qed risk services

A response to ASIC's Consultation Paper 309

Response to CP309

Preamble – QED Risk Services is the predominant provider of compliance services to the credit intermediary sector. The following comments and feedback are strongly related to the mortgage broker sector. However, QED has tried to be all-inclusive in its feedback.

<u>Reasonable inquiries and verification steps</u>

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

These comments relate to living expenses as, in practice, there is no excuse for failing to properly evidence income.

QED has similar concerns to ASIC on this topic, however we do think that a quasi "minimum standard" could apply with a caveat.

See next question for details.

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

The minimum standard QED would like to see applied is as follows:

1. *Enquire* with the consumer using the standard, categorised expenses breakdown put forward by LIXI in the past, or similar. Various banks have put forward their own lists.
2. *Verify* by comparing the results of enquiry with a relevant benchmark. The law says that "the" consumer's financial needs to be verified and benchmarks are not specific to "the" consumer. However, they are a reality check of how the consumer compares to their peers and therefore incredibly useful in verifying the consumer's claimed level of expenditure.
3. *If using this minimum standard* the person making the assessment (preliminary of final) must be compelled to thoroughly document the reasons why they thought this was appropriate. Examples of this could include that the consumer is well-known to the assessor; or that the consumer's claimed expenses are well in excess of the benchmark; or that the verified income provides the consumer with a substantial buffer over and above that required for positive servicing.

We have seen this approach work well in practice and there are definitely many, many real consumer cases where the approach was completely appropriate.

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.

QED's opinion is that, if adopting a "minimum" approach like that suggested above, there is no "less" approach. When a consumer falls closer to the benchmark; or the overall servicing on their proposed contract is "tight", then further verification must be sought. In the case of mortgage brokers, it is often the case that this area is where their role comes into its own in that they can have rich and meaningful discussions with their clients about how their budget practices might be amended to achieve what they want without hardship.

Some products have their own peculiarities and the financial enquiries and verification are "different" but not "less". An example of this is bridging home loans. In this case, the most important financial aspect of the consumer's situation is the ability to sell the outgoing property. An appropriate assessment here is a comparison of the amount of the loan to the reasonable realisable sale price of the property within the required timeframe.

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.

All liabilities and expenses must be enquired about in all circumstances. The consumer's primary source of income must be enquired about in all circumstances.

In circumstances when the primary income source covers all liabilities, expenses and any proposed new credit, it may be appropriate to not make further enquiries about other sources of income.

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.

The above comments on enquiries apply equally to verification. As noted in the response to question B1Q2, the individual circumstances of the consumer need to drive the **level** of enquiry that must take place and be documented.

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?

QED's experience tells us that the approach as outlined by us in B1Q2 would have almost zero impact on consumers. If anything, they would experience a more consistent process.

Even if ASIC were to recommend a more heavy-handed approach – which QED would strongly discourage – the impact on the consumer is not likely to be large. For example, many lenders currently require borrowers to provide a quantity of bank statements so it might not be such a stretch.

However, an impact may be felt in an increase of processing times. If a broker and then a lender both have to spend some hours sifting through bank statements, this could disadvantage the consumer by adding crucial time onto the approval process.

This is why QED would prefer such processes to be only an add-on in those cases where it was decided that extra verification was required.

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.

In line with the above response, business costs would increase significantly if a higher standard were mandated by ASIC, requiring more work and scrutiny in ALL cases. The relationship between more verification requirements and higher business costs in having to comply with these requirements should be obvious.

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

As long as any mandate from ASIC was not in the "heavy-handed" category as contemplated above, QED actually believes that it would be a nett positive outcome on competition. In the broker segment, the participants that are currently exhibiting compliant behaviours are somewhat disincentivised by the way their less-than-compliant peers operate. Making it clear what the baseline is would have the effect of levelling the playing field.

<u>Verification of consumer's financial situation</u>

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?

The Household Expenditure Measure

C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?

Yes. We do, however, believe that ASIC needs to have a more cautious approach to its promotion of bank statements as a verification tool. Bank statements are a point-in-time piece of information and consumer behaviour can change significantly once they have taken on a sizeable credit obligation.

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?

We believe that these services will have an important role to play in the future as the technology improves.

However, current issues include:

- The inconsistency in features and usefulness between the different services;
- Consumers' reluctance to use the services, particularly where the service requires the input of the consumers' internet banking credentials;
- The ability to capture the consumer's entire banking picture; and
- The added cost to the overall process.

It is foreseeable that vulnerable consumers could have their permission to use these services abused by those requesting the use of the service.

<u>Questions at C2</u>

QED believes that the responses we have provided above largely address these questions.

However, we are somewhat confused and concerned at the flavour of ASIC's "rationale" comments in relation to bank statements and their routine use as a form of verification.

Certainly, yes, we agree that if an intermediary obtains bank statements as a part of the credit assessment process, they must not use only the pieces of information that they want to use – e.g. using them to verify income but not analysing expense data.

However, as stated previously in this response, bank statements have limited usefulness in terms of verification of how a consumer will behave in the future post being granted credit. In some ways, we believe that bank statements, even though they provide point-in-time information about a specific consumer, they may be less useful as a verification tool than, say, the HEM, which identifies the expenditure of a statistically significant cohort of consumers in the individual consumer's income band, household demographic and geographic location.

In summary, QED is somewhat concerned with the orientation of ASIC's commentary in this section of the consultation paper in relation to bank statements.

Use of benchmarks

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

Yes we do believe that this clarification would be useful. ASIC makes some useful statements such as the suggestion that buffers to the HEM amounts should be used.

However, such buffers should be scaled to how the intermediary views the situation of the individual consumer. ASIC makes the ongoing assertion that HEM is a "low budget" indicator. The fact is that, within the "demographic bucket" of the individual, HEM consists of the median expenditure on "basics", the 25th percentile of "discretionary" items and no "luxury" items. Whilst ASIC may call this "low budget", we think that it forms a reasonable platform for someone suddenly taking on the biggest financial commitment of their lives.

We believe that "per case" buffers of HEM are entirely appropriate.

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

An example that QED has seen is to place a buffer on the HEM figure, depending on the broker's assessment of the consumer with a higher buffer where high expenditure is perceived and, conversely, a lower buffer where tight budget management is perceived.

The client's disclosed expenses are compared to the buffered HEM figure and the higher figure is utilised in servicing.

This is just one approach.

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

We believe that the stronger and deeper utilisation of the HEM, in the right context and in fully understanding how they work, will only benefit consumers. We cannot see a return to the pre-automation days of credit provision. The entire economy would collapse under such pressure and inefficiency.

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

None. Only good can come of this.

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

Yes. QED sees too many examples where intermediaries and credit providers clearly do not understand the difference between requirements and objectives and how these must be positively demonstrated to be matched to the credit products that the consumer is provided with.

We see "objectives" as being where the consumer wants to get to and "requirements" as being the things about a credit product that will help to get them there. Documented clarification and guidance on this would be helpful in spreading the message.

Too often, we see terms such as "Refinance" being listed as the requirement and objective. This is an *outcome*, not a requirement.

Guidance would definitely be of value.

<u>Consumer's requirements and objectives</u>

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

Benefits are that, with guidance, providers and intermediaries would actually take positive steps to ensure that credit products actually match up to consumers' needs. Risks and costs to consumers are virtually none.

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

An increase in processing times in order to properly articulate requirements and objectives in accordance with the already existing requirements, as well as interim costs to further upskill in this area.

<u>Areas where the responsible lending obligations do not apply</u>

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.

The key example of this QED has seen has been in the case of assistance for SMSF loans. Whilst overall harmless to the consumer, brokers do risk incorrectly representing that their SMSF clients have consumer rights by providing NCCP disclosure and performing assessments, as such it may be appropriate to caution against this practice. However more commonly, we have seen the opposite where lenders try to put forward consumer loans as commercial. This particularly relates to car loans.

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.*

Again, QED clients are in no uncertainty about their obligations.

However, we do know that a lot of intermediaries that treat small business customers with the same spirit of fairness as required under the Credit Act. This is because they have no desire to put their clients into credit obligations that would be detrimental to them.

Fraud risks and impact on responsible lending obligations

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 consumers entering unsuitable credit contracts as a result of fraud? Why or why not?

No, we do not this is an area that ASIC should be commenting on. Credit Providers are already doing enough work in this area. Brokers, for example, are already running scared of banks with the way in which they unilaterally cancel the accreditation of brokers where they think they have identified fraud.

ASIC could possibly provide "safe harbour" methods for brokers to meet a standard that ensures they are not suspected of being involved in fraud but we do not believe that this is ASIC's role.

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.

None – see above

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

Don't believe ASIC should be involved in this.

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

Don't believe ASIC should be involved in this.

Questions at D3 - Use of repayment history information

We believe it is too early to comment on the role and use of information from the new credit data regime and that ASIC should be silent on it for the time being.

Questions at D4 - Records of inquiries and verification

We generally think that the standard for data recording in this area should be left at a "reasonableness" test. It is crucial for participants to accurately record their understanding of their consumers' needs overall. We do not believe that specific, mandated guidance by ASIC in this area would be useful.

Questions at D5 - Content of a written assessment

We believe that the requirements for this are simple and that ASIC should not need to provide further guidance.

The requirements are clear. An assessment must sufficiently articulate:

1. Why the credit service provider thinks that the consumer could afford the credit commitment; and
2. Why the credit service provider thinks that the product that was provided to the consumer had the features that met the consumer's requirements and objectives.

If anything, ASIC could be clearer on the latter point above. QED encourages its clients to positively demonstrate that specific features of the chosen product specifically matched the consumer's articulated requirements and objectives and how they matched.