SocietyOne

20 May 2019

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

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

Dear Ms Grey,

CONSULTATION PAPER 309

We write to make submissions in relation to Consultation Paper 309 (CP 309). You may treat this submission as nonconfidential.

Background

The SocietyOne group of companies operates a marketplace (or peer to peer) lending business through which consumer credit is provided. Since August 2012, SocietyOne Australia (**SOA**) has held Australian credit licence 423660, pursuant to which it provides unsecured personal loans.

Submission

We answer the questions set out by the Australian Securities and Investments Commission (ASIC) in CP 309 below most relevant to us. We have not answered all the questions raised in the paper.

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?

We consider that the usefulness of ASIC identifying the inquiries and verification steps to be taken depends on the level of prescriptiveness applied and how ASIC will factor in the different types of providers and products within the market.

As a general proposition, we would favour a more principles-based approach rather than prescriptive guidance or regulation. We find that there are many complexities in relation to the variables considered in performing a credit assessment and feel it would be challenging for ASIC to produce regulation or detailed guidance factoring in all the nuances that apply across the spectrum of credit providers and credit products.

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.

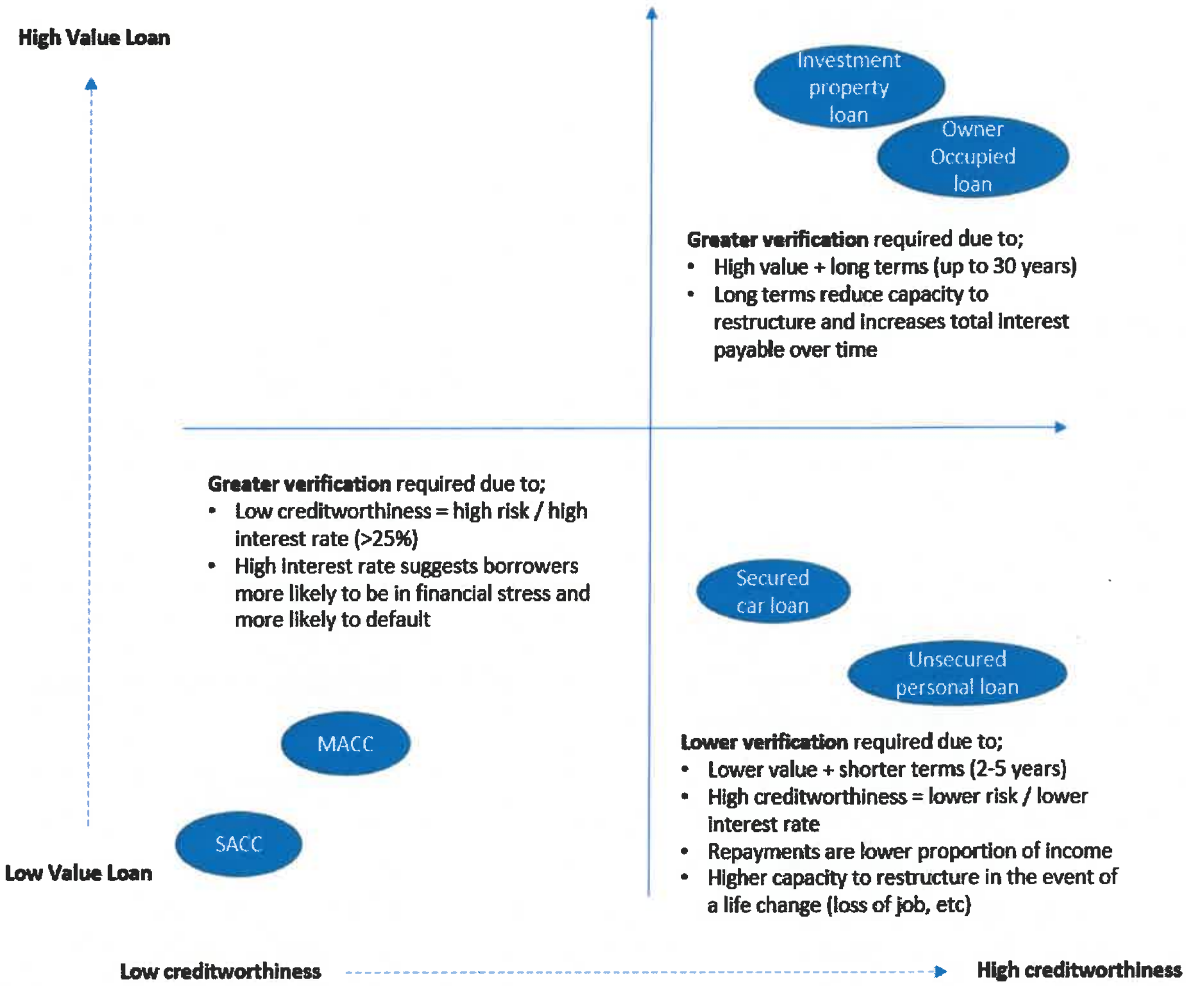
We consider that certain credit products may require fewer enquires and verification steps compared to other products, depending on certain risk factors. Such products would typically feature:

- a relatively low level of credit (e.g. personal loans up to $50,000);
- relatively short terms (2, 3 or 5 years); and
- high quality customers, i.e. customers indicating sound credit history.

We consider that other credit products in the market would reasonably require more verification and inquiry. Such products would typically include one or more of the following features:

- have a longer term and provide higher amounts of credit;
- take security over the main assets of the borrower (e.g. home or car); or
- offer small amounts of credit to people who are in a financially challenged situation.

We have tried to encapsulate a principles-based approach in the diagram below:



We would emphasize that the approach suggested by the diagram above is not a set of rules, rather provides indicators as to when the assumptions may apply. These indicators may be displaced by other characteristics of the borrower and the application.

<u>B1Q4</u> 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.

We feel that in all circumstance the following aspects of the customers financial situation are relevant and should be inquired about:

- income;
- other liabilities;
- relationship status and, if relevant, partner's income;

- dependants;
- accommodation expenses; and
- living expenses.

The provider of an unsecured personal loan product should not need to obtain a list of a customer's assets (nor verify them), given that the customer does not provide any security for the loan. In this case, there may be less need for a customer to provide a detailed statement of financial position and income and other liabilities may be of more importance.

***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.**

We feel that in all circumstance the following aspects of the customer's financial situation are relevant and should be verified:

- income;
- other liabilities;
- accommodation expenses.

Living expenses are, for the vast majority of consumers, a mix of essential and discretionary items. A backward-looking review of a customer's bank statements does not always provide clarity and value. There are circumstances in which additional verification of stated expenses is appropriate, based on certain borrower characteristics and product features, but we do not believe that this should always be necessary.

***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?**

There is a clear correlation between the amount of verification required and the cost of completing an application. Therefore, greater levels of verification will increase the cost of borrowing and could:

- make smaller loans uneconomical;
- reduce the appetite of reputable funders to fund applicants at risk of financial hardship.

The likely outcome of this would be to increase the exposure of consumers at risk of financial hardship to SACC and MACC products as these may be the only products with an interest rate that will sustain the costs.

The experience of SocietyOne over total personal lending in excess of $500 million has demonstrated that calculations with respect to a borrower's surplus of income over expenses is not statistically predictive of default by a borrower. The corollary is that the costs associated with a forensic examination of a consumer's expenses outweigh any benefits.

***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.**

Whilst we would seek to automate these inquiry and verification steps as much as possible, for example via open banking, the impact of material additions will increase the cost of underwriting a loan. Many of the potential additional items, such as verification of living expenses have statistically shown not to be predictive of loss. Therefore, unlikely to show a material cost saving through lower losses.

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

Large banks have a material advantage over other lenders, through holding customers' transactional accounts. Therefore, an increase in verification requirements could very well reduce competition in favour of the banks and increase price.

Any changes should therefore be delayed until open banking is fully in place and operational.

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

We consider that more clarification of guidance about use of benchmarks would be useful only if a safe harbour is included, allowing for a risk-based approach to going beyond the use of HEM to verify a customer's living expenses. A safe harbour would mean that additional verification of living expenses would only be required when certain indicators were identified.

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

HEM is a useful tool utilised within our business and we apply an income and geographical adjusted HEM to determine the plausibility of a customer's stated living expenses.

Bank statement data is also useful in making decisions around living expenses versus other discretionary or essential expenses, but it involves a level of subjectivity, and past experience is not always a reliable guide to the future. The continuing use of HEM as a comparison tool is therefore valuable to ensure that the inevitable subjectivity and uncertainty in the review of bank statement data does not lead to adverse customer outcomes.

In our view if an appropriate safe harbour is included, customers could benefit from additional safeguards while receiving the benefit of greater competition and lower costs. A highly prescriptive regime will give no greater safeguards but could reduce competition and increase the cost of borrowing.

Yours sincerely,

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