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20 May 2019

Ms Fleur Grey,
Senior Specialist
Credit, Retail Banking and Payments, Financial Services
Australian Securities and Investments Commission

By email: responsible.lending@asic.gov.au

SUBMISSION PAPER:

Consultation Paper 309 – update to ASIC's Guide RG209: Credit Licencing; Responsible Lending conduct

This Submission Paper was prepared by Prospa Pty Limited.

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Dear Ms Grey,

Prospa Advance Limited Pty ("Prospa") welcomes the opportunity to provide feedback on ASIC's Consultation Paper.

Prospa is not subject to Responsible Lending provisions as outlined within the National Consumer Credit Protection Act ("NCCPA") as Prospa exclusively lends to small businesses. However as ASIC's RG209 Guide is relied upon as an industry guide more broadly by the likes of Australian Financial Complaints Authority ("AFCA"), of which Prospa is a member, contributing towards this consultation process was considered important for Prospa.

1. A little about us – "Prospa"

The use of online small business lenders such as Prospa by Australian small businesses is increasing, due to their ability to provide online application processes, timely credit decisions and funding, unsecured finance, repayment flexibility and an excellent customer experience.

As awareness increases, we expect small business owners will increasingly consider online small business lenders as an alternative to traditional lenders.

Increased awareness has been driven by several factors including:

- Increased number of industry participants;
- Increased marketing investment by industry participants;
- Increased media discussion of online lenders; and
- The Australian Government reference to online lenders as a viable alternative source of finance for small business owners (at both the State and Federal level).

Prospa is currently Australia's #1 Online Small Business Lender[1], operating out of its Sydney headquarters. Prospa has supported small businesses with business funding for over 7 years and employs over 230 company representatives in Australia.

Prospa offers Small Business Loans between $5,000 to $300,000 and a Line of Credit for up to $25,000. All customers of Prospa are small businesses with all funding decisions achieved by assessing well over 450 data points, including turnover, profit & loss, business tenure, size and industry sector.

Prospa has developed a sophisticated risk-based scoring methodology developed over many years of lending to small businesses which verifies specifics of the small business applicant by utilising data from resources such as (but not limited to): ASIC's website, Equifax, bankstatements.com and the Australian Tax Office.

All applications are processed using Prospa's bespoke secure online and phone application process, querying data sets that determine overall approval limits and risk-based pricing.

[1] Market position for online balance sheet lenders to Australian small businesses, based on Prospa's volume as a percentage of total market volume in 2017 as reported in KPMG "The 3rd Asia Pacific Region Alternative Finance Industry Report", November 2018; USDAUD FX rate of 0.767.

2. Impact Prospa has on the Australian economy

A recent independent study conducted by RFi Group and the Centre for International Economics on behalf of Prospa, revealed the positive economic impact of Prospa's lending to small business in Australia. See full report here.

The research showed Prospa lending between 2013 and 31 December 2018 contributed $3.65 billion to Australian nominal GDP and helped maintain 52,500 annual FTE positions. These findings demonstrate that by providing small business owners with fast, simple access to finance, Prospa is not just directly contributing to its customers' revenue and jobs, but to the wider Australian economy.

3. Importance of Self-Regulation

Achieving the right level of regulation to keep small businesses moving in today's economic environment is critical. Prospa's overall purpose is underscored by this sentiment by making reasonably affordable credit available to all small businesses, safely, fairly and with the customer's best interest put first.

Self-regulation is something Prospa has a deep commitment in achieving, partnering with the Australian Finance Industry Association (AFIA) and six of Prospa's fellow online small business lenders to establish AFIA's Online Small Business Code of Lending Practice ("OSBCLP").

As part of the Code, the participating signatories have introduced a standardised pricing disclosure tool with 6 pricing metrics to their loan contracts, and a clear and concise loan summary before a loan is accepted by the customer, making it easier for all small business owners to make educated financial decisions for their specific business.

Kate Carnell AO, Australian Small Business & Family Enterprise Ombudsman, publicly supports the adoption of the OSBCLP as shown in a recent video:
https://www.youtube.com/watch?v=gtoWmE28McQ&feature=youtu.be

4. Importance of Prudent Lending

Prospa is in the business of extending funding options to its small business customers fairly, prudently and with adequate levels of skill and good will. We have developed and relies on our own Prudent Lending Framework ("Framework") to determine the creditworthiness of small businesses requesting funding from us.

A key concept of the current regulatory framework is that lenders must not enter into a credit contract with a consumer, suggest a credit contract, or assist a consumer to apply for a credit contract if that credit contract is unsuitable for them.[2]

Measuring verification quality using loss rates

A further constraint is commercial, with a lender's risk appetite dictating their individual business models and how they determine and assess serviceability, and their acceptable loss ratios. Loans that are repaid on time and in full are profitable, delinquent loans and defaults are not. It is in the interest of lenders,

2 ASIC, Credit licensing: Responsible lending conduct, November 2014.

especially new online lenders like Prospa, to ensure that as much as possible we adjust our risk settings to ensure we lend to customers who can repay us.

Prospa's low delinquency rates are testament to the effectiveness of our Framework which is continually reviewed and monitored. Adjustments can be made as required to take into account factors such as macro economic trends, our desired portfolio performance and the seasonality of Australia's small business sector.

Determining what is reasonable

Prospa strongly advocates that the expected level of enquiry and verification outlined in RG209 can be **practically** achieved through available means whilst not losing sight of the true spirit and intent behind the law i.e. making **reasonable enquiries** that are **scalable** and take into consideration the customer's **requirements** and **objectives**.

Imposing verification requirements that cannot be achieved in a timely digital manner will remove an incentive for customers to consider using an alternative lender. This would have the unintended consequence of reducing competition and present a poor customer outcome. With the advent of Open Banking, timeliness of customer response will become even more important.

Small business lending has a different use of funds profile

The use of funds for small businesses is very different to that of consumers. Instead of consuming funds immediately upon receipt on a 'consumable' good or service, small business owners invest in goods and services that will enable them to maintain or grow their business. They invest is ways to increase output and jobs. Prospa queries use of funds closely as we do not provide funds for debt consolidation or other negative uses.

Small businesses are more volatile

Lenders need to ascertain a profile of the small business applicant then make a risk-based determination around the applicant's capacity and willingness to repay without risk of suffering financial hardship. This assessment isn't about **preventing** a customer from falling into hardship, it's purely an assessment done at a **point in time** which factors in all known and disclosed financial details, personal circumstances surrounding each individual applicant and the details that could reasonably be verified at the time of application.

However, things don't always go as planned for a small business. Their customers may be late paying, there could be a natural disaster or staff could leave suddenly. Circumstances can change quickly through no fault of the business owner.

In addition, lenders **cannot** be held liable for how customers manage their finances post approval. Poor money management decisions on the customer's behalf are not the responsibility of the lender and this needs to be reinforced within RG209, on sites such as ASIC's "MoneySmart" and throughout consumer financial educational materials prepared and promoted by government, regulatory bodies and consumer advocates.

Lenders and their respective funding partners require a sustainable level of comfort and support when enforcing their contracts and should be able to do so without unwarranted fear or threat of regulator / AFCA intervention (assuming of course all contracts are fit and proper, meet Unfair Contract Term standards and an adequate credit assessment was undertaken). That “moment in time” credit decision must not be ignored or used against the lender later down the track.

In addition to standard financial hardship policy options, Prospa believes all lenders should build into their customer management programs an element of “fairness” with options costed for and made available to customers who do experience unforeseen changes with their financial circumstances during the term of their loan contract and be helped without fear or threat of significant penalty or detriment. Often, if genuine flexibility is offered early, instances of financial hardship can be avoided.

Taking a balanced approach between enforcement of contract terms and the ability to adapt and assist customers when appropriate to do so helps to build trust, customer loyalty and belief in the credit sector.

5. RG209’s impact to SME funding

ASIC’s RG209 guide, if drafted appropriately, will provide the desired level of clarification industry requires. If the revised RG209 does not address the current inconsistencies around what and who are regulated by consumer protection laws, this could have unintended consequences to SME funding for years to come.

ASIC RG209 guide needs to consider technology advancements and the ever-increasing expectations of consumers and SME customers since it was first drafted. Much has changed!

Whilst Prospa makes no comment throughout CP309 regarding “Consumers” seeking credit for personal, household or domestic purposes - as Prospa **does not** lend to this cohort of Australian consumers - it’s important the boundaries that separate “Consumer Credit” to “Small Business Funding” are well defined within ASIC’s revised RG209 to achieve clear understanding across Australia’s Credit sector, regulators, consumer advocates and most importantly, Australia Financial Complaints Authority (“AFCA”).

Today, there is much confusion and varying opinions around when responsible lending provisions (as defined within the National Consumer Credit Protection Act (“NCCPA”)) apply to small business funding and when they don’t. Prospa encourages ASIC to help clarify this area within its updated RG209.

In many cases over the past 3-4 years, the definition of what constitutes a “small business contract” has been inconsistent across this stakeholder group making it extremely difficult for Prospa and those in the business of small business funding. In some cases, this lack of clarity will have resulted in unnecessary declines and / or costly dispute resolution outcomes with no benefit to the customer.

Prospa strongly encourages ASIC to clarify within revised RG209 (and any other supporting reference materials ASIC makes available to the general public), that NCCP provisions **do not** extend to small and medium sized businesses. This is consistent with Commissioner Hayne’s conclusion post the recent royal commission into Australia's Banking, Superannuation and Financial Services sector[3] and recommendation **1.9 – the NCCP Act should not extend to 'small business' lending**.

Prospa adopts the Small Business definition:

> *"any business or group employing fewer than 100 full-time employees, where the loan applied for is less than $5 million".*

Prospa's adoption of this small business definition is consistent with Hayne's recommendation **1.10 – Definition of 'small business'** and that this definition be adopted by The ABA and updated within their Banking Code.

6. Implementation of RG209

Prospa has extracted a selection of key issues from CP309 below which we believe are important to the development of the revised RG209 and have a potential impact or link to Small & Medium Enterprise ("SME") Business Funding. If RG209 is not drafted carefully, additional unintended consequences will occur resulting in increased levels of confusion, a fragmented regulatory framework, unnecessary declines and increased costs of compliance which ultimately, will flow through to customers as higher rates.

Extracts from CP309:

Part B - General Approach

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

<u>Prospa's Response</u>:
Yes, depending on:

- Whether the customer meets the definition of a 'SME'.
- The recency of interaction/other applications.
- Whether it's an existing customer.
- If looking at replacing / restructuring existing facilities with same or similar features / benefits.
- Where the customer sits on 'potential detriment indictors', For example: customers with a higher credit score or credit risk grading.
- The 'risk ranking of the product' applied for.

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[3] Final Report – Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Section 5 Lending to small and medium enterprises.

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

Prospa's Response:
Minimum inquiry

A credit bureau inquiry for the business owner(s)

Three months of cash flow for existing customers and six months for new customers

Additional inquiries for SME funding:

- Use of funds
- Inquiries about the size (turnover);
- Industry and/or business seasonality trends;
- Time in business;
- Suitability of product / service offering;
- Profit & Loss statements (subject to loan amount requested or where applicable).

Verifying this information should be left to the lender to determine what and how much they choose to verify subject to their own risk scoring model and appetite.

Confirmation of any known "material" changes the business could expect to see within the foreseeable future (positive or negative) should be included as a standard area of inquiry undertaken by the lender.

In addition, in the event an individual is to act as a "guarantor", then increased "disclosures, enquiries and verification" on that individual's identity, financial circumstances and enable adequate understanding of what the guarantee means which they are signing up to.

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

Prospa's Response:
The context behind this question is important:

- Not all financiers have access to the same tech solutions;
- There is a transition to Comprehensive Credit Reporting / Open Banking by product type and financier;

- Verifying liabilities in all cases may only be able possible post Comprehensive Credit Reporting implementation for all product sets and after allowing organisations a transition time period;
- There is a distinction between ‘validation’ and ‘verification’;
- You cannot verify expenses where there is discretion.

For individual SME Owners:

- Bankruptcy check;
- ASIC check; and
- ATO check.

Director check (and in some cases where the risk assessment warrants, a personal credit check once consent is obtained).

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

Prospa’s Response:
Potentially, it may:

- Increase the price for products as additional costs are incurred in setting up the product due to increased manual due diligence;
- Increase friction, drop outs in the process; and
- Reduce Customer Experience / User Experience, slowing down the flow of SME funding.

Impact will vary depending on the adoption of Comprehensive Credit Reporting and Open Banking. As mentioned, slowing down the speed of application and response for SMEs will have a significant impact.

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

Prospa’s Response:
SME Lenders who don’t lend to consumers, need to be expressly catered for within the revised RG209 so that current ambiguity is eliminated, and improvements can be achieved. If not, competition and customer choice will reduce.

Advantages include but not limited to:

- Mandated verification steps will necessarily result in homogenous business models and reduced ability for lenders to provide differentiated offers to the market. As we have already discussed, this will result in less incentive or consumers to switch from their traditional banking provider, resulting is less competition and ultimately less consumer choice.
- Dictating the risk appetite for a lender will also impose expensive compliance costs on new entrants and immature segments of the industry, making the barrier to entry higher for new competitors; and

reducing the ability of current participants to develop operating leverage and produce operating efficiencies (which would enable them to pass these onto customers in the form of lower rates) and
- AFCA would have a clear framework of the appropriate framework to apply when assessing disputes.

Part C – Updating or clarification of current advice

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?

Prospa's Response:
The context behind this question is important:
- Not all financiers have access to the same tech solutions;
- There is a transition to Comprehensive Credit Reporting / Open Banking by product type and financier;
- Verifying liabilities in all cases may only be able possible post Comprehensive Credit Reporting implementation for all product sets and after allowing organisations a transition time period;
- There is a distinction between 'validation' and 'verification';
- You cannot verify expenses where there is discretion.

For individuals SME Owners:
- Bankruptcy check;
- ASIC check; and
- ATO check.

Director check (and in some cases where the risk assessment warrants, a personal credit check once consent is obtained).

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 consumer before obtaining the consumer's consent to use this kind of service?

Prospa's Response:
Yes:
- A clear position from ASIC in relation to data aggregation services and the impact of these services on the consumer's rights under the e-payments Code which relies on client consent will be important as will guidance on whether a lender cannot proceed if consent is not given.

- In addition, clarity is sought as, there seems to be a potential mismatch between CP309 and developments in privacy law (For example: ACCC inquiry into digital platforms and Consumer Data Right privacy safeguards) and consumer expectations about the use of data, particularly where ASIC expects credit providers to use data, they receive for purposes it was not collected for. For example: collecting account data for checking affordability but using it to identify vulnerability indicators / hardship, fraud or AML/CTF due diligence / monitoring.
- The Draft Consumer Data Right Rules also make clear that the use of data collected under the Consumer Data Right should be minimised wherever possible in clear contrast to how data should be used in CP309, which will create a compliance issue.
- This issue of primary vs secondary privacy consent under the Privacy Act is important, particularly if the secondary use of data identifies potential vulnerability indicators / hardship for example what happens if you see very personal information. For example: oncology treatment costs or marriage counselling costs on a bank statement, where the data was collected for an affordability assessment rather than for vulnerability checking.
- Guidance from ASIC would be welcome on how should a financier deal with this – at origination and in life – and for in life, what's the impact on current facilities / any requests for 'new money'; as it potentially moves the line between being a financier and being an advisor to the consumer, and will likely lead to higher drop off rates / decrease in customer experience, potentially marginalising customer cohorts.
- Standardised data attributes from providers is suggested to improve consistency.

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?

<u>Prospa's Response</u>:

Guidance should continue to be offered as non-prescriptive to allow industry flexibility and innovation and promote competition and increased consumer choice.

It would be helpful to clarify requirements previously mentioned for:

- Defining industry expense standards if these should be different from the ATO industry expense standards;
- Verifying discretionary expenses; and
- Defining a 'vulnerable customer'.

Part D – Additional guidance on Specific Issues

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.

Prospa's Response:

- Prospa supports the outcomes from the Royal Commission namely that NCCP should **not** apply to SME lending and would be concerned if ASIC was to consider issuing "guidance" on SME lending as it may create potential confusion and unintended consequences.
- RG209 should be a principle-based guide, not "product specific" as this is too granular.
- There is value in RG209 dealing with Guarantors and how RG209 (ASIC) caters for these individuals – more importantly, when it comes to exercising a guarantee, what checks, and balances should be considered when establishing the guarantee initially (if any). This becomes important if a guarantor lodges a dispute with AFCA around their inability to cover the loan they are guaranteeing.

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.

Prospa's Response:
As outlined within D1Q1 in addition to where we have a sole trader/self-employed person and a PAYG person applying for a loan for a vehicle - is it a predominant purpose business or personal use.

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 consumer? Why or why not?

Prospa's Response:
Yes, industry would benefit with guidance from ASIC on the reporting of RHI when accounts are in collections and subject to a payment arrangement (indulgence) or Hardship, but guidance should not be too prescriptive. For example: if ASIC prescribes how a piece of information on the bureau should be used in a credit assessment as a follow on, it could have unintended consequences in usage of other data reported on the bureau.

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7. Conclusion

Prospa supports the implementation and regulation of a practical, fair, reliable and stable underwriting framework across Australia, no matter the customer type.

As part of this CP309 consultation process, Prospa anticipates the right balance of regulation, risk and reward is achieved which is rightfully articulated and reinforced within the revised RG209 guide. Core measures of success Prospa hopes to occur once ASIC has considered all submissions received is:

- **Consumers** and **SMEs** are aware of and understand the various credit products and services available to them and how Australian law and regulation applies to them specifically by relying on concise, easy to understand, and consistent materials circulating the public arena; and

- **Lenders** can lend in a manner that is acceptable across all stakeholder groups including: consumers, SMEs, regulators, external dispute resolution schemes, industry bodies and advocates without fear of reprimand when operating in accordance with guides such as RG209 and acting in the true spirit and intent behind all consumer and SME protection laws within Australia.

ASIC has enforcement powers to adequately enforce regulation on those who are not lending responsibly. Its evident that a “blanket” approach to regulation does not work across the vast number of differing consumer credit providers and SME lenders throughout Australia so the revised RG209 Guide will go a long way in clarifying the standards ASIC requires of industry.

Prospa welcomes ASIC’s support in keeping credit flowing for SMEs and to work with industry in establishing a level of protection to all stakeholders who have a vested interest in all money lent being paid back in accordance with the agreed contract terms whilst being fair and accommodating to those whose circumstances change before all obligations have be fulfilled.

Small business lending is different. Small businesses take loans to support business objectives and to enhance the business’ capacity to increase output and create more jobs. The funds they borrow are not consumed but used to generate increased output which must be taken into account when assessing future serviceability.

Because of this, it is important to fundamentally differ in the way that we treat consumer credit and business credit, particularly when assessing serviceability.

For small business lending, the key question is to assess the ability of a borrower to service a business loan in the context of whether the business is able to generate sufficient income to repay to loan. It is therefore necessary and often part of the assessment process used in relation to business credit, to consider the current cash flow of the business evidence by account behaviour.