BANK OF QUEENSLAND RESPONSE TO CP 309

Responsible lending

In considering any potential changes to the current Regulatory Guidance in RG209, BOQ believes that ASIC should consider fulfilling two key objectives:

1. Ensure the responsible lending obligations are set at an appropriate level which balances the competing goals of protecting consumers and providing consumers with access to credit; and
2. That the responsible lending obligations are set out in a clear, unambiguous fashion, which minimises the risk of different banks forming different interpretations of the regulator's expectations.

With respect to the first objective, the proposals to verify expenses in great detail for all customers irrespective of their standing will place an onerous and unnecessary imposition on customers and the Bank. The likely impact will be to increase the price of credit, reduce aggregate lending, deliver a poor customer experience, exclude some segments from credit altogether, stifle innovation and reduce competition. BOQ proposes a balanced and scalable approach based on materiality and customers' characteristics, not a "one size fits all".

As summarised in the second objective, the lack of clarity in RG209, has created an "*uneven playing field"* in which regulatory arbitrage has become a means of achieving competitive advantage. Recent case studies from the Royal Commission into Financial Services highlight just how wide the gulf is in interpreting what the current regulations are taken to mean, and demonstrates the urgent need for clearer guidance.

Balancing lending standards and access to credit

There is a direct correlation between lending standards and access to credit. Tighter lending standards will inevitably make it harder for customers to access credit, and looser lending standards will deliver the opposite. Determining how tight responsible lending obligations should be is a question of judgment that necessitates balancing these competing interests.

BOQ believes that banks should not lend irresponsibly as it would not be in the interest of customers. BOQ agrees with the underlying policy intent of the Responsible Lending obligations, namely to ensure that products sold to customers are "not unsuitable," and would not lead the customer to experience substantial hardship.

While recognising the importance of ensuring that this obligation is met, it is important that the frameworks put in place to deliver this outcome are not onerous. Imposing excessive compliance burdens on lenders, could lead to a number of unintended outcomes that are not in the customers best interests. In particular, it could:

- **Deliver a poorer customer experience**, due to longer and more complicated assessment processes
- **Stifle innovation**, as lenders are forced to shift a greater proportion of their resources to compliance activities;
- **Increase compliance costs,** resulting these being passed on to customers ;
- **Reduce competition** between lenders, as the smallest lenders struggle to absorb the additional compliance costs associated with the tighter standards:
- **Slow growth in lending across the industry**, as lenders tighten expectations to meet the new obligations, with potential macroeconomic implications for economic growth;
- **Exclude some customer segments**, as lenders shift away from more complex customers (such as the self-employed) to avoid the high costs associated with these more resource and time intensive assessments.

Importantly some parts of Australia's credit system lie outside of the Responsible Lending framework. For example, "buy now pay later" arrangements are not regulated under the National Credit Act and providers are not required to comply with responsible lending laws. Last November, ASIC highlighted the rapid growth in this sector, with transactions increasing from 400,000 in 2015-16 to 2,000,000 in 2017-18.[1] ASIC also noted *"One in six users had either become overdrawn, delayed bill payments or borrowed additional money*

[1] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-357mr-asic-puts-spotlight-on-the-rapidly-growing-buy-now-pay-later-industry/

because of a buy now pay later arrangement.'[2] If Responsible Lending obligations place significant compliance burdens on customers and lenders, this could lead to a perverse outcome as customers shift to unregulated lenders, where the level of protection is lower.

Clarity of obligations

At a minimum, all banks should fulfil their responsible lending obligations. These should be clearly defined and understood by the industry to ensure all customers can be confident of receiving a threshold level of service.

To restore trust in the industry, individual banks will need to go above and beyond this threshold. BOQ believes an assessment of responsible lending begins with a good customer conversation that will assist in understanding the customer's situation and the implications of the lending. Ultimately this is about taking a more human approach to deliver better customer outcomes.

While information about how Responsible Lending standards are applied by different banking institutions is limited, it does appear that the approach BOQ adopted in recent years is significantly stricter. The difference in approach is most apparent in relation to the verification of expenses.

BOQ's approach to expense verification is more costly and time consuming than simply relying on a HEM benchmark as a backstop to declared expenses. This has required the collection of additional information from the customer, including making further inquiries or obtaining additional documentation, and has made the application process more complicated and time consuming for the customer.

Verification plays an important role in the responsible lending framework. However, banks

[2] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-357mr-asic-puts-spotlight-on-the-rapidly-growing-buy-now-pay-later-industry/

can chose to adopt a "lighter touch" approach to expense verification under responsible lending obligations and use this to offer customers a simpler and quicker application process. Also, more in depth verification processes can discourage third party brokers from recommending a lenders product.

Where ambiguity exists in the responsible lending obligations, there is a potential incentive for some banks to adopt the minimum acceptable standard, and use this as a competitive advantage against those with more robust processes and methodologies.

BOQ supports the observation in ASIC's 2010 RIS, when considering the risks of principles based regulation, *"Without the imposition of a minimum threshold of enquiries, there is a risk that some credit providers may not always conduct a suitable level of inquiries to meet the obligation."*[3]

Having lenders compete on price, innovation and customer service will deliver good customer outcomes. In contrast, creating an incentive for lenders to compete with each other through loosening lending standards is in no one's interest.

Whatever standard ASIC chooses to adopt, it is important that the regulator's expectations are clearly articulated in the regulatory guidance, to ensure that all lenders are in no doubt about ASIC's expectations.

[3] https://download.asic.gov.au/media/1345490/RG209-RIS.pdf

BOQ's Response to CP309 proposal questions

B1Q1 Would it be useful for licensees if ASIC were to identify the enquiries and verification steps that we consider should be taken? Why or why not?

BOQ Response:

BOQ's overarching view on this is that it would be useful if ASIC were to identify the minimum enquiries and verification steps that should be taken.

The main positive for having clearly defined enquiry and verification standards in writing will be to ensure a transparent level of consistency across all competitors in the industry, thus providing an even playing field for all banks and non-banks. These standards, especially a minimum defined standard, would allow no room for "regulatory arbitrage" and, assuming effective enforcement, would provide assurance for all stakeholders, and especially customers, that everyone is following a common enquiry and verification process. From the customers' perspective, they should have assurance that the responsible lending framework is delivering a consistent outcome for them, irrespective of the lender that they choose to deal with. BOQ therefore strongly supports this outcome.

A further positive is the customer benefit that a defined minimum standard provides, which will ensure that Requirements and Objectives obligations are demonstrably being met. Definition of a clear and defined minimum standard that would provide clarity, without restricting lenders from using discretion, would be valuable guidance. If prescribed conditions are too onerous then that could stifle innovation and competition and would run the risk of removing lender discretion.

Starting from minimum standards and then progressively increasing the rigour of verification, as product complexity and customer risk increases, would provide a scalable process consistent with materiality and risk.

It is essential that, in such an approach, guidance and enforcement are consistent. If not, there could be a situation where some banks do not comply but are not penalised for non-compliance whilst others that do comply are disadvantaged by following procedures diligently. The lack of enforcement would both incentivise non-compliance from banks, and undermine the customer outcomes that responsible lending seeks to deliver.

Another key issue arises if the minimum standard is set so stringently that not everyone can comply with it. For example, if there is a standard that only a large bank can comply with, or afford to implement, this could eliminate competition that would harm customers and would not allow a fair playing field for lenders.

B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.

BOQ Response:

Some examples of industry practice that we believe should be reflected in the guidance include the extent to which detailed analysis of expenses on the applicant's bank statement is needed. For instance, a line by line categorisation verification of fixed expenses can be supported in certain circumstances, but with discretionary expenditure not examined as closely as long as the enquiry has been documented and benchmarked.

It is also important to consider that customers can change behaviour. Verification of the past is not as effective as a discussion on what will occur in the future for that customer. It is difficult to verify a future set of expenses without the use of benchmarks.

Some written clarity on these matters from ASIC would be beneficial as consistency would then be achieved along with improved quality of outcomes for customers. Critically, industry practice needs to be made more consistent through the clearer definition of regulations under new ASIC guidance.

A further example is the treatment of different products, and of customers according to their financial conduct and financial position. This can be illustrated through the difference in the steps that need to be taken in assessing differing products such as a lower value small credit contracts, compared with an owner - occupier home loan, and similarly, a customer with a relatively low debt to income profile and proven payment conduct, as compared with a customer with a high debt to income profile and prior history of payment delinquencies. Should the same approach be applied to both or is there a case for scaling according to such variables as product type, complexity, customer conduct and financial position?

In all circumstances, inquiries should be made on income and verified against documents such as payslips or bank statements. However, for certain products such as low value personal loans and credit cards and for certain low risk customers, expenditure should not need to be verified against statements; only checked against a benchmark. Results too far outside of a suitable benchmark would be a prompt for further enquiries.

The financial position and capabilities of the customer need to be considered. For examples where customers face a greater risk of experiencing financial hardship, banks should conduct more detailed enquiries and verification to ensure the loan is "not unsuitable". Therefore we should be able to tier verification by customer attributes and by product complexity/size - refer to next section.

B1Q3 Are there any kinds of credit products, customers or circumstances for which you consider it may be reasonable to undertake **fewer inquiries and verification steps**? Please identify the kinds of products, customers and circumstances and particular features you think are relevant.

BOQ Response:

An approach that commences with minimum standards has merit.

Below is a table that outlines what we believe should be used as the minimum standard:

Small and medium amount personal Loans (inc Credit Cards)

Expenditure Verification Matrix

	Low value loan amount e.g. $5k	**High Value loan amount e.g. $50k**
High customer "risk" -Low servicing surplus or -Low credit score (bureau) or - Centrelink payment recipient or -Inconsistent conduct or -Hardship in last 24 months	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks. Verify non-discretionary expenses against statements.
Low customer "risk" - High servicing surplus or -High net worth or -Long term good conduct or -High credit score	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.

Notes to table: Income is always enquired and verified against documents eg. payslips and statements. Enquiries are also made of other liabilities.

Thresholds can be established to define "low" or "high" credit score.

Thresholds can be established to define where declared expenses are unreasonably outside of benchmarks.

Secured (Home) Loans – Expenditure Verification Matrix

	Low value loan top-ups against existing loan eg: up to $100k	**Any other new loan**
High customer "risk" -Low servicing surplus or -Low credit score (bureau) or - Where the borrower is contributing less than 10% deposit from genuine savings or - Centrelink payment recipient or -Inconsistent conduct or -Hardship in last 24 months	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks. Verify non-discretionary expenses against statements.
Low customer "risk" - High servicing surplus or -High net worth or -Long term good conduct or -High credit score	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.	Verify expenses against benchmarks and have further enquiries (and documented verification if required) where unreasonably outside of benchmarks.

Notes to table: Income is always enquired and verified against documents e.g. payslips and statements. Enquiries are made of other liabilities and reasonably checked against documents.
Thresholds can be established to define "low" or "high" credit score.
Thresholds can be established to define where declared expenses are unreasonably outside of benchmarks.

As a baseline, income should be enquired and verified against documents at all times and expenditure needs to be checked against declared expenses only using a benchmark (for example HEM or a modified version thereof incorporating additional buffers, for example a Lixi style breakdown of expenses by category). This is the prompt for further enquiries. For the higher risk categories we would obtain documentary evidence for non-discretionary expenses. Any benchmark data used must be up to date and of sufficient quality to be fit for purpose and used consistently by the entire industry.

There should be a scalable approach where expense verification increases according to product complexity and depending on the risk characteristics of the customers as shown in the matrices above. ASIC guidance as to appropriate thresholds would be useful here, which could then be applied consistently across the industry.

If the minimum standard is too high, there is a significant risk that it could allow credit providers that are not regulated under NCCP, such as buy now pay later companies, to capitalise on customers leaving the banks to provide credit to a lower standard and without adequate protection for the customer. It will also promote the growth of the shadow unregulated banking market. In addition, there is the risk that too high a standard will result in creditworthy individuals being refused credit (preventing lending) which is not the intention of the responsible lending laws. It would be a perverse outcome if ASIC's revisions to RG209, undermined good customer outcomes by driving customers to unregulated segments of the lending market.

How to define, identify and treat higher risk customers, including those in hardship, who may be subject to a higher threshold, should be defined by ASIC and set consistently across all banks.

B1Q4 In your view, what aspects of the customer's financial situation would a licensee need to **enquire** about in **all** circumstances? If you think some aspects of the customer's financial situation do not need to be enquired about, please explain why.

BOQ Response:

The overarching consideration here is the need to keep in mind the primary purpose of the regulations which is to ensure that a customer is only sold a credit product which is not unsuitable and which would lead the customer to experience substantial hardship as a result.

For all applicants a Bank should always enquire about income, which is verified against documents, and about expenditure which is also verified either against benchmarks or documents, in accordance with the table in B1Q3.

As CCR matures, access to bureau data may be used to reveal an applicant's credit commitments and behaviour with other lenders.

B1Q5 In your view, what aspects of the customer's financial situation would a licensee need to **verify** in **all** circumstances? If you think some aspects of the customer's financial situation do not need to be verified, please explain why.

BOQ Response:

In general, as a minimum standard, income should always be verified against documents and this can be done via pay slips and/or bank statements. Automation of this process is preferable to a time consuming manual approach. Guidance in support of ASIC's expectations regarding the automation of income assessment would be welcome.

In regard to situations where for example conduct is good, and high margin servicing is clearly shown, there should not be a need to verify expenses against documents e.g. statements. To verify expenses, BOQ would propose the use of a benchmark such as HEM (or modified version thereof) which can be used with or without a buffer, as illustrated in the matrices above. Only higher risk cases would require additional verification of non-discretionary expenses.

B1Q6 What would be the **effect on customers** of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for customers?

BOQ Response:

We consider that there are more negative effects than positive if ASIC were to implement compulsory documentation - based verification for every application and customer circumstance.

The positives may be that it could deliver better outcomes for customers as expectations are clear.

However, expense verification against documents in all situations is unnecessary and would impose a high cost of resources. The negatives also include an increased price for credit products due to additional costs in assessing the loan as a result of increased diligence being made mandatory. There would also be a reduction in customer/user experience as the decision time would be much longer and more documentation would be required.

BOQ is already witnessing a significant reduction in application and approval volumes as a result of more stringent application assessment processes and there are significant risks to the industry and the broader economy that arise from restricting access to customer credit. Whilst the forensic nature of inquiries may at times be warranted, customer expectations of "reasonableness" in relation to the lending request should also be a consideration for proposed guidance. Creditworthy customers are currently being denied access to credit facilities that they could manage without substantial hardship.

There would also be a number of risks associated with expense verification using documents being needed in all situations including: the risk that credit demand moves to near prime lenders or unregulated sectors (the shadow banking market) and the risk of restricting credit in complex circumstances such as self-employed customers as banks may not want to spend the time to verify complex situations and withdraw from certain market sectors, leaving these customers to search elsewhere for credit. There is also a potential issue in the minimum standard being too high which could be discriminatory to less financially knowledgeable customers who cannot answer or understand all the questions being asked of them.

There would need to be clear guidance in how to treat unique cases such as concessions for spousal non-borrower income and expense contribution.

B1Q7 What would be the **effect on business costs** of ASIC identifying particular inquiries and verification steps? Please provide details of the effect on compliance costs for the licensee, and any factors that are likely to affect the level of cost or cost savings.

BOQ Response:

This depends on where the minimum thresholds are set and how that compares to what BOQ is already doing.

If there is a much higher minimum standard, then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.

B1Q8 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

BOQ Response:

This could either improve or reduce competition depending on where the minimum standard is set and how effectively it is enforced.

Competition may improve as regulatory arbitrage reduces and creates more transparency and certainty for customers. The increase in consistency in verification practices could also see an improvement in product competition for the same reason.

However, competition may also reduce as decreased product returns lead to products being withdrawn from the market or priced higher which may lead to customers going to 'alternate' financiers who operate outside the NCCP regulations.

C1Q1 Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available forms of verification?

BOQ response:

There will in the near future be additional sources of information that should be used in the verification process. The main sources are Comprehensive Credit Reporting ("CCR") information and data made available through an open banking regime.
CCR data on an applicant's credit commitments, along with their limits and behaviour should be used as the CCR data environment matures.

Open banking is less advanced but will provide information that can be used to auto verify income and expenditure.

Additional information can be obtained from third party service providers of superannuation data from which income can be derived.

The context behind this question is important. While each of these types of information is appropriate, the bigger question is how extensively and in which circumstances they need to be accessed. For smaller banks, the technology and manual costs involved in fully implementing checks against all of these data sources would be prohibitive. Accordingly, a scalable approach is to be preferred, especially for the verification of expenses (see section B1Q3).

Whatever the guidance is that ASIC decides as appropriate, it must be clear and transparent to ensure consistency of process across all credit providers.

C1Q2 Do you consider that the examples listed above are appropriate? Why or why not?

BOQ Response:

Yes, they are all relevant but not in all circumstances (see comments above in respect of scalability). In addition, irregular non-monthly expenditure is easily missed and difficult if not impossible to assess. Also, the need to build necessary information (12 months) is costly and challenging for some businesses.

Further, for any item used for living expenses, verification should not be taken as a definite figure unless it cannot be varied; or has been confirmed by the customer as an expense that will continue to be paid after the loan is made.

There is a major flaw in assuming that forensically verifying income and expenditure will provide a more sound basis for assessing a loan application. This is because the assessment takes place at a point in time and does not allow for future changes in income or, particularly, expenditure patterns. For example, it is not unusual for a home loan applicant to reduce discretionary spending in order to be able to afford loan repayments on purchasing a new home.

In addition, there is no statistical correlation between delinquency or hardship and level of expenses.

Customers should have the opportunity to state whether they expect their discretionary spending to reduce, and if they state that they are willing to reduce discretionary spending, this should be recorded and taken into account. Benchmarks are useful tools here to determine if the customer's expectations are reasonable.

C1Q3 Are there particular issues with using data aggregation services that you consider should be raised in our guidance? Please provide details of those issues, and information that you consider should be included in our guidance. For example, would it be useful to include specific guidance on matters the licensee could, or should, raise with the customer before obtaining the customer's consent to use this kind of service?

BOQ Response:

Several important issues arise in this context.

Most important are privacy considerations. Customers need to be informed of the implications and risks (e.g. scamming) of divulging online banking credentials (as is required by one of the third party providers of such services). There will be a need to inform the customer what a bank intends to do regarding access to, storage and usage of this information and the implications e.g. for security.

A particularly difficult area is the customer conversation when very personal information is identified e.g. oncology costs; marriage counselling, gambling and alcohol expenditure.

There is a risk of a bank becoming the customer's ethical and moral guardian/decision maker and it is not clear what, having gained insights, a lender should do as a result.

Also problematic is the issue of joint accounts where it is not clear who is responsible for which expenditure items and, in the event that a joint account customer applies for a loan in his or her own right, what servicing calculation would be appropriate using data from an aggregator?

C2Q1 Do you consider that the proposed clarification of guidance on reasonable verification steps would be useful? Are there any other aspects of our guidance on verification that you consider would be useful?

BOQ Response:

Guidance should continue to be offered as non-prescriptive to allow industry flexibility and innovation. It would be helpful to clarify requirements for:

- Defining and verifying general living expenses
- Defining and verifying discretionary expenses
- The treatment of joint accounts
- Reviewing bank statements so a lender does not risk becoming a financial or moral advisor/ethical life coach to customers

Guidance on what constitutes "reasonable verification steps" would be useful including the definition of minimum standards and a scalable process based on customer and product characteristics (see matrix in B1Q3). Scaling should be "up" from a simple and consistent approach as set out in that table and not "down" from a high benchmark. To do so would create higher complexity and more arguments to justify why a financial organisation did or did not scale down.

A point to consider is a higher verification threshold when income is low even if a low value loan is being requested, for higher risk customers or customers who may be more vulnerable. This is reflected in the matrices set out in B1Q3. This requires definition and should include low income, Centrelink and hardship customers as a minimum. The term "vulnerable customer" however should be avoided as it can be offensive to some customers. Instead, the focus should be on risk and levels of sophistication.

Overall, having clear guidance on proposed reasonable steps of verification in writing would be beneficial to ensure consistency as currently some banks do not do line by line verification while other banks do. This is delivering a poorer customer experience, less competition in the credit market for customers and less access to credit as a result. With clear guidelines the verification process should become the same for all.

More difficult lending standards and processes result in those banks with slower and more difficult verification processes being treated by some customers as a lender of last resort, indirectly resulting in those with easier processes having increased volume and in some cases, higher credit quality customers.

C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?

BOQ Response:

No, while it may create greater certainty, there may be significant unintended consequences as the "if not, why not" approach is highly prescriptive, removing lender discretion and imposing potentially a heavy compliance burden.

There is a need to keep the primary reason for "why" (avoidance of substantial hardship) in mind and considering how an "if not why not" approach would serve the primary purpose of the regulations. The issue is better addressed through guidelines on minimum standards and thresholds for scalability.

Guidance on this standard and thresholds plus on what comprises non-discretionary versus discretionary spend would be useful.

If the focus is on 'if not, why not' then the unintended consequences may be:

- A reduction in competition
- High compliance burden
- Risk appetite to be set at 'if not, why not' which may impact innovation / choice

Minimum standards and scalability would be a better approach.

C2Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?

BOQ Response:

As stated in response to B1Q6, we consider that there are more negative impacts than positive if ASIC were to implement compulsory documentation - based verification for every application and customer circumstance.

The positives may be that it could deliver better outcomes for customers as expectations are clear.

However, expense verification against documents in all situations is unnecessary and would impose a high cost of resources. The negatives also include an increased price for credit products due to additional costs in assessing the loan as a result of increased diligence being made mandatory. There would also be a reduction in customer/user experience as the decision time would be much longer and more documentation would be required.

We are already witnessing a significant reduction in application and approval volumes as a result of more stringent application assessment processes and there are significant risks to the industry and the broader economy that arise from restricting access to customer credit. Creditworthy customers are being denied access to credit facilities that they could manage without substantial hardship.

There would also be a number of risks associated with expense verification using documents being needed in all situations including: the risk that credit demand moves to near prime lenders or unregulated sectors (the shadow banking market) and the risk of restricting credit in complex circumstances such as self-employed customers as banks may not want to spend the time to verify complex situations and withdraw from certain market sectors, leaving these customers to search elsewhere for credit. There is also a potential issue in the minimum standard being too high which could be discriminatory to less financially knowledgeable customers who cannot answer or understand all the questions being asked of them.

C2Q4 What additional business costs would be involved in this approach?

BOQ Response:

As stated in response to B1Q7, this depends on where the minimum thresholds are set and how that compares to what Bank of Queensland is already doing.

If there is a much higher minimum standard then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.

C2Q5 What additional business costs would be involved in this approach?

BOQ Response:

This could either improve or reduce competition depending on where the minimum standard is set and how effectively it is enforced.

Competition may improve as regulatory arbitrage reduces and creates more transparency and certainty for customers. The increase in consistency in verification practices could also see an improvement in product competition for the same reason.

However, competition may also reduce as decreased product returns lead to products being withdrawn from the market or priced higher and this could lead to customers going to 'alternate' financiers who operate outside the NCCP regulations.

C3Q1 Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?

BOQ Response:

Yes - guidance would be welcome especially in the context of the scalable approach to verification set out in section B1Q3.

The key reason why it is reasonable that declared living expense figures are compared to a benchmark is to ensure that they are not too low and if so, this is a trigger for making further enquiries. Benchmarks can be used to check the reasonableness of self-declared expenses and from a materiality and scalability perspective they have utility in particular defined circumstances (see B1Q3).

It is important to recognise that current expenditure is not necessarily a guide to future spending patterns, especially in respect of discretionary expenditure. A customer's expenditure patterns will change over time, especially if a new home loan is taken out requiring "belt tightening".

For customers with good income and conduct applying for a modest unsecured loan, forensic enquiries into their line by line expenditure is unduly burdensome and will certainly not reduce arrears, defaults or hardship. There is a need to apply a minimum standard and scale up from there (not down).

ASIC guidance as to what a minimum standard should be (including type of benchmark and any additional "buffers") and the triggers/thresholds to define up - scaling would be welcome.

An Industry -wide standard benchmark would be ideal for industry, for BOQ and for bank customers.

BOQ currently uses the higher of verified declared expenses or HEM scaled by income and geography. Our benchmark is also updated every six months.

Why Not seek guidance:

If the guidance were to be highly prescriptive this could result in an overly complex further regulatory overhead, impacting negatively on customers and the Bank.

C3Q2 Please provide information on what buffer amounts you currently apply, or would otherwise consider to be reasonable.

BOQ Response:

Currently:

- BOQ uses the higher of verified declared expenses or the HEM figure
- BOQ utilises income and geographical HEM data
- No buffer is applied to "raw" HEM - it is useful as an absolute "floor" to sense check against declared expenses
- HEM remains a useful measure of basic costs

BOQ would consider as additional buffers:

- A buffer for customers who identify as 'living with parents' for their current residency status and whom haven't demonstrated making a mortgage repayment previously.
- Buffer for unexpected expenses or increases in living expenses

C3Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?

BOQ Response:

As stated in response to B1Q7, this depends on where the minimum thresholds are set and how that compares to what Bank of Queensland is already doing.

If there is a much higher minimum standard then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.
The benefits to customers in the use of benchmarks are in improving the speed and consistency of decisions and servicing outcomes and enabling an allowance to be made for future changes in discretionary spending.

In the absence of benchmarks there will be a higher cost of due diligence to verify and question information (particularly expenses) if benchmarks cannot be used in calculating servicing capacity. This may involve highly manual processes or third party vendor costs to procure tools to automate processes. Customers will likely experience:

- Slower time to decision, poor experience
- Potentially higher costs of credit
- Credit rationing for complex circumstances eg: self employed

C3Q4 What additional business costs would be involved in this approach?

BOQ Response:

As stated in response to B1Q7, this depends on where the minimum thresholds are set and how that compares to what Bank of Queensland is already doing.

If there is a much higher minimum standard then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.

C4Q1 Do you consider that the proposed clarification of guidance about understanding the customer's requirements and objectives would be useful? Why or why not?

BOQ Response:

Whilst report 493 is the context for interest only home loans, there needs to be consideration of product nuances. For example, for car loans, customers select the term, payment structure, and features – is this output a record of meeting their requirements and objectives? Further, it is not clear how truthful customers will be in answering this type of question and can this information be verified?

ASIC should also clarify what lenders (as opposed to intermediaries) are obliged to do should a customer express a requirement or need that the lender cannot fulfil (for example, a particular product feature that the lender does not offer).

How far can a third party introducer make inquiries and undertake verification on behalf a Bank? There is a question of why introducers ask the same questions as a Bank does.

C4Q2 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?

BOQ Response:

As stated in response to B1Q6, we consider that there are more negative effects than positive if ASIC were to implement compulsory documentation - based verification for every application and customer circumstance.

The positives may be that it could deliver better outcomes for customers as expectations are clear.

However, expense verification against documents in all situations is unnecessary and would impose a high cost of resources. The negatives also include an increased price for credit products due to additional costs in assessing the loan as a result of increased diligence being made mandatory. There would also be a reduction in customer/user experience as the decision time would be much longer and more documentation would be required.

We are already witnessing a significant reduction in application and approval volumes as a result of more stringent application assessment processes and there are significant risks to the industry and the broader economy that arise from restricting access to customer credit. Creditworthy customers are being denied access to credit facilities that they could manage without substantial hardship.

There would also be a number of risks associated with expense verification using documents being needed in all situations including: the risk that credit demand moves to near prime lenders or unregulated sectors (the shadow banking market) and the risk of restricting credit in complex circumstances such as self-employed customers as banks may not want to spend the time to verify complex situations and withdraw from certain market sectors, leaving these customers to search elsewhere for credit. There is also a potential issue in the minimum standard being too high which could be discriminatory to less financially knowledgeable customers who cannot answer or understand all the questions being asked of them.

C4Q3 What additional business costs would be involved in this approach?

BOQ Response:

As stated in response to B1Q7, this depends on where the minimum thresholds are set and how that compares to what Bank of Queensland is already doing.

If there is a much higher minimum standard then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.

D1Q1 Are there any forms of lending where the responsible lending obligations are being used by licensees in situations where the law does not require the responsible lending obligations in the National Credit Act to apply? Please describe the situations where this takes place.

BOQ Response:

BOQ notes that there was no change proposed by the Royal Commission in respect of bringing small business lending under the provisions of the NCCP. However there are several examples of types of lending where the distinction between a customer loan and a commercial loan is not clear.
Clarity would be welcome on the treatment of:

- Novated leases
- Sole traders
- Self employed
- Partnerships with individuals
- Refinance of a home loan that is being refinanced to cross - secure a new business loan.

Responsible lending obligations should apply to small business lending but not to the extent that the compliance overhead is excessive, otherwise there is a danger of credit providers opting out of servicing this sector. BOQ suggests a scalable approach based on materiality for which ASIC guidance would be useful.

BOQ notes that a benefit could be resolution of the issue of loans being applied for as "commercial" to avoid NCCP when in reality the purpose is personal.

BOQ is often called upon to consider business finance where it is about an acquisition or expansion, and serviceability can only be assessed on projections / assumptions flowing from that business case. Often these requests will either be from an existing home loan customer, or require the refinance of a home loan.

BOQ's understanding is that assessing servicing on this basis does not fall within responsible lending which focuses on historical income. If as a result BOQ adopts a complying approach then it would represent a further contraction in the availability of credit to small business.

BOQ believes that there is a need to have the option of assessing small business transactions on other than the traditional servicing criteria and guidance in this regard would be welcome.

In circumstances where a home loan is included, this may need either some sort of dual assessment based on existing income for the home loan and additional income for the business loan, or even the option of approving the home loan based upon business case / projections. Many small businesses today are being forced to more expensive unsecured non-bank financiers. Again, guidance would be useful here.

D1Q2 Are there any forms of small business lending where licensees are unsure about whether the responsible lending obligations in the National Credit Act apply? Please describe the situations which give rise to this uncertainty.

BOQ Response:

Yes - please see the bulleted list above (D1Q1), plus the circumstance where there is a combination of a sole trader/self-employed person and a PAYG person applying for a loan for a vehicle - is this a predominant purpose business or personal use? Guidance would be useful here.

D2Q1 Would specific guidance about loan fraud and the impact on responsible lending obligations of the licensee be useful? Would guidance encourage broader improvements in processes for identifying fraud and reduce the risk of customers entering unsuitable credit contracts as a result of fraud? Why or why not?

BOQ Response:

BOQ suggests that any such guidance should be relatively prescriptive in setting out obligations rather than detailed guidelines.

D2Q2 Please provide details of any risk factors that you consider it would be useful to identify, and additional verifying steps you consider to be reasonable in those circumstances

BOQ Response:

Pay slip fraud – it is often difficult to verify income with the employer due to privacy. It is also important to note that responsible lending is not designed to protect a customer who is a participant in a fraud against the financial institution. Other tools and software may evolve across this subject, with potential Australian Tax Office ("ATO") direct information being a verification option in the future.

The harm is caused by that customer and they should not benefit under the law in any way as a result of the fraud. The responsible lending rules therefore should be interpreted to determine whether it is not unreasonable for the lender to have provided the loan using the information provided by a customer.

D2Q3 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?

BOQ Response:

As stated in response to B1Q6, we consider that there are more negative effects than positive if ASIC were to implement compulsory documentation - based verification for every application and customer circumstance.

The positives may be that it could deliver better outcomes for customers as expectations are clear.

However, expense verification against documents in all situations is unnecessary and would impose a high cost of resources. The negatives also include an increased price for credit products due to additional costs in assessing the loan as a result of increased diligence being made mandatory. There would also be a reduction in customer/user experience as the decision time would be much longer and more documentation would be required.

We are already witnessing a significant reduction in application and approval volumes as a result of more stringent application assessment processes and there are significant risks to the industry and the broader economy that arise from restricting access to customer credit. Creditworthy customers are being denied access to credit facilities that they could manage without substantial hardship.

There would also be a number of risks associated with expense verification using documents being needed in all situations including: the risk that credit demand moves to near prime lenders or unregulated sectors (the shadow banking market) and the risk of restricting credit in complex circumstances such as self-employed customers as banks may not want to spend the time to verify complex situations and withdraw from certain market sectors, leaving these customers to search elsewhere for credit. There is also a potential issue in the minimum standard being too high which could be discriminatory to less financially knowledgeable customers who cannot answer or understand all the questions being asked of them.

D2Q4 What additional business costs would be involved in this approach?

BOQ Response:

As stated in response to B1Q7, this depends on where the minimum thresholds are set and how that compares to what Bank of Queensland is already doing.

If there is a much higher minimum standard then the costs would also increase for banks and, as a result, for customers. There may also be an opportunity cost resulting from a need to divert finite resources from other regulatory/compliance areas to fulfil the requirement for higher levels of verification.

There could also be impacts to staff morale as they may become disengaged in a process that is seen to be moving away from recent advances in customer experience through automated credit decisioning.

D3Q1 Would guidance about use of negative repayment history information and hardship indicators reduce the risk that credit providers consider it necessary to refuse applications for further credit products that may in fact be affordable for the customer? Why or why not?

BOQ Response:

There is no evidence of this from other countries using RHI in their credit reporting systems e.g. ARCA research in the USA, NZ and Canada. RHI or a hardship indicator should not be a reason for blanket refusal - the application needs to be referred not rejected outright.

Guidance would be useful insofar as it protects the customer from automatic rejection.

D3Q2 What are the benefits, risks and costs for customers in this approach (including any effect on access to and cost of credit for customers)?

BOQ Response:

There is a substantial benefit for industry and for responsible lending if RHI information is visible to all lenders. It results in decisions that are fairer for customers.

D3Q3 What additional business costs would be involved in this approach?

BOQ Response:

There would likely be more referrals to a manual process so higher costs would result (but it is expected that such volumes would be low). Other additional tools or risk profiling may also assist in determining the best customer outcome, which may be to lend or not to lend.

D4Q1 Do you consider that guidance on industry best practice for recording the inquiries and verification steps that have been undertaken would be useful for licensees? Why or why not?

BOQ Response:

Yes. It would be helpful to have guidance on records management and the length or scope of records kept on enquires and verifications. This would assist in the governance of origination processes and in any business or regulatory review. Information security and confidentiality are an ongoing industry focus.