 looks to provide guidance on what 'best practice' responsible lending looks like, and provides examples to illustrate good vs. poor practice across three main areas:

- Making reasonable inquiries and verifications
- Assessing product 'suitability'
- Recording appropriate steps and actions taken

At a base level, lenders must ensure compliance with responsible lending expectations, however when executed well, responsible lending practices can be a strong driver of brand reputation and customer satisfaction.

Responsible lending challenges

RG 209 is intentionally principles based, providing significant scope for a lender's own interpretation, but this can create challenges across the industry, including:

- Defining substantial hardship
- Assessing what is reasonable when considering information capture and verification
- Understanding how much reliance can be attributed to the past when making decisions about the future
- Determining the balance between protecting individual customers from unsuitable contracts, and providing easy access to credit for those who have the desire and ability to service it
- Accepting that not all customers need to be assessed in the same way, and determining the basis for applying appropriate treatment
- Ensuring that any solution implemented today remains applicable and adaptable in the long term

Responsible lending is not a new concept and all lenders have embedded processes to varying levels of rigour and success. However, to truly realise the benefits, lenders need to embrace responsible lending as a core principle and redesign their technology and processes around this. Incremental change to existing processes will not meet the needs of diverse customers, nor unlock the opportunities that emerging data and technology can provide.

Building a market leading solution framework for responsible lending

To realise the opportunities that are presented within RG 209, the following solution framework principles should be adopted:

- **Interactive application data capture** – application data capture should develop with the individual consumer's circumstances and back-end decision process. Data should auto-populate from verified sources to develop questions and inputs interactively. Decisioning should be progressive, leading to a quick path to 'yes' or 'no'.
- **Integrated prediction and decisioning** – a fully flexible and compliant prediction and decisioning solution which dynamically addresses every relevant component of RG 209 as the application progresses. The regulatory requirements for compliance would be consistent across lenders, however, the risk appetite parameters could be modified to align with a lenders specific business model.
- **Self-describing decisions & predictions** – decisioning software should build up the evidence in support of a responsible lending outcome. Key questions should be addressed, and answers captured, and both decision outputs and model outputs must be transparent and explainable. All information supporting the responsible lending assessment of an application is instantly available and auditable.
- **Data driven consumer insights** – diverse data sources can be leveraged to derive a more fully formed view of a consumer's profile and behaviour. By better understanding a consumer, automated lending processes can be tailored to support their individual circumstances and needs.
- **Continuously improving mechanisms** – the framework needs to evolve, using new data as and when available, and feeding back improved understanding when collected. Machine learning techniques are ideally suited to this and can be used to improve and optimise for responsible lending outcomes. For example, predictions about future spending patterns based on historical data can be improved as real-world spending patterns are monitored, analysed and fed back into analytical models.

- **Ongoing monitoring** – despite all best efforts, real-life can be unpredictable. Monitoring behavioural patterns and account conduct can help provide early hardship indicators, allowing lenders to provide timely intervention and customer support.

The future of responsible lending

Lenders must recognise that consumer needs in assessing responsible lending are diverse and wide ranging. One-size-fits-all approaches to lending that are commonly used today may be confusing to unsophisticated consumers, while being onerous to consumers with high levels of financial literacy.

By embedding responsible lending principles into their DNA, and leveraging AI innovations and emerging data, lenders can realise opportunities beyond compliance, such as improved customer satisfaction, stickiness and brand reputation.

Contributors



Nigel Butler is a highly respected credit risk management expert who has worked in the finance industry for nearly 30 years. Responsible lending is just one of his many passions. Connect with him to discuss the far-reaching implications of RG 209 and what this means for you.

Rich Data Corp is an Australian based Fintech specialising in the practical application of AI to support innovation in credit risk management. Combining global experience and advanced prediction, RDC empowers lenders to make faster, safer and more accurate lending decisions.

Contact us

Email us to understand how we can help you implement a market leading technology framework for responsible lending at conversation@richdataco.com

