PUBLIC HEARING ON
RESPONSIBLE LENDING GUIDANCE

Australian Securities & Investments Commission

TRANSCRIPT OF PUBLIC HEARING
SYDNEY

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At Wesley Conference Centre, Lyceum Room, 220 Pitt Street, Sydney

Before: Mr Sean Hughes, Commissioner
Ms Karen Chester, Deputy Chair
Ms Danielle Press, Commissioner

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INTRODUCTION

MR HUGHES: And welcome to the public hearings for consultation on ASIC's guidance on the responsible lending obligations. My name is Commissioner Sean Hughes and I'm joined by my fellow Commission member Deputy Chair Karen Chester, and Commissioner Danielle Press will be joining us this morning as well. I want to begin by acknowledging the traditional owners and custodians of the land on which we meet here today and I pay my respects to elders past, present and emerging, and I extend that respect to Aboriginal and Torres Strait Islander peoples here today.

These hearings are held under section 277 of the National Consumer Credit Protection Act 2009 and I will be presiding at this hearing. Before we commence with our participants I'll provide a brief background on responsible lending, our reasons for conducting these public hearings, how they will proceed, the matters we aim to address today and then finally just some housekeeping matters for your comfort and your safety.

Firstly, responsible lending. The responsible lending obligations are principles based. Lenders and brokers are required to both make reasonable enquiries into a borrower's financial situation and to take reasonable steps to verify relevant information. Parliament introduced the responsible lending laws to ensure that anyone applying for a loan was not provided with one that they cannot reasonably afford. The focus of these obligations is on each individual applicant for credit, meaning that the test of what is reasonable is one that looks to the individual consumer's circumstances. These responsible lending obligations commenced nearly 10 years ago. At that time ASIC published guidance to assist industry to better understand their obligations and ASIC's expectations for compliance.

This guidance has not been updated since 2014. Now, we have taken numerous responsible lending actions and these actions have tested and provided clarity on the law. We've also ensured that consumers harmed by irresponsible lending are compensated and that real consequences for those who engage in misconduct is enforced. It's very important to be clear about when responsible lending obligations apply and equally when they do not. The responsible lending obligations apply to credit that is wholly or predominantly for personal, domestic or household purposes. This extends from small amount credit contracts and consumer leases to personal loans and credit cards to home loans and loans for investing in residential property. Responsible lending obligations do not extend to loans that are predominantly for other investment or business purposes even if they are secured over residential property, and these loans are not the subject of these hearings or indeed our consultation. The consultation paper that we issued in February 2019 which I'll come to shortly noted that it might be useful for our regulatory guidance to be very clear about what is and what is not covered, and that's also important in the context of the process as we are conducting today.

Our Regulatory Guide 209 has been in place since 2010. This guidance sets out our expectations for meeting the responsible lending obligations. It was developed as an indicative guidance rather than setting minimum standards. For example, it provides guidance on factors to consider when making a decision about the level of inquiries and verification steps that are reasonable. And since its introduction in 2010 we've updated RG 209 to reflect judicial commentary and new legislative requirements for certain types of credit. 209 was last updated in November 2014 and we're taking this opportunity this year to update our guidance to ensure it remains relevant, clear and timely. New data sources such as open banking and comprehensive credit reporting, learnings from our reviews in recent years and importantly judicial consideration of responsible lending laws all mean that it's timely to do so.

In February of this year we issued our Consultation Paper 309. We've received 72 submissions in response to this paper of which 64 were non-confidential, and we published those non-confidential submissions on our website in July. The team, Karen and I, have reviewed each of these submissions. The participants invited to these hearings here today in Sydney and next week in Melbourne have been drawn from those who provided a written non-confidential submission. Our selection of participants is focused on delving deeper into the particular issues which we feel would benefit from further consideration, and we consider that the participants that we've selected are best placed to assist with our enquiries.

Now, not everybody who made a submission has been invited to appear. Each submission has however been carefully considered and following these hearings we will consider further opportunities to consult including with parties who have not presently been invited to appear. Ladies and gentlemen, the purpose of these hearings is to provide an opportunity to explore and to seek to better understand key themes, concepts and practices including significant matters raised by stakeholders and submissions. Participants have been informed of the broad matters that we're interested in hearing about from them today. And I want to emphasise that this is an information gathering exercise not an investigative or enforcement exercise. We are not here to interrogate in an adversarial manner the business operations of the entities represented here today. We want instead to test the views raised by stakeholders in their submissions.

We will also not be providing guidance to entities through these hearings and nothing that is said here today or next week should be taken as a final ASIC position. Licensees can have confidence in relying on existing guidance and existing expectations. These hearings, the submissions made and any further consultation we undertake is invaluable to increasing ASIC's understanding of the current consumer lending landscape and the regulatory issues that are faced.

At the conclusion of our full consultation process, we will publish a report that outlines the submissions received including additional information provided through these hearings and importantly our response to this consultation. We will also publish the updated regulatory guidance setting out our views and expectations for all licensees, and this will provide further clarification on our position on how responsible lending obligations should be implemented with the benefit of having considered the views of stakeholders who have participated in this process, and we expect to publish that updated guidance before the end of this calendar year.

Now, the matters that we aim to address through today's hearing in Sydney include: challenges for expense verification and tools that are available, currently used or being developed that help to verify or test estimates of expenses, including the Household Expenditure Measure, or HEM; data aggregation services; comprehensive credit reporting, or CCR, and open banking; the value of information about expenses and the approach taken to post-loan spending reductions, products and circumstances where fewer inquiry and verification steps may be reasonable and the effect on access to credit; and risk factors that enable an appropriate determination of what measures are reasonable to undertake for applications by individual consumers.

Now, I want to emphasise that these hearings are being conducted with as little formality and technicality as possible, but I do wish to remind everyone here today that audio of these proceedings is being taken and live streamed. A full transcript will be available on ASIC's website. Media representatives may take photographs and audio-visual recordings during the hearings but not of witnesses or participants giving evidence. Participants have each been provided with a time slot and we will endeavour to stay within the time allotted. Participants will be invited to introduce themselves, their organisation and their roles and have the option, only an option, to provide very brief opening remarks, no longer than one or two minutes. Participants should know that we have read their submissions carefully, so opening remarks should not repeat matters already contained in their submissions except to highlight one or two key matters they wish to bring to our attention. Any written opening statements or any other documents which participants wish to provide or refer to will be treated as an addendum to their submission and will be published on our website. Participants are required to be truthful in their remarks. A person who appears at this hearing must not give information that is false or misleading.

Ladies and gentlemen, we will not be taking comments from the floor. And for the smooth running of the hearings and to avoid disruptions, we ask all of you in the room today to keep noise to a minimum. For those who are not called as participants who wish to provide further information or feedback to ASIC on the hearings or on our proposed guidance, please speak to the ASIC staff at the registration desk.

And one final comment on submissions. As I indicated earlier we've received 72 submissions. There are some matters raised in those submissions that we factually or otherwise disagree with. We do not intend to address or respond to all of the matters in these hearings. We may refer to some of these matters as relevant and important to today's discussion. However, I want to be absolutely clear that our silence on a matter raised should not be inferred as acceptance of it. Similarly, statements that may be made during the course of today that are contrary to our understanding or our view will be treated the same way. Our purpose through these hearings is to listen, not to make decisions. Our position on these matters, where relevant, will be published in the report that outlines our response to submissions, made through the consultation process and our updated guidance.

Ladies and gentlemen, just some quick housekeeping matters before we start today's hearing formally. We ask that those in attendance, please switch off or put on silent your mobile phones or other devices. In the event of an emergency requiring the evacuation of this building, please follow the instructions of wardens and head towards the green exit signs at the back of this room. Your emergency assembly point is Hyde Park, via Market Street, behind the St James train station. And if you believe you need assistance in evacuating, please advise the wardens. If otherwise you require assistance, please speak to our staff members at the registration desk outside the hearing room.

So with no further opening comments, including from my co-pilot, Deputy Chair Karen Chester, we'll now call our first participants to the hearing, the Commonwealth Bank. Thank you.

COMMONWEALTH BANK OF AUSTRALIA

MR HUGHES: Could I ask you to introduce yourselves and if you have a brief opening statement, please do so?

MR HUGGINS: Well, first of all thank you very much for the invitation to attend today. We very much appreciate that. We'll just quickly introduce ourselves and I'll ask Michael to do the same. So, I'm Daniel Huggins. I run the Home Lending Business for the Commonwealth Bank.

MR KAVANAGH: Hi. Michael Kavanagh. I'm the Chief Risk Officer of the Retail Bank of the Commonwealth Bank.

MR HUGGINS: Good morning. We have no other remarks.

MR HUGHES: All right. We'll kick off straight into the questions, then. In your current consumer lending practices for a standard home loan, at what stage in the application process do you look at the specific circumstances of your customer?

MR HUGGINS: Well, perhaps useful in answering that question to run through, we're asked, we're looking for specific circumstances all the way through that engage with the customer on home loans. So perhaps useful to run through how we do that with the customer.

We apply an appropriate base level of enquiry and verification for all home loans and then we step that up, depending on the product or the circumstances for that individual customer. In terms of the specifics of enquiry we are making, first, we'll understand customer requirements and objectives. So that's the first step for us in enquiring about the customer's situation.

Second, we'll take reasonable steps to understand and verify their financial situation as you would expect, so that it involves, first of all, understanding and verifying all income that they have. Second, we'll understand and verify all expenses that are material to that customer situation. So credit cards they might have, any other loans, home loans that they may have with another institution, or indeed the Commonwealth Bank.

Then we'll make an enquiry about the smaller living expenses. There's three sort of difficulties with those smaller expenses and understand the specifics of the customer situation. The first is we can't get an understanding of total expenses. So we understand the expenses that a customer might have with us in our transaction accounts. But if they have accounts with other participants in the market, then we won't have visibility of that, that may change over time, but at the moment we don't have that.

Second, we need to characterise whether the expenses will materially impact the financial situation, whether they are discretionary or non-discretionary, and you can't do that from the information provided on statements. So, we don't get the sort of skewed little data around, well what has someone actually spent at Target, is it clothing for a child, or is it DVDs or video games.

And, third, we can't understand what's ongoing. So what's reasonable to accept will reduce over time if someone has been purchasing Uber Eats seven days a week, is it reasonable that they would decrease that on an ongoing basis or not.

So, the sort of three parts of the smaller living expenses, having verified material expenses of how do you understand total expenses, how do you characterise the expenses and what do you reasonably expect is going to be ongoing, means that we will ask a customer what is ongoing, and then we'll compare that to see whether it's plausible to the HEM benchmark.

So that's how we do that. We will always take the higher of that of the HEM benchmark, or the customer's declared living expenses, but we'll test the plausibility. Where it's below that benchmark, we will then make further enquiry of the customer and indeed or we'll see elements of the customer such as that they have dependence, we might ask them about school fees or some indirectly.

So that's sort of the specifics of how we would do that with a customer. We'll apply buffers and floors to that on the way through as we assess that to determine whether a customer has a net income surplus, and then look at customer behaviour before we make that enquiry. So, we'll also look at whether that customer has in the past gone into arrears on other accounts. So we'll look at that specifically for each customer as well, before we make an offer of credit. So they are the sort of key things that we're looking at specifically for each customer that we go through.

MS CHESTER: Just coming back to the balance about what's sort of reasonable when you're making your enquiries and verifications, Daniel and Michael. In what circumstances of a particular customer application, when you're looking at this balance, so, perhaps looking at it from the perspective of, what is the consumer detriment you're focusing on when you're trying to make that balancing act about what's reasonable to enquire and verify?

MR HUGGINS: Well, we are applying an appropriate base level of enquiry for all customers and we think that's appropriate. Because all products, we think that it's appropriate that there be a base level of enquiry. So we don't look at this from a perspective of, well, for some customers or some products, we won't do that enquiry, we look at it from a perspective of there's a base level and then we'll uplift that, depending on the specific product, or what we see what the characteristics of the customer and the behaviours of the customer.

So, for a home loan, for example, which is an interest-only home loan, then there's going to be further enquiry and discretion about that interest-only home loan, because of the nature of that product. Similarly, if a customer has a guarantor on a home loan, then that's going to have enhanced enquiry versus the base enquiry that we make for all customers. Similarly, when we see a customer behaviour which may indicate that it's a higher risk situation, that customer may have previously been getting into arrears, or we may see differences between information that we have from our own source about income, for example, which is different from what they have disclosed, and that would see us make further enquiry of that customer. Similar in home loans, if we see that a customer has in the recent past made an application and the circumstances of that application have changed materially, then that would trigger us to make a further enquiry of that customer. So, it's very much a base of enquiry for all customers, regardless of the product, and then we step that up depending on the product or the customer. Add anything to that?

MR KAVANAGH: It may be, it might be helpful to just explain a little further around exactly what we mean when we talk about the base level of enquiry. As Dan mentioned earlier, in income in all cases we collect that information and verify the income information that has a material impact on the credit assessment. Similarly for the material outgoings of a customer, that is other debt obligations that they may have, rental expenses and so on, we assess and verify those. When it comes to the smaller expenses, our position is they're quite difficult to – in fact, in many cases impossible – to independently verify. So what we do there is we collect the information from the customer and we test it for plausibility against a benchmark, such as the HEM tables.

MS CHESTER: So, again, just maybe coming back to less credit risk lens but the risk of consumer detriment. What factors would you look for in a consumer to think whether or not there is a risk of substantial hardship in terms of meeting the repayments? And then what would that make you pause and think in terms of what other information might be important or necessary to obtain?

MR HUGGINS: Well, I mean, first, we're going to look to see fundamentally, whether they can afford the loan. So obviously if their servicing position is negative then that's going to result in either an outright decline of that loan, or further conversation. We will then look for specifics around the behaviour of that customer and what we've seen in the past. If we've seen that customer, you know, previously being able to make payments, then we would make further enquiry with that, and then the products that the customer's taking would also then have an impact on the risk of that.

So as I mentioned before, an interest-only type loan would result in us making further enquiry. We will also look in the home loans, for example, we're doing a review of the transaction statements to understand whether the conduct is good. Whether there are things that we can see in that information that the customer hasn't disclosed to us we would make further enquiry. And we'd do that, you know, in an automated way to look at the other liabilities, we're using CCR, comprehensive credit reporting, to understand again whether there are things about what the customer has told us that are inconsistent about that we can see and that requires further enquiry.

MR HUGHES: Can you talk to us about the expenses that you consider to be discretionary in terms of real or actual things?

MR HUGGINS: Yeah, that's where the difficulty is. So, obviously as we mentioned before, for expense items that are material, other loans, we can see that, we can verify that independently. But when we start thinking about discretionary verse non-discretionary, the data that we have available to us to characterise something as discretionary verse non-discretionary is not at the level that allows us really to do that. You can do it at a high level, but if someone and has gone and spent $200 at Woolworths, it's not clear to us whether that's on the basics of food or whether actually there are items in there which are seen as being more discretionary. Similarly, if we see that someone has spent $150 at Kmart, we don't know the specific items. So you, from that data, I can't easily distinguish between what is discretionary versus what's not discretionary and therefore what's going to be ongoing. Similarly, if we see someone who is spending significant amounts of money at a bakery, for example, it may be that that person is a celiac and therefore needs gluten-free bread versus someone that just prefers, you know, a more artesian bread and could actually change that and it's a more discretionary expenditure. So we don't have a specific means at the moment to split between discretionary and non-discretionary and that is true of any of the different tools that you might be able to use.

As a consequence we have a conversation with the customer about, with a detailed breakdown of the home loan space with 11 categories, where we ask the customer what is their ongoing expenditure. That may include items where the customer has said [indistinct] so I'm going to decrease that spend. Indeed it may also include items that are not apparent to us. We've had someone was living in a flatting situation or at home and they're going to buy a property, they will then have utility bills where they may not be in their historical expenditure and then we will test that ongoing expense disclosure to the customer for plausibility against the HEM benchmark.

MR KAVANAGH: There are parts, just to be a little more specific on a couple of points. So some of the expenses that we would consider to be discretionary would be items such as eating out. The extent to which the customers choose to eat out, subscription services that they may have. The extent to which they go to the movies and entertainment, gifts that are provided, club memberships, international holidays. So Dan spoke a little bit about how once we've collected those expenses from a customer it's difficult to verify them. However, as we do collect them through the interview process, we can have discussions around the extent to which those expenses are likely to be continued at the current trajectory or they may be pulled back.

MR HUGHES: And, Michael, in that latter situation when you're conducting that interview do you consider the importance of that item to the loan applicant?

MR KAVANAGH: Yeah. That's right. So Dan gave a good example there. There are on occasions sets of customers where an item will be important and for another group of customers still important but more discretionary. We, in some cases, these discussions run the risk of getting into value based judgments, so we need to be careful about ensuring we've got the right balance there. So we tend to err on the side of comparing those smaller expenses to a HEM benchmark as a means to test for reasonableness or plausibility.

MR HUGHES: Thank you.

MS CHESTER: Dan and Michael, you touched on before some areas where it's difficult for you to, you can make sort of enquiry about expenses but then to verify it's quite difficult. What are the ones that really matter? And are there different ways that you're looking at trying to get sort of comfort around verifying those expenses in terms of the assessment for the application?

MR HUGGINS: Yeah, the ones that we've seen have the most material impact are on the outcomes of the customers are the ones that we're able to verify. So whether someone has a mortgage, whether someone has a personal loan with us, someone has a credit card somewhere else. And then obviously we need to make sure that there is a plausible total amount for those expenses. That, having done that, we then see that the reasons why someone gets into hardship post loan tends to be something which it's very difficult or impossible to assess up-front what is someone's job security is someone going to lose a job. Is someone going to have a material health issue, a heart attack? Is there going to be a family breakdown, you know, a divorce? Those are sort of the key things that would then following that enquiry result in someone getting into trouble.

What we do do during the enquiry, particularly in the home loan space where we can see dependants, for example, we're going to, we prompt our lenders then to have a conversation about school fees. Where we can see that the income threshold for the Medicare private insurance tax is there, we will actually then trigger a conversation, "Hey, have you made sure that you've captured your private health insurance costs in your expenses?" Where we see that the overall threshold is not, is below that HEM benchmark and therefore less plausible. We will then trigger to have a further conversation with the customer, "Hey, this looks low." So we are triggering based on what we can see to have a further conversation. But again it's challenging to know one thing that is discretionary in one person is less than discretionary to someone to someone else. So that's a challenging thing for us to go into, but.

MS CHESTER: So in terms of thinking of pre- and post-loan expenses, you would have a view about what you consider to be discretionary but informed only on the discussions with the individual customer?

MR HUGGINS: Yeah, that's right. As Mike said there are certainly some areas, like international holidays or eating out or movies, that you would see as being more discretionary. But again, it's a, it's hard - - -

MS CHESTER: You identified some lumpier ones like school fees and health insurance – how would you treat those and how would you have - - -

MR HUGGINS: So we are, where we can see that that maybe a conversation to have with a customer, we're having that conversation with customers and we would expect that to be in as an ongoing expense.

MS CHESTER: And there's no areas where you see that there's obstacles or limitations to having those hard conversations with the customer?

MR HUGGINS: Well, it's certainly hard. I mean, I think anywhere where you're seeing a medical expenses come into someone's expenses then there is a question about, well, how intrusive are you being in those conversations and are you getting that balance right of, well, if someone has an oncologist's transaction item in the statement, well, where does that conversation lead. So, we're certainly with every customer asking and having a conversation with them about whether they see any potential for things to change from what they've disclosed. But, yes, there's certainly a balance on how intrusive can you be and is it at the level that the community expects.

MS CHESTER: Well, I guess there's a call that you have to make in terms of discharging your obligations under responsible lending - - -

MR HUGGINS: No, that's right.

MS CHESTER: - - - so is it focusing then on what you consider to be the sort of the big expense discretionary items and getting a handle on those and - - -

MR HUGGINS: That's right. So the material items that we can see and we can verify and in all cases we are enquiring about and verifying those.

Those smaller expense items as I mentioned before, there's a range of challenges with those ones.

MS CHESTER: You touched on before the HEM benchmark for economists and statisticians. It's great when a benchmark becomes a household term in Australia, which this one certainly has. It would be good to get a little bit more of a better handle on how you use the HEM benchmark in the application process. I guess, firstly, what version of it you're currently using? And how do you tailor it for the individual customer?

MR HUGGINS: Oh, I don't know exactly the date of the version we're using. It's tailored based on a customer's income and on dependants. So it steps up according to if you've got a higher income or more dependants. Then it steps up, I think we're on the latest update, but I'm not exactly sure of the date of when that latest update was. It would have to be 2000 - - -

MR KAVANAGH: Have to get, yeah, it's - - -

MR HUGGINS: - - - the latest version of - - -

MR KAVANAGH: - - - the latest version I'm not exactly sure what date that was but it was recently deployed.

MS CHESTER: And tailored for geography as well?

MR HUGGINS: No, we don't tailor it for geography. We tailor it for, as I mentioned, just for income and for dependants and then in - - -

MS CHESTER: Why not for geography?

MR HUGGINS: We haven't seen that that makes a material difference in the outcomes for the customers at this stage so we, we haven't done that at this, at this stage. It's really about, well, what, what level results and, in an assessment such that we can be sure we've covered items that are most material to the customer and ensure that the lend is therefore suitable for them or not unsuitable for them. In terms of how we use the HEM benchmark in the processes, we will enquire first about what the customer's ongoing expenses are and then we will compare that disclosure in all instances to the HEM benchmark, where it is below that, and we will, we will make further enquiry of the customer and then we'll use the higher of whatever the customer's declared or the HEM benchmark.

MS CHESTER: And, I mean, we understand that the HEM benchmark has evolved over time, things like the income bands were introduced. What time period were the income bands being introduced and CBA beginning to apply those to the individual customer?

MR HUGGINS: I'm not sure when income bands were first introduced in those HEM benchmarks. We've certainly been using income bands for, for some time, for - - -

MR KAVANAGH: 2017, if I can - - -

MS CHESTER: Okay, thanks. So coming to what does it tell you about the consumer expenses, comparing it to the HEM, just take us through what are some of the things that aren't included in the HEM benchmark that you'd need to make sure you get comfort on when you're comparing it to actual expenses that you've enquired about?

MR KAVANAGH: So it's an important question because the HEM benchmark represents the ongoing living expenses, which don't include things like other repayment obligations that customers have for other debt or their credit cards, rental amounts, private school fees. So as we, we make enquiries about those other expenses and those other expenses get added on top of, of the HEM benchmark if that's used as the flaw in the calculation, but essentially those are the further considerations that we take into place in, in the interview with the customer.

MS CHESTER: So given some of those significant costs that aren't included in the HEM benchmark, on average how many of your applicants for home loans give you any expenses that you've enquired about and verified and it's still below the HEM benchmark?

MR KAVANAGH: I think it's, it's currently running at about 40 per cent of cases where the expenses provided by the customer are below the HEM benchmark, but importantly that comparison does not include the loan repayment, repayments that they're making, the credit card debt, rent, other rental payments that they may be making. So the comparison that we do to the HEM benchmark is based on those other smaller expenses, not the more material ones, such as loan repayments, rent, other school fees.

MS CHESTER: So you're comparing it to their total expenses, which would include all those things that aren't in the HEM benchmark?

MR KAVANAGH: No. When, when considering, how, how do we apply the flaw in the calculation, the first thing we do is consider the more material expenses that are not, not included in the calculation of the HEM itself. So we, we obtain those from the customer, we verify those with sources such as our own bank records through the credit bureaus. So that's a category of expenses that we collect and verify and use in the servicing calculation and then we add on top of that customer's other ongoing expenses. For those other ongoing expenses, they are compared to the HEM benchmark.

MS CHESTER: So you do an apples and apples. So HEM benchmark, what's in the HEM benchmark and what's in their expenses, you take whichever is the highest of those two and then you do the add on, on top, to get the total expenses.

MR KAVANAGH: Well, you add on- - -

MR HUGGINS: So you might, you might have a credit card which has a $10,000 limit. We would be allowing, you know, 3.8 per cent, $380 for that credit card. For many customers they will pay off that credit card every month, we'll still be allowing that $380 plus whatever they've disclosed in CDLE. So they may be in customer declared living expenses. So it may be in that credit card that, they are using it for their groceries and, you know, effectively we're allowing that amount for the credit card that gets added on top of HEM.

MS CHESTER: And, Dan, you mentioned before that quite often that quite often you're adding buffers and making adjustments. Do you have a buffer or a safety valve adjustment that you make if the HEM is the highest of the two given it's still considered to be a fairly conservative benchmark?

MR HUGGINS: No, we don't, we don't buffer the HEM benchmark. We obviously, as I mentioned, compare it to, you know, it – our view is that the methodology is such that it provides a reasonable level of expenditure for a customer such that they wouldn't be in substantial hardship at that level of expenditure. Therefore we consider it to be a relevant basis upon which to be comparing their expenses and obviously in terms of how that methodology is created, with it being 50 per cent of basis and 25 per cent discretionary expenditure, we would expect that there are customers who are below that level of expenditure. So just the way it's been statistically generated, there are going to be, you know, a number of customers who are below that. So we don't see it as being an unreasonably low measure. We see it as being a, a sensible base level to compare to, for customers to compare customer's ongoing expenses to see whether they are reasonable.

MS CHESTER: And when you're saying that if the HEM is the higher, then you're sort of satisfied that they're not in hardship from an expense perspective. Is that before or after you add in all the things that aren't included in the HEM benchmark that you make that assessment that they're unlikely to be in hardship from an expense perspective?

MR HUGGINS: Well, so we – yeah. So I mean those other expenses like the other credit cards or the other loans, they get added on top. So we're only talking here about those smaller expense items which are challenging to verify at an individual level, that's the specific category we're talking about with HEM. On top of that, you are adding, you know, the other, the other commitments the customer may have, a car loan, other loans with other institutions, credit card debt and they, they all get added on. So it's not that we are comparing HEM to the, to the total expenses of the customer, including those other commitments. It's, they come out separately and therefore the pool of expenses that we're actually allowing for a customer where a customer will have other commitments, whether that's credit cards or other loans will be, will always be higher than HEM because you are adding that cost associated with those two, at a minimum the HEM benchmark.

MS CHESTER: So really, the hardship assessment for you is beyond the HEM, it's what else you're adding in and then deciding what you think is discretionary and what's not?

MR HUGGINS: As I mentioned before, we are having a conversation with the customer about what their ongoing expenses are going to be and then we are comparing that to see whether that is viable or valid and based on that, yes, we then see that that is a reasonable level of expenses for a customer so that they won't be in substantial hardship moving forward. Given that our experiences that, providing you have captured those major expense items, you've then had the conversation about ongoing expenses and compared that to that floor HEM level and included an allowance for that, that after that we tend to see the way in which a customer will get into hardship tends to be job, health or family breakdown.

MR HUGHES: I just want to be clear, do you support the verification of fixed living costs, such as housing costs or insurance?

MR HUGGINS: We certainly support those, verifying those major areas of expenses and so we see rent, for example, for someone, yes, we'll look at that, we verify that, we think that's appropriate. As you start getting down into those lower levels of utilities, there's a question about, about whether some of those may go up or down. So again, you start getting to this question of what of them are going to be ongoing if someone has been in a flatting situation, well, actually they may have had no utilities. So you still, you still get some of these same problems with some of those types of expenses around, well, what's going to be ongoing in those spaces. So generally the answer is yes, where there is that fixed expense item, then yes, we should be capturing that, verifying that, you start getting some of those areas into the grey where, where you get these same challenges we were articulating before around, well, how much of it's ongoing, can you identify it, can you verify it.

MR KAVANAGH: I think in the, just to add to Dan's point a little bit. In the case of home loans, sometimes the very act of applying for a home loan can result in a change to some of those, what you would consider, fixed costs. So if you think about utility bills, often a person purchasing a home, whether it's moving from a rental situation to home ownership or upgrading a house or indeed downsizing, the previous fixed costs could be at quite a different level to the ongoing costs. So there are still some complexities to be worked through and what appear to be seemingly relatively fixed costs. Which is in part the distinction that we make around those expenses that we test for plausibility and we collect at a granular level, but in terms of verifying those costs, it typically would rely more on the comparison to the HEM benchmark for a test of plausibility.

MR HUGHES: In our consultation paper this year we flagged our intention to make a simple, clear statement that the responsibility lending obligations do not apply to lending for business purposes, at the bottom of page 4 of your submission, you say that you request guidance on whether it's reasonable to rely on a customer's declaration that the lending is predominantly for business purposes. Can you tell us, then, given that clarity as to what obligations do and don't apply to, why do you think further guidance is required in terms of this reliance on customer declarations?

MR HUGGINS: I think as we put in our submission, we're supportive of the clarity which is, which is [indistinct] very clear around when and where it doesn't apply, particularly to small businesses. As we mentioned in our submission, we do see a number of scenarios, typically for a small business person where, you know, you may have a business operating in the bottom floor of a building and they're living on the top floor or there's a small farm where the person's living there but the income is from that small farming operation.

And again, it's subjective as to, well, is this loan primarily and it's been secured against the property, it may be the residential property, can we rely on the assurances of the customer that, yes, indeed that loan is actually being used for my business or is it, or is it not. So I think that the clarity we'd be seeking is often that we are, that the customer is telling us that this loan is for business purposes and it's helpful for us to be clear on whether you can rely on that or not, or whether, you know, we need to go and see if it's for renovation of a store, or do we need, we need to get to, does that need to be a construction loan and then you're actually seeking receipts from the builders, that indeed that money was then spent on a store refurbishment downstairs. So, that's the clarity we're looking for, I guess. Is how much is it that we can rely on the customer telling us, yes, this is indeed what we're going to use that money for, this is not - - -

MS CHESTER: So, I'm still a little unclear. So, I understood that the code did set out the process that you go through to do that, to work through and be able to use the borrower declaration. So are you saying there's not enough guidance in the code for you to go through that process and make that assessment yourself?

MR HUGGINS: I think as we mentioned, it would be helpful specifically to understand where a customer has provided us with those assurances that we can rely on those assurances.

MR HUGHES: So the challenge, and we throw the challenge back at you, the challenge for us is, you know, how do we stipulate a subjective assessment and guidance? I mean, the very thing that we're accused of doing, which is reaching into the offices of lending institutions and making decisions for them, is the very thing you're asking us to do.

MR HUGGINS: Well, I think as we've said in our submission, I think we are supportive of increased prescription which sets out what those minimum standards are that we would be, that you would expect us to follow and indeed the community would expect. So we are supportive of that level of prescription.

MR HUGHES: So, Dan, you are looking for some prescription?

MR HUGGINS: Yes.

MR HUGHES: All right, thank you.

MS CHESTER: So we're in the home stretch. Just one thing that we thought would be helpful to touch on, I mean, credit conditions are also front and centre for your business. And there's always a number of demand and supply side drivers. It would be good for us to get a little bit of, step back for a moment, to get a little bit of a sense of what sort of root cause analysis does CBA do around what are the drivers to credit conditions, impacting the broader market but also impacting your book, and what sort of analysis does that involve and how often do you do it?

MR HUGGINS: Our view has been that credit conditions lately - - -

MS CHESTER: So, sorry, I'm not asking for a view. Just I want to understand the analysis that you do within the bank to form a view as to what drivers are contributing, so I don't need a macro view today, but just how you go about the process will be really helpful.

MR HUGGINS: Well, we look on a weekly basis and then on a monthly basis at what's happening at overall market demand, what are we seeing in our application flows. Similarly, once a week I'm looking with our operations teams around what's happening on the operations side, are we seeing anything which is resulting in increased demands in those operations teams, before we make any change to our processes. We will typically assess the impact that that's going to have on our processing times and on our people. What we've seen lately is the drivers have been much more demand drivers, rather than supply or changes that we have made in our operations and indeed our operational performance and turnaround times in the home loan space has been quite stable.

MR KAVANAGH: It is, in terms of the analysis that's undertaken to determine this, it is quite extensive, so as Dan said, we're looking on a weekly basis around some of the key features of applications that come through. So, we will look at people that are applying for investment loans, owner/occupied loans, whether customers are coming through direct to branches or through brokers, the average size of the loans that customers are seeking out. So there's quite a bit of data and analysis that informs the view that Dan suggested there around, in our view, this is predominantly a demand side issue right now in terms of the supply of credit.

MS CHESTER: Okay. And it's then in terms of what you're internal processing times are like to get an idea of what's impacting on the supply side. Is that one of the key drivers? The efficiency for – what are the other sort of supply side drivers that you're looking at when you're sort of forming that overall view of the attribution to what really is happening to credit conditions?

MR HUGGINS: We're looking at policies and the impact a policy change might have on supply and our willingness to provide credit whether a policy change is going to change our overall willingness to lend them the amount that we'd be willing to lend to a customer with all the information that we require on that. So it's broken into what is going to make the process more onerous in terms of, I think in terms of collection of information from a customer, how can we improve that along the way. And then also the impact of any policy changes that we might make on our, either willingness overall to lend to specific segments of customers or the amount that we'd be willing to lend to those customers.

MS CHESTER: Okay, thank you.

MR KAVANAGH: Some of those policies will include things such as the take-up of comprehensive credit reporting, so as more credit providers provide information to the credit bureaus, that's additional information which is helping us identify a debt that may otherwise have been undisclosed. In some ways, we had previously done that through a review of our own transaction statements. But occasionally, more structural shifts that are going on within the market itself also have an impact. In terms of the materiality of comprehensive credit reporting, for example, on the supply of credit, that's tended to be relatively low in our case.

MS CHESTER: Okay, great. That's really helpful. And good to get a better understanding that it is a constant feedback loop that you've got internally around the demand side factors at the moment. Just coming back, because I think we've got time, to the point that I think Sean was sort of kind of alluding to a little less directly than I might. When I read through the submission, there's a bunch of areas where you want us to be very principle-based in our guidance and there's a bunch of areas where you want us to be quite prescriptive, and we touched on one a bit earlier. And when we look at those two buckets, some of them are where you guys have to make a call, or where you're dealing with declarations from consumers, or you're dealing with floors.

MR HUGGINS: Why don't I start with articulating how we think about that with prescription and then, Michael, if you want to add some detail on the areas. The way we view this, there is a minimum level of enquiry which all customers should be afforded to ensure that they get the protections and the right outcomes, and that should be prescribed. And certainly there are some areas which we find very challenging, which perhaps we would like you to form a perspective on, but that may not be possible. But certainly we think that there is a base level of enquiry which is appropriate and that should be prescribed, such that regardless of where a consumer goes in the market, whichever licensee they go to they can be sure that they are afforded the protections that come from that base level.

Many providers, us included, many licensees will then choose to go over and above that as we do today. That's fine. And that's where the overlay of the principle comes in. So we don't think they're inconsistent. We think there is a view which is, this is the principle, this is what we're trying to achieve, here's the minimum we expect every licensee to be doing. We don't think those things are consistent. Clearly, there are some areas that we find quite challenging. We are, if, ASIC had a view on how we might think about those areas as it pertains in that minimum area, we would find that very helpful. But you may not be able to do that and that would need to be left to our judgment which is fine. But we certainly think there is a minimum level.

MR KAVANAGH: Yeah. So I guess just with reference back to the Consultation Paper 309. There are some areas where additional detail has been put forward and we found that additional detail in many cases to be helpful. So looking at items such as how we should think about the recording of requirements and objectives for consumers or the detail of what should be included in the written assessment report for consumers were both very helpful additions. Also, going back to the areas where we collect information and verify information from consumers. Thinking about income and then the different verification sources that could be used to obtain the comfort that the estimate that's been provided by the customer is appropriate. In the consultation paper there are some examples of where that information can be sourced which we think is useful. We also think that the delineation between those significant expenses – so such as debt repayments, rental outgoings, private school fees potentially – and from those that are the smaller ongoing expenses is an important one. And then for that latter category of the smaller ongoing living expenses, essentially verifying or testing for those by comparing to a benchmark such as the HEM benchmark is the appropriate and most efficient way to achieve that outcome.

MR HUGHES: Just picking you up on that, do you think that the guidance could also promote more efficient application of the responsible lending obligations by reference to particular customers and particular products? So I think you touch on this on page 2 of your submission. Do you think the guidance should delve more into detail on issues such as high-net-worth customers and particular types of products and on lower levels of verifications, is that what you're suggesting?

MR KAVANAGH: Yeah. We, as Dan has said a couple of times, that we do believe that for all customers, there should be a base level of expectation and enquiry that is afforded to them for their safety to the extent that there's some additional detail around the specific means by which we may enquire and verify against customers. That would be of use. It would be efficient from both the customer's perspective as well as the industry perspective. So, if you were to think of a consumer knowing that they're going to get a degree of enquiry and verification that is of a similar, at least base level standard, would be useful for them and they may then be more likely to have the required documentation as they come and apply for the loan. And similarly for credit providers to have a degree of predictability of what to expect or what should be expected to safeguard a customer would also be of use. But then, beyond that base level of enquiry there are opportunities for different credit providers to step up where they see fit to do so.

MR HUGHES: Thank you. We don't have any more questions for you. Is there anything you want to say in closing?

MR HUGGINS: No.

MR KAVANAGH: No.

MR HUGHES: Well, Michael and Dan, thank you very much for joining us this morning. We appreciate the effort and the submissions you've put in and look forward to talking to you further. Thank you.

MS CHESTER: Thank you. And thanks for being first cab off the rank.

MR KAVANAGH: You're very welcome.

MR HUGHES: So just do a quick changeover now and our next participants will be from the Bank of Queensland.

BANK OF QUEENSLAND

MR HUGHES: Good morning. Well, good morning, Anthony and Chris. If you'd like to start with a brief introduction of yourselves and any succinct opening statement and then we'll head off into questions. Thank you.

MR ROSE: Great. Thank you. Anthony Rose, the interim CEO of Bank of Queensland and I'm joined with Chris Irwin, our Head of Retail Credit Risk. Thank you for the opportunity to appear before the Commission today to discuss ASIC's consultation regarding responsible lending obligations and Bank of Queensland's submission responding to ASIC'S consultation paper. By way of background, BOQ was first established in 1874. Today we employ more than 3,000 people and serve nearly a million customers through a national network of around 170 branches. A unique franchise model network of owner manager branches forms part of the two million small businesses contributing to the Australian economy. Responsible lending is an important issue for all customers irrespective of who they borrow from. It is therefore important to place customer outcomes at the forefront of any deliberations around responsible lending.

As we've previously noted in public commentary, our approach to responsible lending has seen us validate expenses declared by all borrowers in their home loan applications against bank statements. This invariably identifies items that warrant further consultation with customers to more properly understand their position which has impacted on time to decision and on the experience for our customers. In our view, this has led to some customers to, sorry, this has led some customers to instead seek finance from other lenders whose approach may not have been as rigorous. This is particularly pronounced for customers who choose to use a mortgage broker. We therefore welcome ASIC's decision to review its responsible lending guidance and see this is very timely. Our submission makes a number of comments regarding the current responsible lending framework, and Chris and I are happy to elaborate on our submission in any areas where you'd like additional context. But before that I would like to emphasise the importance of responsible lending obligations delivering the right outcomes for all customers irrespective of who they seek a loan from. When considering any changes to current guidance, it's critical to think about the impact of these changes and whether they're likely to lead to better customer outcomes at an industry wide level. Customer outcomes should be viewed from two perspectives.

Firstly, ensuring that customers do not enter into obligations that are not unsuitable for their particular circumstances. But also ensuring that customers who would otherwise qualify for a loan on suitable terms are not denied access to credit. Importantly, while additional obligations may provide some additional protection at the margin, they also impose additional costs and burdens on customers by requiring the collection, lodgement and verification of additional information. This more intensive set of requirements can also lead to a slower and more complicated approval process. The customer frustration and dissatisfaction with this can lead, that this can lead to, should not be overlooked and is something we are all too familiar with given the approach to expensive verification adopted by BOQ in recent years.

Responsible lending obligations also need to be set at an appropriate level which balances the competing goals of protecting consumers and providing them with access to credit. There is a risk that the changes to responsible lending obligations could lead to a situation where people who should be able to access credit are no longer able to do so or at the same levels they otherwise would. While responding to lending needs, needs to provide appropriate protection to customers, it is equally important that it does not unnecessarily constrain access to credit as this would have real consequences both for individual customers and the broader economy.

Finally, whatever determination ASIC makes about the appropriate settings for the responsible lending framework, we believe greater clarity and certainty of the regulator's expectations should be incorporated into the regulatory guidance. Hearings throughout the royal commission have shown that different banks have clearly interpreted the current guidance in differing ways. In our view, regulatory guidance that provides too much latitude for subjectivity and interpretations is not the best outcome for customers or competition. Where ambiguity exists in the responsible lending obligations, there is a potential incentive for some banks to adopt lower standards and use this as a competitive advantage against those with processes and methodologies that provide more protections for customers.

Having lenders compete on price, innovation and customer service will deliver good customer outcomes. In contrast, creating incentive for lenders to compete with each other through the application of differing responsible lending standards is not in the best interests of customers or the industry. I am happy to elaborate on these issues or any other matters that you may wish to discuss and welcome your questions. Ultimately we believe that regulatory guidance, which provides the industry with clear directions and sets responsible lending expectations at an appropriately robust level will be critical to ensuring a well-functioning lending market which is able to deliver the right outcome for all Australian borrowers. Thank you.

MR HUGHES: Thanks, Anthony. And following on from your remarks about differences in approach, can you give us some examples, some specific examples of what you think you’re doing differently to your competitors which you would say is a more diligent process but which puts you at a competitive disadvantage?

MR ROSE: We took a decision is response to the shifting expectations from the community and from regulators some time ago to move to a practice of expense validation of all, of bank statements for every single loan application that, mortgage loan application that comes into the organisation. The, so simply going through that expense analysis, so it’s not just a customer declared series of numbers which is then compared to a benchmark and therefore, in a lot of cases, the benchmark is relied upon, we actually go through that assessment. That invariably throws up pieces of information that raises the necessity to have a question with the customer.

At the end of the day, we need to make sure that we have informed, conscious decisions that are being made and that the risks are appropriately understood. Those objectives are actually completely aligned and consistent between the borrower and the lender. Both parties want to achieve that outcome. So what that means is the additional questions that we may ask the customer and then ask for validating support behind that has meant that the number of customer interaction points that we've had on average have been materially higher than a lot of our competitors.

We think producing better quality outcomes, but a lot of customers, and in particular those who choose to use the broker market, haven't, we haven't seen as many, as much flow and activity through that channel as a consequence to some of the additional requirements that we have in place.

MR HUGHES: So if you can clearly delineate where your practices are more diligent, why do you keep doing it?

MR ROSE: Well, that's a good question. I mean, our, you know, there, there have been a number of reviews by the regulatory environment, including a targeted review by the regulator, by APRA a couple of years back. That set what we thought the standard was and we have been following to that standard consistently. It does appear that the benchmarks and barriers haven't necessarily been enforced to the same standard and that the industry's been allowed some time to move to, sort of, where APRA had set expectations and I think we had moved more quickly. So it's a question of, you know, constantly, we're constantly reviewing that position. We are working on ways of using digitisation to simplify and enhance the process for both customers and for ourselves to help improve that, that process but we don't want to diminish the quality of the conversation that we have today with the customer. It needs to be as informed as we can reasonably make it so that everybody understands the risks that are being undertaken.

MS CHESTER: So I think you referred to it earlier, Anthony, as you did see it producing better quality outcomes, the approach that you're taking, which I think you suggest in your submission is more diligent than other participants in the market. So then just trying to then understand, you have a proposal in your submission, around pages 8 and 9, around a new risk matrix for a minimum standard and you sort of have high-risk and low-risk customers, based on servicing surplus net worth and things like that, which would be different to what you're doing at the moment, which you referred to as quality outcomes. So under that matrix approach, that would mean that you wouldn't, you'd only require verification of non-discretionary expenses for the highest risk category of customers. So what was the, sort of, the evidence or the analysis based on your own customer book that suggested that that matrix and that approach would still give you the quality outcomes you've referenced from your current, more diligent approach?

MR ROSE: So the way we've thought about this proposal is we do believe there needs to be a minimum standard that applies to all and we think that that, that should be the, the starting position and then there would be an expectation of scaling up, if you like, that minimum standard, depending upon the risk and complexity of the actual underlying customer. If you take it from a customer perspective, it's, you know, what would the reasonable expectations of a customer be and they will differ quite significantly from a first home buyer than they may to somebody who is later in life on their third upgrade of their home, who had proven, over a long period of time, quality servicing characteristics and understand how to manage their commitments and so, so the nature of the degree of inquiry that you would have with somebody at, at those different stages, needs to be appropriate to their personal circumstances.

At the moment, the framework that we had adopted was a little bit one size fits all. Again, we think there, there is merit in taking a different approach to the one that we've put in place but we, we again would like the industry and regulatory environment to land on a position such that if we were to relax what we currently do today for those, let's say, higher quality, more sophisticated customer base, we would feel very comfortable in doing so. We do feel comfortable in doing so, but we want to make sure that we've met the full regulatory expectations at the same time, in making those changes.

MS CHESTER: So just so I understand, so based on evidence and analysis you've done around your own consumer book identifying high and low risk, you do this and you still get the same quality outcomes, that's your assessment, what you're proposing?

MR ROSE: Well, what we're - - -

MS CHESTER: In terms of meeting obligations.

MR ROSE: Well, well, we're measuring this from a customer's perspective. What's the quality outcome from a customer perspective and, to be honest, for somebody who's taking out a 40 per cent loan to valuation ratio loan, who's got a long established track-record and history with us and asking for all of the documentation that we do today is arguably, they would see as a step that's probably not required for their degree of sophistication and we'd agree with that. So, which is quite different to somebody at a different decisioning [sic] point in their life.

MS CHESTER: So what's, so if you've done the analysis that you think that that's a better model for your bank and it's going to meet your obligations, what's the impediment for you doing it today?

MR ROSE: So with all of the change, I suppose what we're saying is, we've been wanting, and given the timing of this at the moment, we've been keen to see where everything lands to then move to that, let's just call it, and I want, I don't want to use the word risk-based approach because it's the wrong, it's a more, a fit, a customer fit for purpose approach is probably the right way to describe it, that we would move to once the, you know, the position for the industry solidifies rather than moving at multiple times across a relatively short period.

MS CHESTER: So there's no impediment under the current guidelines of you doing it, it's more you wanting to see how we land the next iteration? So there's nothing in the current guidelines that would preclude you from - - -

MR ROSE: Look, the regulatory expectations, if you look at the targeted review that APRA undertook, probably sets a benchmark that was one size fits all. So again I think we would need to ensure it aligned to where the collective regulatory environment settings end up landing.

MS CHESTER: Yes. So, I guess, we're focused on the responsible lending guidelines as they stand today, and that's kind of our focus. So if you can be patient with me. I'm just trying to work out, there's no impediment in those responsible lending guidelines for you sort of heading down the road of this matrix at the moment?

MR IRWIN: I can probably talk about that. The, I guess, current regulatory guide in the requirement for reasonable steps and reasonable enquiries, as we've talked about it, it is a little bit ambiguous and we have taken the approach to work with our customers, and whilst it is sometimes onerous, as Anthony outlined, getting a fully informed decision. That for the bank has been an imperative that we've worked through. And we have looked at it to say we are probably fulfilling the regulatory responsibilities to a full degree. And we've been supportive of that.

I think Anthony's comments around our customer impact is true and that's something that the banks had to consider how we balance the customer outcome, which can be different in different circumstances. So that scalability issue is one we've been working through as a business to understand [indistinct] obligations perhaps a little bit more flexible and we have actually have done some review, both in terms of, I guess, quantitative and qualitative with our customers to see what are those outcomes and expectations. So whilst we would say yes, we are meeting all the regulatory requirements and would like to perhaps see how we can get a better outcome from our customers, not just spending less time with those customers perhaps of proven conduct, you know, equity in their property, but also making sure we spend extra time, extra conversation with the customers who also would warrant further review. That's something, the model we're working with at the moment. So maybe a better way - - -

MS CHESTER: Okay. I'm still not quite sure of the answer but - - -

MR ROSE: Well, maybe a better way to answer your question. We probably understand at the moment that we may well have a degree of application to how we'd interpreted responsible lending obligations that is maybe beyond where we will all land. We're averse to reducing from that level with haste given the fact that the settings are being re-established through this process and we prefer to do that in one go rather than have a couple of goes at it. You would understand the complexity of the actual process and you know training staff and in dealing with customers once rather than multiple times is obviously something that we'd be making sure we do.

MS CHESTER: Okay. So it's more coming to a landing than anything in the current guidelines? I think that's helpful to establish.

MR ROSE: Yep.

MS CHESTER: Coming back to your point earlier, Anthony and Chris, around the consumer lens here, when you sort of thinking through what's reasonable to enquire and verify in the circumstances of the particular customer, what's the form of consumer detriment you're focusing on there in terms of making the call about what information you need to consider or not consider?

MR ROSE: So, again, as we've talked about, it's about making sure that there's a properly informed decision by the customer in the obligations that they're actually taking on. So when you think about expense validation, there are elements of expenditure patterns which are non-discretionary and there are elements that are discretionary. Now, we could have a definition of what we believe that to be, but actually each individual customer will have their own measure on what that is. So that's the frame that we think is critically important. A particular customer may consider, you know, private school fees to be a non-discretionary spend. Others may consider it to be more discretionary. The, just basic behaviours.

The other element that I would put into this assessment is we need to be careful that when you're looking at a period of time to assess behavioural spend, it is only a point in time. So having a quality conversation, let's just say with a couple that is choosing to move into a home that has had a recent period of going on extended holidays, that suddenly makes a conscious choice that says, well, in that new environment the scale and size and nature of the holidays that they'd taken won't be affordable under their, without implications for their current living and lifestyle. But enabling, ensuring that they understand that, such that it is an informed choice, is really the important criteria. So in a lot of cases it would be for us, you know, there might be a payment or to another bank account that the customer may, or a debt that the customer had had which they hadn't declared, had overlooked to declare. However, that was an understanding what the obligations of that is and making sure that that's fully incorporated into the picture is critically important. So there's aspects like that. And then there's the, that delineation between discretionary and non-discretionary which each customer has their own personal assessment as to what's critically important and what isn't.

MS CHESTER: So in terms of, I guess, the point of view from your assessment about what would constitute substantial hardship for a customer to continue to meet their repayments on their loan, say a home loan, it's going through that dialogue with the customer around discretionary expenses?

MR ROSE: Moving into a different subject now when you get onto hardship, when we've been talking about a loan application. An assessment for their validity to take on the loan, right, so their consciousness around that, it's different I think when you're talking about a customer who's already a borrower, who then goes into hardship.

MS CHESTER: Oh no, sorry, we were on the same category. We were talking about, how do you make your assessment around consumer detriment? And consumer detriment would be here if it was not responsible lending and there was actual hardship for that customer in meeting the repayments. So just, so not that they've hit a period of hardship, but meeting the repayments causes them hardship.

MR ROSE: Well, our, so we, because we do validate 100 per cent of all applications to their expense patterns and then we would take the higher of either that amount or the HEM benchmark, which we apply a postcode and an income based granularity to that and take the higher of, that would determine the serviceability capacity of that existing customer. And having gone through that process we do find on a regular basis items like an undeclared financial commitment which otherwise, you know, would not have been captured in the, in that assessment through going through the bank statements, which then becomes an important part of discussion for the customer. So do they restructure their financial affairs? Do they, you know, might be a motor vehicle lease, it might be something of that nature. Do they scale down the size of their loan application so that they can make it affordable? That's the type of discussion. And that's the part that I think we are keen to make sure is maintained. Again, taking a fit-for-purpose approach for each, depending upon the customer cohort and their degree of sophistication and capacity that is maintained. We do see examples every day where through that process that conversation with the customer does make their decision more conscious and more informed.

MR HUGHES: So when you talk about scalability, if you were writing this guidance for us, what additional steps would you say need to be put in place for particular types of products or customers? Where does it start to scale up in terms of the intensity of your assessment?

MR ROSE: We've put a table, which we've tried to set out in our submission. So, you know, a lot of it is the nature of the customer. So depending upon the size of the loan relative to their – so if serviceability is demonstrably large, then the degree of, relative to, you know, things like the HEM benchmark as a benchmark, then the necessity to actually go through all of those steps probably doesn't warrant a lot of value and may not be seen as a good experience for the customer. Clearly, when serviceability is tighter that would be a trigger. The, you know, size of loan, their stage of loan, where a borrower is, first home buyer versus somebody who's got an established repayment history. They're the types of guidelines that I think would be sensible. Is there anything else, Chris, you wanted to add on top of that?

MR IRWIN: Yeah, thanks, Anthony. We have talked a lot about the impact on the customer, which relates, I think both to, as encountered in the regulatory guide, the size of the loan, the complexity, the relative nature of the financial requirement to their own circumstances. So, we'd like to see the continuation of that. However, I think on the positive side, we would like to see more recognition perhaps of a customer's conduct, or their financial position, which may be just their high net worth. In the right, again, circumstances in the right product origination as well.

MR HUGHES: And are there, is there a differentiation between product types?

MR IRWIN: Yeah, definitely. I think - - -

MR HUGHES: In the scalability test?

MR IRWIN: Yeah, I think definitely. The small value products, or short-term products, I think the customer expectation often is for a, sometimes a quick and more immediate answer on those particular products. And depending on the customer's circumstances, then that certainly can be a less onerous process, both for the customer and obviously the institution, which I think is a good outcome.

However, we recognise, again, as you've mentioned, with a table and a scalability approach. A customer particularly, you know, it's not just the first home buyer, but all customers for their own occupier home loan, which is critical to them, it's their residence, it's their often key financial commitment. That those particular customers, those particular applications, that there's a strong focus on the approach. And, again, as Anthony has highlighted, areas of customers having perhaps low serviceability, from our calculations, or indeed limited equity in those properties, they're the loans that we think those customers we should have deep and more informed conversations and perhaps deeper, more informed review of the information.

MR ROSE: I would just to reiterate the point. I think the ultimate impact of a customer's default on a product is very relevant. If it's a, you know, a small ticket credit card which is really about managing transaction activities and they default on that, they may have an adverse outcome on their credit history. But that is quite different for them to remediate and address over time than it is for the impact of no longer having the owner/occupier home and having to move out of that residence are very, very different outcomes. And I think the framework needs to reflect that as well.

MS CHESTER: So just so I understand. On the serviceability, and I might have got confused a little bit earlier, when you're working out the serviceability, what's the expense benchmark that you're using there? Is it the HEM, because that's the one that you consider to be sort of, below that would sort of suggest potential hardship in meeting repayments? I'm just trying to - - -

MR ROSE: Well, I mean, a large number of our customers would have validated and, you know, we do validation of underlying bank statements, their spending behaviour would come in below HEM. We apply the higher of, in determining their maximum loan size, so for serviceability, so that gives us confidence that it is a very sensible benchmark to use. Now, we use, and I'm not sure it's consistently applied across all the industry, but it's a geographic and income-based framework is what we use and, as I said, a significant proportion – and we're happy to provide the details subsequent – do validate below that benchmark, which is what you'd expect. I mean, it should be something akin to a median for non-discretionary expenses.

MS CHESTER: We might jump to HEM then if that's okay. So, you're using which version of the HEM at the moment with the income bands and geography, the most current version?

MR IRWIN: Yes. We're currently using the version which uses the scalable income, which, you know, has been adjusted. It's also the, I think, based on the 2015/2016 census survey information. So, we're using that. I think it's, and we do update that every six months, we're due to update it later on this month. And I think as Anthony has highlighted, we use the higher of the customer declared expenses, or the HEM benchmark. So, in that, not just the higher of it, but also we are looking at those applications, predominantly those that are under HEM, but also even above, just to ensure for those customers that what they declare, which often I'll say can be something that is needn't be discussed through that conversation that we have with our lenders and customers upfront. We do use bank statements to work with our customers on what are those expenses. I think that's quite a prudent approach as well.

MS CHESTER: Okay. But there's a number expenses that aren't included in HEM, and some of them are quite material. Can you just run us through those and how you deal with those. Because I'm assuming when you're comparing the transaction statement with expenses, it's apples to apples. So what expenses are in the HEM, you're comparing to the expenses on their transaction statement - - -

MR IRWIN: Correct.

MS CHESTER: - - - that align with that. So how do you deal with the others?

MR IRWIN: Yeah. So, I think you're referring to, obviously the HEM covers the suite of products that are more living expenses and there is other things, like private school cover, life insurance, I think HECS as well, they're outside of that.

MS CHESTER: Super?

MR IRWIN: Yes, correct.

MS CHESTER: Couple of little things.

MR IRWIN: So there are some things we do capture with our customers. Now, they're not going to be for every customer, but certainly I think what we work with our lenders on – and I think the whole industry is agreeable on this – you need to understand the customer first and foremost. So, certainly the process shouldn't be a checklist, rigorous approach for each and every customer. It is understanding the customer's circumstances and getting their particular lifestyle understood first, and then going through that expense question. But, I guess, coming back to your original point, yes, there is expenses that are outside of the living expenses we compare to HEM.

MS CHESTER: And so how do you enquire and validate those? Because some of them are discretionary and some of them may not be.

MR IRWIN: Yes, that's part of our lending application process.

MR ROSE: So we get bank statements and we have the discussion with the customer around, you know, understanding, you know, their particular circumstances. I mean, some, as I said before, the discretionary versus non-discretionary nature of a customer will vary, because we have an approach of using the higher of, you know, so we validate their actual expenses that allow them to live at the level that they, you know, they expect are comfortable with. We take the higher of approach. That is a bit - - -

MS CHESTER: So, sorry. Just so I understand, because we heard it was a little different earlier on this morning with another lender, so when you're taking the higher of, is it the apples for apples? So what are the expenses in HEM, compared to what are the expenses in their transaction statement, and if it's the expenses are less, you take the HEM. What do you then do with the non-HEM expenses? I'm just, you see what I'm saying? When you're taking the higher of, how do you deal with the non-HEM expenses?

MR ROSE: We validate their actual expenses under the 12 LIXI categories. Okay. We then look at the HEM position, and we take the higher of those two aggregate amounts. So, not an individual line by line, we'll obviously look at each of the elements but we look at the aggregate position and the actual validated spending pattern.

MS CHESTER: So you're comparing the HEM then, Anthony, to what you consider to be their total expenses including discretionary and non-discretionary expenses?

MR ROSE: Well, things like, things that are discretionary, it depends upon what where you draw the line as to discretionary and non-discretionary. The items that, we would classify the non-discretionary as being the elements required to live, right. And but discretionary would be to go on a holiday to, depending upon the scale of those things. Now, those things are discretionary and people will always trade off those things relative to the nature of the home that they purchase. So, you know, we look at making sure, as best we're able, that that understanding of the trade-offs that that customer is going to make, is as clear to them as it can be.

MR HUGHES: But if you're looking at an item of expenditure at a supermarket how, how do you drill into, you know, something that's essential, a living expense, and a something that's discretionary like at chocolate bar? I mean, how do you work out what's discretionary and non-discretionary when you just have a line item which says, you know, $200 at Safeway?

MR ROSE: Well, you're probably going into a layer of detail that we would look at aggregate spend patterns over 90 days of bank statements on the 12 LIXI categories so, you know, again I don't think anybody, or we certainly wouldn't be advocating you going down to analysing individual shopping statements and delineating between discretionary and non-discretionary there. It's what are they actually, you know, what are they actually doing. For those types of, you know, shopping-related bills the vast, I suspect all of that would go straight into the non-discretionary bucket.

MS CHESTER: So maybe I can be helpful to make sure that we've interpreted what you've said correctly. So when you're comparing HEM, you do it to what you consider to be a total expense bucket for that consumer against their transaction statements but you've taken out, based on discussion with the consumer, what you consider to be discretionary expenses that they can go without post the loan or the credit?

MR ROSE: Yes.

MS CHESTER: And that's informed by discussions with the consumer and taking out those discretionary items from the total expense?

MR ROSE: Where we see items that are lumpy or, there would be a discussion.

MS CHESTER: So give us a quick run-through, then, of the discretionary items which are sort of the top items that you'd be looking at taking out of the total expense bucket for them and making that comparison to the HEM.

MR IRWIN: Because I think it's, first when we talk about that is the non-discretionary, so I think we would clearly say, as has been articulated, things like food, basic clothing, medical, transport, utilities. So they're non-discretionary and I think, you know, through the HEM benchmark that's, at the moment, you know, it's appropriate to see whether that changes. We'd like to see that improve. But discretionary then we would say are items that the customer can vary or reduce, i.e. discretionary, but in determining that the bank and our lenders, we don't apply our own judgement on that. We do talk to the customer or revert back to our lenders to talk to our customers and then understand the customer's position.

So rather than call out everything being, everything that's non-discretionary as being discretionary, as Anthony mentioned earlier, we have that in the form of customer conversation, which might be, again, private education, it might be overseas holidays. And so gathering that information I think it's important to remember when we talk about our application process it is the customer declaring their living expenses. We then review that compared to HEM and also review those bank statements for any, and it's a reasonable approach, to say is there any information within these bank statements of 90 days that is different to what the customer, and I don't mean as in down to dollars and cents different, but is it something that you would look at and say the expense the customer has declared is not reasonable compared to what they're actually, spending patterns are.

We also capture their credit card statements as well because obviously that's an additional piece that most customers now utilise for their living expenses so it's probably a fuller approach and I think that has achieved a good outcome in terms of our lending to make sure our customers are capable without going through substantial hardship of meeting their commitments.

MS CHESTER: And so what percentage of your customers, when you ask them for their total expenses before you do your own inquiries and verification, what percentage of them would their expenses be below the HEM that's appropriate for them?

MR ROSE: It’s north of 40 per cent isn’t it?

MR IRWIN: Yeah, it’s around about the 40 per cent.

MS CHESTER: So more than 40 per cent would be below the HEM?

MR ROSE: Yes.

MS CHESTER: Okay.

MR IRWIN: It’s, it’s actually something that has, I think when we introduced the LIXI categories in 2018 we found that, and I think for the customers as well, a better process. So moving to the 12 categories in the LIXI working group analysis we’re actually finding now that there is probably around about 60 per cent of our dealers now that are using the customer-declared living expenses. So it’s, you know, only about 40 per cent that use the HEM benchmark and I think that, not just, you know, move to 12 categories but the better customer conversation as a part of it.

I think the bottom line that we have from this, Anthony has mentioned it and I think probably we mentioned credit consistently through the two hearings, would be that customer expectation of what is the discussion that we’re having with them. I think that’s probably going to be critical depending on what product, which bank, which organisation. I think we also talked about potentially rewarding those existing customers I think not just for the customer’s position on the product but also the existing customer and the new customer often there's a different conversation as well.

MS CHESTER: Just two quick follow-up questions then on the HEM. So firstly, what’s the delta between the expenses that are in HEM versus the expenses that are covered by your LIXI 12 categories?

MR IRWIN: The categories are pretty much aligned to the HEM benchmark and what’s covered there. Elements, and you talked earlier about other commitments so child support, or alimony as it’s sometimes called, life insurance, those things are outside of.

MS CHESTER: Outside of both?

MR IRWIN: Yes, outside of those, and so we capture them separately, like board and those sort of other fixed commitments as well.

MS CHESTER: So all the things I mentioned before for HEM, like super and all the rest of it, they’re not in your 12 categories either?

MR ROSE: Super mightn’t be a good - - -

MR IRWIN: No.

MR ROSE: - - - example because we would use income post - - -

MR IRWIN: Voluntary super.

MR ROSE: So it would be, but, but the other categories would be, would definitely be captured. So life insurance would be captured as part of the spend.

MS CHESTER: In your 12 categories. Okay, that’s great.

MR ROSE: Would be captured outside of that. So whether that's child support or other support payments that, that that person has got an obligation for.

MS CHESTER: And of the frugal 40 per cent that are below your HEM benchmark, what then do you do with them, what further inquiries or verification do you do around their expenses or do you then just take the HEM benchmark?

MR ROSE: We would take the HEM benchmark. So we would, we validate, get to a position and go, well, we're comfortable that this customer can actually operate at that level, but nonetheless we're going to apply the HEM benchmark, which then means they get a lower loan size than they otherwise if we were to use their declared expense, the expense profile that we validated.

MS CHESTER: And the process of validation, Anthony, is it any different from the normal inquiry and verification that you do?

MR ROSE: It's the same. So it's consistent. So maybe another way to maybe just elaborate on the discussion is because we validate 100 per cent of mortgage applications back to bank statements, what our data is telling us is that the HEM benchmark actually is providing a pretty good estimate a little bit below, you know, a little a bit above should I say the median if you like of actual expense pattern in the way it's distributed across the population.

MS CHESTER: Thank you.

MR HUGHES: Just on verification and inquiry, you've got your matrix in your submissions. Are there particular types of products or customers where you think it would be reasonable to rely on a lower level of verification and inquiry?

MR ROSE: I used that description before. What's the impact? A $5,000 credit card which helps somebody manage their day-to-day expenses and if they end up defaulting the impact of that for them is, is a very different level of impact to that that would be experienced on a customer who has to move out of their home because of a default on their mortgage. So we think that absolutely the, the way the framework is established needs to take that into consideration.

You know, the cost of providing the type of serviceability assessment you would want to put in place for a home mortgage, to apply that to, you know, a credit card, personal loans at the same level would actually add a degree of cost to the provision of that credit that would be very significant and, you know, would question whether that was actually in the best interests of having an efficient economy. So I think the impact lens is really important to, to overlay in how the elements are applied. A different standard for a different impact.

MS CHESTER: Just coming back quickly to verifying expenses. I got a sense that a lot of your comfort comes from the transaction statements. Are there any expenses that you have difficulties verifying?

MR IRWIN: I think obviously expenses, we look at 90 days and that captures a lot of the non-discretionary expenses, what you call general living expenses. And it also does capture utilities as well and, you know, things that may be only monthly. There is in that, obviously the annual expenses that some might have, like, your car insurance, or other periodic payments like that.

But again, it's the customer conversation that we have upfront that's important as well. So when they're recording information I'd say that, you know, there is a reasonable degree of review on that if someone says that their insurance is a year $200, and then obviously you would question that. And then obviously look at the statements to verify, is that reasonable or not.

We do recognise there is customers, whether it be, you know, families living with parents, so multi-generational families, or people that are living in different circumstances that may have lower costs. And as long as we have that discussion and recognise that, then I think that is appropriate for what we would look to do.

MS CHESTER: You did raise a concern in your submission, I think it was page 13, about what you thought were, I'll quote you to make sure I don't misattribute this, that creditworthy customers are currently being denied access to credit facilities that they could manage without substantial hardship. I'm just trying to understand, if someone's been assessed as creditworthy, why they'd be refused credit by your bank? What's causing - - -

MR ROSE: Yeah, I suppose that is a concern relating to whatever the design of the framework we put in place, we need to make sure that, you know, those that are eligible to receive credit can access it. So, it's a general concern, there's nothing specific in that, other than it's important to make sure that whatever framework we come up with doesn't impede the provision of credit to worthy borrowers.

MS CHESTER: Maybe I'd misread it. I thought it said, are currently being denied access to credit facilities, that you're experiencing that at the moment? That's okay, we won't hold you up on that one, but it would be good to get that clarified. Everyone's reading submissions very closely.

MR IRWIN: I think in that respect, what we're talking about is perhaps the credit conduct of a borrower through their credit information and their conduct with the bank, or indeed any bank, it may be proven. However, through the lens of we would ask a customer to provide us with other information which may be more standard and I, you know, fully support pay slips, but pay slips, other documents, other verifications. As Anthony highlighted earlier, some customers with a proven, strong record may not choose to provide you with all that information. And, so, you know, they, as Anthony said, go elsewhere and that may be outside the regulated sector as well. So I think we have to be mindful of that.

MS CHESTER: So it's folks that you've assessed as creditworthy, but they won't give you the information needed to verify and meet you're responsible lending obligations?

MR ROSE: No, it was more a comment that, apologies. It was more a comment that because of the requirements for information that we request. So, here's the list of information you request, that if they go to another provider, they're being asked for less information and particularly in the broker space, you know. We had a broker aggregator group that we brought on to our business recently. One of our largest generators, put some deals through the system, quite comfortable with the process, but did say the information requests that you had for my customers were well above what other lenders are prepared to ask for. Had, hence, thank you, but we won't be using you again.

So, you know, that difference is a real element for the efficiency as they would see it of their operation of their business for their customers. And, you know, we thought that, you know, we think that the request for information that we have are sensibly structured, albeit the caveats of the discussion that we had earlier today around where this could land. So, we understand that, but we're conscious of it and it is something that, you know, we would need to have addressed through to make sure that that doesn't become an ongoing issue through where all of this lands and when we set our settings accordingly.

MR HUGHES: So just in wrapping up. Why do you say then on page 16 that the emerging digital solutions have shortcomings in terms of effective verification of expenses?

MR ROSE: Because at the end of the day, like I. I'm not sure there's a solution at the moment that can read the minds of customers, that the discretionary versus non-discretionary decision is, you know, is individual and, you know, and hence, you know, I don't think. Certainly where we are today, the ability to have that discussion that might say, you know, here's an expense pattern that you've demonstrated over this period that for you to afford the loan that you're asking, would be potentially problematic for you. However, you know, if you no longer did the overseas holiday, it would then become something if you're prepared to make that trade-off that would meet your new lifestyle expectations. They're the sorts of things that don't necessarily get properly addressed.

MR HUGHES: Look we might have to wrap it there, but we may come back to you with some further questions. But thank you very much - - -

MR ROSE: Thank you.

MR HUGHES: - - - Anthony and Chris for your time. We appreciate your submissions and your answers.

MR ROSE: Thanks for the opportunity.

MR HUGHES: We're now going to pause the transcript until 11.15 and have a quick break. Thanks very much.

SHORT ADJOURNMENT

ATHENA HOME LOANS

MR HUGHES: All right, we'll resume the public hearing on Consultation Paper 309, and the third participants, from Athena Home Lending we welcome Mr Joseph Seychell and Mr Nathan Walsh. Joe and Nathan if you wanted to introduce yourselves and make any brief opening remark. Thank you.

MR WALSH: Thank you Commissioner, Deputy Chair. My name is Nathan Walsh, I'm the co-founder and CEO of Athena Home Loans. I'm joined by my colleague Joe Seychell, who is the Chief Risk Officer for Athena. We'd like to thank you for including us in the hearings today. We'll clearly bring a very different perspective for the, from the large established incumbents, that of a new lender trying to use technology and design to deliver better customer outcomes in an industry where the community is crying out for real change. We know the consumer protections embedded in RG 209 are critically important and the opportunity for additional guidance is to make those even stronger.

So maybe just a brief to emphasise just a few of the themes we hope to come out of the discussion today. First off, the importance here of competition and innovation and avoiding any increased prescriptions having an inadvertent impact of further cementing the dominance and pricing power of the incumbents. And in that regard, the value that the, the framework around scalability of enquiry and verification plays, recognition that not every customer and every scenario is the same. And the value of additional guidance both from a process point of view that every responsible lending enquiry should start out with an assessment of the scale of enquiry required. But also additional potential factors to be included in terms of what is scalable enquiry in Table 3. Particularly 3, that we'd love to call out around a demonstrated track record of managing a level of credit, calling it a like for like refinance versus a first home buyer are very different scenarios. The financial sophistication of the borrower and also the risk profile of the lending. In that, a very specific scenario around an opportunity to improve mortgage portability. So making it easier for customers with existing credit to switch lenders and unlock significant financial benefits. Many have talked about there being groups of borrowers with good credit, low LVRs, being managing a mortgage for many years but are nonetheless finding it hard to switch.

We'd also call out an even larger problem are those who are deterred from even going through the refinance process in the first place. Only about 5 per cent of borrowers are refinancing each year even though the majority could be getting much better cost to credit and that's costing borrowers billions of dollars. Thank you.

MR HUGHES: Thanks for that, Nathan. So you've obviously positioned yourself as a very different type of entity. What do you think is different in the way that you go about complying with your responsible lending obligations?

MR WALSH: In terms of the responsible lending obligations there is no difference to the existing incumbents. So we are a credit licensed entity.

We have the same responsible lending obligations. And although we're not an ADI, we're applying the same APRA guidance around things like buffers and shading given our warehouse funding arrangements. So the difference is not the what we're doing, but more around the how we're going about that. In terms of our perspectives on consumer lending we should probably start with a very much a focused approach we're a focused specialist home lender. We are focused on a direct channel. We deal directly with all our customers and therefore avoiding some of the complexities of a broker channel distribution. And we're also a focused value-led proposition, so simple digital solutions targeting low risk lending.

But what we do see is an opportunity to really disrupt some of the market conventions that aren't serving customers well today. So today new customers get discounts but loyal customers pay the price, and we believe existing customers should never pay more on a like for like loan. Today the industry's characterised by a very high price opacity, you know, customers requiring to negotiate down from high standard variable rates and we believe in transparent everyday low prices. Today, Australian household debt is amongst the highest in the world and we believe customers need help to pay down their home loan faster. And today borrowers perceive refinancing processes to be painful and slow, and we believe making that a simple and digital refinance process.

And we should highlight that those industry issues, I mean, ASIC is not the root cause of any of those, but there is an opportunity of each of those for this process to become an important step forward in the right direction. So when we talk about things like the mortgage market inertia, the fact that only 5 per cent of borrowers are refinancing each year, the idea that this inertia is central to many business models where borrowers take advantage of the opportunity to systematically raise rates on their back book. We ask the question, is this responsible lending? The opportunity for ASIC guidance really focused around scalable enquiry and verification to get the balance of both protecting the vulnerable but also facilitating competition. In terms of the household debt burden, the Australian household debt income ratio has grown by 300 per cent over 30 years. Australia now amongst the highest in the world. And particularly the growing proportion of owner-occupied mortgage debt with older demographics. So it's nearly double the proportion with pre-retirees 55-64 since 2001.

The industry convention where many borrowers on a refinance default back to another 30-year loan perceiving that to be an advantage from responsible lending. We ask is that really responsible? So again the opportunity to shift the responsible lending focus from a static to a much more dynamic focus around how do we actually help educate customers to build safety buffers and pay down their loan faster?

And then finally around the industry pricing conventions around things like opacity, the loyalty tax, rate bait. Customers are systematically underappreciating the compounding impact of interest rate differentials and comparison rates are poorly understood. So we ask the question, is it responsible lending that such a large proportion of borrowers are still paying standard variable rates? Recent estimate that it was at 9 per cent. Potentially 200 basis points above a competitive rate, a typical mortgage that would cost $169,000 over the life of the loan. Is it responsible lending to have scorpion loans with a sting in the tail? So short-term fixed rate that default back to a standard variable rate or potentially default back when there is some kind of variational change. Again opportunities in guidance on requirement subjective to ensure there is a plain language playback of the true cost of credit.

MS CHESTER: You've raised some policy issues there that we're familiar with, that perhaps go a little bit beyond what we can focus on today with responsible lending, but certainly some things on our radar screen and to-do list. I think you were here a little bit earlier this morning when we were hearing about what a credit provider or lender will do in the situation where declared expenses from a loan applicant is less than the HEM. Having had a look at your submission, take us through what steps you would go through because they seem to be a little bit different from the steps that others have suggested to us this morning.

MR WALSH: Yes. So we are going through a process where all applicants are asked to provide categorised expenses. We started with the LIXI categories but have done multiple rounds of consumer testing to say what are people finding easy to actually understand and manage within a digital framework? All applicants are then invited to use our data aggregation service where we can directly be downloading that information on a direct basis. We're comparing, for those who choose not to provide that data aggregation, we're actually comparing all of those versus a disaggregated view of HEM. So that includes income, number of dependants, marital status and postcode. And then we actually have scalable enquiry based on both the comparison to HEM but also how realistic or how reasonable is the individual category level of information. We're finding today that it's only 11 per cent of our customers who are at or below HEM level. And I should note that's below that - - -

MS CHESTER: After having gone through those processes you talked about?

MR WALSH: After going through those processes. And we should note that's relative to that disaggregated view of HEMs. So income and postcode, you know, being part of those components. And then where, clearly we're in the case that gets into the very detailed enhanced verification required for where there is a reasonableness in terms of the total or the category level.

MS CHESTER: So for the 11 per cent, Nathan, that are what they declare to you as below the HEM, what would you then do?

MR WALSH: So we are then getting into individual expense level information. So again, prompting a client, "Would you like to use data aggregation and look into the individual expense information?" The, the typical, the bias is to default to HEM but we do allow, given income and postcode level, HEM does create some anomalies to allow someone to establish that in fact their lifestyle does, does support at a below HEM, given it's a very small proportion of the, the total population.

MS CHESTER: But after you've gone back and done some form of verification with data aggregation or something like that?

MR WALSH: That's correct. Based on the actual expense information of the customer.

MR SEYCHELL: Yeah. At that point, we've triggered the most scalable of our enquiries, not actually doing a real detailed review of that amount.

MS CHESTER: So, but the lower 11 per cent under HEM, you don't default to HEM, you do further enquiries and scale it right up. Okay, that's really helpful to know. Thank you. You touched on before, a different approach, outlier approach to, sort of, using technology and data to improve and speed up the process of assessing credit worthiness but also, is this responsible lending. Talk us through, from the perspective of stepping back and looking at the investments that you make in those new systems and using data and technology. What cost savings does that result to for you as a lender in a commercial sense? What sort of business case is around that?

MR WALSH: So in a sense, by using digital processes, we are clearly looking to have a more scalable business system but still meet all of those responsible lending obligations. So we've taken very much a regtech at the core mindset. So in our user experience designer testing, compliance is not an afterthought, it's not design the experience and they have the lawyers come later and impose a lot of disclosure and other – but how do we actually continually test the customer's experience of the compliant process itself. That's also translated into things like how do we imbed, you know, single platform and a holistic data model that actually makes it easier to manager, not only to current regulatory obligations but as customer and regulatory needs change, make yourself flexible to manage those components. But giving a bit of a flavour, once you've collected that data online, that's all going into a decision engine. We're running over 100 different business rules across each application and that can be highlighting a clear no, but in many cases what that's really doing is, on average, three to four areas of scalable inquiry that's required with customers. We're not managing people out of that process, detailed conversations are in place with loan experts and credit teams. Every loan has a detailed review by an experienced credit representative and quality teams before unconditional approval.

MS CHESTER: Some folk have suggested that, perhaps more reluctant to go this route and they raise issues around, sort of, the quality of the data that's coming through and some privacy issues around it. How have you dealt with those issues in the way that you've approached it?

MR WALSH: Well, I think even relative to, sort of, the benchmarks that were discussed this morning, I think we're probably getting to a shape of the expenses that's probably a little closer to the total population than, that others who are using non-digital processes. But I think ultimately, you know, this is a lot around making sure that there is great design and customers understand the detail of what's being requested and then you also have the processes to ongoing test the business rules that you're applying and validate that they're the right ones.

Privacy is important [indistinct] is a customer right to provide data aggregation, it's not an obligation. And we are finding the majority of customers are choosing still to use the traditional provide bank statements rather than go through that data aggregation service.

MS CHESTER: So the fact that you're getting to the 11 per cent instead of others that are around the 40 per cent of declared expenses below HEM, only part of that could then be the data - - -

MR WALSH: For all customers, we're going in and getting detailed category level information. We have an option to provide guidance as to what, you know, typical breakdown of expenses, again to try to prompt people to think about what am I missing from each of those individual categories. You go throughout that entire process without choosing to use the aggregation service. We note that those who do choose to use aggregation are also coming in well above HEM. We should note, it's not just, it's only 89 per cent or above but, but typically well above that level. We're talking about, on average, you know, $900 a month is a typical excess expenses - - -

MS CHESTER: Thank you, that was next question, then what are you seeing of the lion share that are above the HEM, what's the buffer in what they've actually declared versus what the HEM - - -

MR WALSH: That's, on an average level, that's $900 and there's clearly a variation around that and I think we, in the past, have shared with, with ASIC some of the visibility around what that, what that data would look like.

MR SEYCHELL: Deputy Chair, if I could just add, I think the comments that Nathan made earlier around the regtech to the core, because this process of, of getting questions, giving, getting information, giving guidance, allowing customers to bring that in along the process is built right throughout all of our application, that actually we're getting to a better result as we, as the application is being put through, as opposed to some teams which are doing an extensive review post the application. So actually it's about thinking about how we're helping the customer through that app, rather than extensive teams later doing reviews that I think are getting to a lot a of questioning about things that actually are probably irrelevant to the actual application. But actually, if a team is doing afterwards, we're going to go and ask around about that $400, that actually didn't make a difference and I think that's where some of the noise is being generated.

MS CHESTER: Okay, thank you.

MR HUGHES: The Financial Conduct Authority in the UK refers to the concept of mortgage prisoners and in your submission, you talk about the challenge for borrowers seeking to refinance at a total net lower cost. What could ASIC do in reforming its guidance to ensure that loan reportability is easier?

MR WALSH: I think that's a real opportunity out of this process to clarify just the industry interpretation of some of the rules to actually alleviate this problem. So just to be clear, what we are talking about here, it's where you have existing credit, you're in good standing on that and there's no expansion of credit coming through the process and really with the goal of unlocking a borrower's ability to get a lower rate on those. We are seeing a significant share of applications where it is, it is good, low LVR, good credit rating, long-standing track record and it is the combination of effects around serviceability where that comes through.

It might be worth, sort of, painting a, sort of, human example of that and I'll just sort of introduce Anna and Liam. So a real customer example, names changed to protect privacy. They're both teachers, they've got two children, live in Melbourne. They've had their home loan for two years and want to refinance from a big bank rate, some significant savings, so saving $57,000 over the life of the loan by cutting their interest by 65 basis points on a $480,000 loan. Now, sadly, their loan was, was declined and it was despite them having a two year track-record, a low LVR, so 69 per cent and strong credit ratings. And I think the key point here is they were actually well positioned on their current loan but the combination of guidance here meant we were assessing a scenario where their interest rate raised by 80 per cent, part of their income was haircut by 20 per cent. We're also assuming that there was no change to their pre-loan expenditure or lifestyle. And for their particular scenario where they had recently had their kids, there was an elevated level of expenditure, they had shifted employment for additional flexibility. This really was a scenario where some of the interpretation, again, not necessarily locked in by ASIC but the way the industry is understanding some of these factors, meant that we were locking in some of those things over a longer life of loan. And so I think we should all agree that in this scenario, having a baby, you know, shouldn't, shouldn't make you a mortgage prisoner and so there was really two, probably worth calling out, a lot of complex factors under this.

It is about the risk credit appetite of individual lenders, choices around interpretation that lenders themselves are making and a lot of non-responsible lending factors here, but two particularly opportunities that we would suggest from ASIC's point of view. First off, guidance on scalable inquiry and verification that do clearly lay out that there is a difference between applying for new credit versus applying for existing credit and that the not unsuitable test, in the context of a switch of credit, is not measuring yourself relative to a baseline you don't have the loan but relative to is there a risk of substantial hardship, is this [indistinct] goals and objectives relative to the current loan.

RG 209, table 3 specifically calls out one example around existing customers of an institution, opportunity to broaden that to reference refinance of existing credit and this would, of course, be part of that broader scalability framework around track-record of managing those components.

The other opportunity is guidance around being clear when measuring substantial hardship about whether this is an objective or a relative basis. In other words, is this relative to an objective modest floor or is relative to the existing pre-loan expenditure patterns of the customer. So by empowering customers to assess the level of appropriate financial capacity after the loan is sufficient for their requirements and circumstances, and using pre-loan expense categorisation not as a, as a lock but a baseline for assessing degree of change that's appropriate. So customers are making an informed view as to what is appropriate. The combination of those two factors would make a very significant difference in terms of these but clearly, ultimately it does come back to lenders, you know, their credit appetite and a number of other factors there as well.

MS CHESTER: So just so I understand, I'm just trying to work out what it is in the current RG 209 that resulted in the impediment to those folk getting the refinance.

MR WALSH: I think it's probably less the words within RG 209 and possibly current interpretation the industry is taking, which again there's opportunity to correct here. If the baseline was, in this circumstance, some change in behaviours over the two years since the original loan was put in that meant both some elevated expenses and some change in employment that actually meant, from a buffers and shading, what was previously a surplus was now a detriment.

We should note, in this circumstance using a disaggregated HEM would have, there would have been a positive surplus in that circumstance. There wasn't a positive surplus relative to the current expenditure patterns of the customer, and so I think it's possibly just some of the uncertainty that the industry is facing about exactly what that baseline will be, absolute or relative. It will actually help a lot in closing out the scenario and helping, you know, people like Anna and Liam.

MR HUGHES: So in your view would that enhanced portability come about through more prescriptive guidance as to what can and can't be used from an information and a verification perspective?

MR WALSH: I think in this case it's possibly around the principles that are being applied. So I think everything we're talking about here is very consistent with both the legislation and the existing RG 209, but possibly just not the way industry conventions are interpreting some of those provisions today. So I don't think this is necessarily being prescriptive as much as just being clear what scenario is being tested. So it's, there's no debate in this, these scenarios. There is existing credit, but are you measuring your responsibility obligations relative to an assumption that that credit doesn't exist, so in other words doing it exactly as if this was an application for a new loan, or coming in to say under every scenario, whether their income is shaded, whether interest rates go up, they will be better off if they're actually paying 65 basis points less on their loan, and so therefore it becomes the fact that they're actually servicing a loan today becomes an important and relevant consideration in terms of that reasonable enquiries verification.

MS CHESTER: So then how do you distinguish, say, between that scenario and one where you are in a situation where post-loan the expenses have gone up for some other reason and you might be heading into struggling-to-repay territory? You refinance, put up their hand for hardship treatment, but it's then established that this was all pre-existing, the re-finance.

MR WALSH: Totally agree, yeah.

MS CHESTER: And I'm just trying to, you've come up with a very narrow example of how Anna and Liam could benefit.

MR WALSH: Yeah.

MS CHESTER: I'm trying to think of another example that, based on what we've heard from consumer groups and the like, about other circumstances.

MR WALSH: I completely agree that the situation is very different if someone is not managing to manage their existing level of commitments, and indeed under some of the scenarios that we're talking about, you know, so it can come, or, or interest rate or other scenarios, you could not manage that without ending up in a, in a substantial hardship scenario. So it's very clear that there are components where the changes we're talking about will not solve every, every scenario, that there are scenarios where the capacity has changed. I think we are really talking here, though, about probably a narrow set of components where someone is well-positioned and managing that, that well, and it's to some extent ensuring that some of the process steps, you're still empowering customers to say, yes, it is worthwhile me gaining the benefit of that lower rate loan, but I do recognise that there are some scenarios where my current lifestyle would need to change.

MR SEYCHELL: And, Deputy Chair, could I just add to that. I think there is, we're not suggesting for one moment for that group of customers that we're not doing any scalable inquiries. There still is a minimum base that needs to be done there, and checking that we are comfortable, because there is a component of our own credit risk appetite to, to assess there as well. But we are talking about the depth of scale for inquiries here for those, for that group of customers. Do we really want to go to, once we can get to the point with a, perhaps a lighter touch for that group, to understand that things are in order, perhaps that should be sufficient. That's all we're suggesting there.

MS CHESTER: So you're saying that that's sort of consistent with the principles in the current guidance but - - -

MR WALSH: Yes.

MS CHESTER: - - - but you don't want more prescription. I'm just trying to work out what we need to add into the equation to get your Goldilocks "not too hot, not too cold" sweet spot.

MR WALSH: So maybe the starting point, table 3, when it comes down to interpreting scalability and reasonableness, there are a number of factors that are called out. This I think would be value in calling out a track record of managing this level of credit is a, is a relevant factor, particularly when you overlay that with some of those other components like, you know, the relative risk profile of this loan, is it a very high, you know, debt-to-income, is it a very high LVR versus less so, et cetera. I think that would be a probably important first step.

And then coming back in the second one where that allows you to determine if something is a relative high or relatively low level of inquiry, some of the additional guidance about where there are differences around some of the factors. So very detailed expense level information is, is, we completely agree, is appropriate in higher risk scenarios, but possibly less important in some of these, the lower risk scenarios, where someone already has a track record of managing that level of credit commitment.

MR HUGHES: Do you have concerns about the reliability or quality of data received from data sharing services?

MR WALSH: So we would say it is a valuable input but there is absolutely a need for some real thought about what is being received and sort of again testing that data against things like external benchmarks remains important. There are hundreds of transactions, you know, when you're going back over months, and that only grows as we move to electronic payments. There is a real need to focus on the signal and the noise, so getting to the view that it's not individual transactions is where the value is, but really understanding at a lifestyle level what is the scale and category mix of expenditure of a customer. In terms of quality, there are categorisation where there tends to be fairly large proportion of other categorised transactions, so whether that is ATM withdrawals or whether that is unlocking the complexities of people who've got multiple financial institutions and all the transfers between them and understanding the purpose of some of those. So each of those does require, you know, ongoing focus. This data aggregation is definitely not a silver bullet.

Probably the other component is just recognising there is volatility in behaviours, so any four-month sample of someone's transactions is clearly not necessarily predictive of what the next 28 or 25 years of their life will end up looking like. What I think is important that we avoid from this process is an industry overreaction, where customers are going through some sort of detailed financial strip search that individual transactions become a weapon of mass distraction that gets in the way of customers' ability to get credit and actually move to better value credit. All I think which is very, it's not driven by the guidance that's been proposed, but the possibility of people misinterpreting what's being actually asked for here I think is [indistinct] guidance being targeted.

MR HUGHES: So you're not suggesting that the guidance itself should prescribe the utilisation of such data-sharing services or the quality of the data? You're saying that it's an industry issue to solve?

MR WALSH: I think what you have said is that the reasonable test should be cognisant of what, as those services become available, the definition of what is reasonable will change and we, we agree with that. I don't think you can mandate the use of the services because after all it's not just today, but even under CDR that's a, it's a right and not an obligation on behalf of a borrower. There will be a need to have a concerted campaign to actually raise awareness and, and encourage utilisation.

What we do see, though, is this is an opportunity to shift from the primary interaction with borrowers being around data gathering to shifting where that's a much more seamless process for both inquiry and verification, and turning that into a much more value-added engagement with the customer around supporting an informed credit decision. This is what my lifestyle looks today. Let me understand what the implications of taking out this loan would be, both from a substantial hardship and also meeting a goals and objectives point of view. We see that's a really valuable tool in the toolkit.

MS CHESTER: So the role of CDR, Consumer Data Right, was around loan portability. Do you see it heading in that direction?

MR WALSH: We do, as long as we sort of come in with this view to say it will be a journey. So clearly having the legislation passed is a really important first step, but ultimately it's going to come back to what is the customer's experience of actually using that service. There's always the risk that incumbents do have an incentive to make a theoretical right become in practice quite hard to use, and experience from areas like the UK, where uptake itself became quite low. And so in that context I think a big test will be is the experience of CDR for customers actually better than the current data aggregation services as they exist today? I think there's a real opportunity for ASIC to play a role as a consumer champion in this context to make sure that we are ending up with outcomes that do support quality responsible lending processes. Opportunities to use things like the MoneySmart initiative to actually help educate customers around the benefits of actually providing those and some myth-busting as well, but importantly taking a, a holistic view across all of the data set, so it's clearly not just a story around open banking but also, you know, comprehensive credit reporting, there's RBA benchmarking around a fairly large part of the industry, and so we'd call out opportunities, for example, around, as CCR, comprehensive credit reporting, builds maturity, to almost have a next wave of that, to move that from being just a focus on credit to improve a broader responsible lending focus. So by adding information around things like monthly balances, interest rates and term remaining, there's a real opportunity for a track record that would both support that initial enquiry of a customer to assess the scalability but also provide an audit trail for ASIC to say, our responsible lending obligations are actually being followed in terms of outcomes by both lenders and the supporting teams.

So we sort of compare the data that ASIC has in other contexts like, you know, market manipulation, like where there's very deep sets of data available and start to say open banking is part of that, but there will always be challenges of building up a financial picture from an individual transaction by transaction versus getting a set of systemised data that actually is comprehensive across someone's full credit exposure.

MS CHESTER: Well, we are shoulder to shoulder with ACCC on the CDR, so, but you're right, there are other issues around portability, including comparability, for another day.

MR HUGHES: Thank you very much Nathan and Joseph. Thanks for your submission and for your very succinct answers.

MR WALSH: Thank you.

MR SEYCHELL: Thank you.

FINANCIAL RIGHTS LEGAL CENTRE

MR HUGHES: We'll now switch chairs. And we'd invite Karen Cox from the Financial Rights Legal Centre to join in. Good morning, Karen.

MS COX: Good morning.

MR HUGHES: I don't think you were here for the earlier session but please feel free, just a brief opening introduction and then we'll fire off into questions.

MS COX: Certainly. I'm from Financial Rights Legal Centre in Sydney. We have run the National Debt Helpline for New South Wales for a very, very long time now. I think 2004, under another name, the Credit Debt Hotline when it first came to us. So we have a lot of years of experience of looking at the trouble that people get in when they do take on too much credit. And because we do do quite a bit of case work as well, then sometimes we get the opportunity to look back at the lending decision and the things that were taken into account and the aftermath that that's caused.

This has given us obviously a very keen interest in this area in particular and obviously in the wake of the royal commission, we would like to do whatever we can to make sure that we find the right path forward, to make sure that people that actually do enter loans that are sustainable and manageable and that don't put them in a position where it's destructive rather than productive.

MR HUGHES: Thank you.

MS CHESTER: Karen, thanks for the substantive submission. We know that you're juggling many balls and so we do appreciate that, particularly since, of the 72 submissions that we've received, there's only a handful where we get a very loud and clear consumer voice and get to hear some of the case studies across the different consumer cohorts that can run into troubles when lending's gone awry for them. I guess, before we get into any questions. It's just good to get your sense of what are, if I might put it, the must haves that you would like to see us get to through this consultation in terms of any changes or landing the responsible lending guidelines?

MS COX: I think there's a couple of things that I'd like to see. One is this concept of verification. I think prior to the royal commission in particular, there was a very strong sense that verification was all about the income side of the equation to, you know, also about liabilities, like other loans, although even that was to a lesser extent than income in some cases. But very much it was that expenses were not really relevant to that equation. And I agree there's a lot of room for debate about what expenses, how much, how much verification has to be done.

But to me, the concept that you only look at one side of the equation, is completely false and misleading. It's not someone's income that gets them into trouble in paying the loan, it's their income compared to their expenses and how that ratio plays out. And we certainly get calls from people from all walks of life. I've certainly heard some of my financial counsellors hang up the phone and go, oh, he's on, you know, 150,000 a year, I can't see how he's gotten into this situation. But that happens all the time, that people on significant incomes, people on middle incomes, it's just about an imbalance in income and outgoings. So I think that it's really important that the guidance recognises that you do have to have some verification on both sides of that equation.

And the other thing I'd like to see, I think, is that the guidance at the moment, in some exceptions, it's very generic. Whereas there are some really obvious hotspots that we see in our work, and it would be really good if the guidance could be a bit more specific about some of those areas, where things do routinely go wrong.

MS CHESTER: That is a perfect segue to the first question I have for you, so, thank you. What are the flags for you in terms of potential consumer risks that would suggest greater care or scalability around enquiry and verification? Very important to draw out the distinction between enquiry and verification, because you've, in your opening remarks, gone straight to verification. A lot of folk will do enquiry but not the verification. So what are sort of the red flags, based on the experience that your counsellors come across, that would suggest on the expense side in particular that, not just the enquiry, but the verification needs to happen, or further testing?

MS COX: Okay. I'm not sure how do I approach that. I mean, there's two different types of red flags, I think for me. I think there are loans that routinely cause problems. So, in that sense, there is, there was a lot of talk in some of the industry submissions about unsecured lending and, you know, being able to scale down some of the enquiries around unsecured lending, because it's low risk, and yet, consistently over two decades, credit card lending has been one of the biggest sources of problems that are calls to centres like ours.

So, I think to just generically say that unsecured lending, or relatively small amount unsecured lending, is something you can scale down, I think, is just wrong. Our experience has shown that that's a place where people routinely get into a lot of trouble.

The other places where we see a lot of problems, we definitely see more problems with broker-initiated loans than we do with direct to lender, not exclusively, but as a whole. So, I think that's a little bit of a flag. Certainly more creative attempts to get loans, so if someone applies to a lender, they get knocked back, I mean, they may might apply to another one, they may not. Brokers might re-present the same scenario to different lenders and with changes to details that you wouldn't see in a direct application. I think that's a real area of concern. Or creative things where part of it is to this lender and something else is put to another lender. Other areas is car yards and retail store credit. We consistently see problems there. They probably differ slightly from one to the other. So, in the car yard scenario, we'll see everything from just poor quality data, right through to fraud, where someone in the car yard actually sets the person up with a fake pay slip and everything that's required to get the loan approved.

In the store situation, it’s not quite the same, but what we regularly see there is a strong influence by sales staff over what’s entered into the application, if it’s actually done right there in the store. And also people consistently given what we would say is far more credit than would meet their requirements and objectives in the circumstances. So, if someone goes in, wants to buy one or $2,000 worth of goods, and they walk out with, you know, 12, 16, 20,000 balance on a credit card that reverts to often quite a high rate.

MS CHESTER: Yes. No, you had some good case studies on that in your submission. So, just coming back then to looking at it through the lens of the consumer, then. So, on the basis of a product, don’t just view it as a low risk product, like a credit card for $5,000, you’ve got to match it up with the consumer risk. So you see there a role to differentiate between higher and perhaps lower risk consumers in scaling up or scaling back down the - - -

MS COX: I found it really hard to think of any circumstances where you can get away from that basic requirement to be looking at income and expenditure, at least to, you know, a certain level. I do have some agreement, I think, with the previous speakers, in that I think that we should consider a slightly different standard when it comes to replacing credit, as opposed to extending credit. And that’s only replacing credit at the same or better terms.

There are many problems the other way. But, yeah, I, look, I think if someone’s on a relatively high income and you’ve verified that both the loan-to-income ratio is in terms of debt servicing, is quite low, and their expenses seem to be broadly in line with what they've declared. I think there are probably circumstances where you probably don't have to look quite as hard. But I can't think of anywhere where you can dispense with it entirely.

MS CHESTER: Thank you.

MR HUGHES: You picked up before that we've heard both this morning and also through the submissions some challenges around the utility of looking at expenses and the verification of those expenses. Now, in the absence of open banking, do you think that data aggregators potentially offer a solution in that regard or is it too early to say?

MS COX: Oh look, I think it's very difficult to say and I'm not aware of the particular risks around the data aggregators that are operating right now. I, it's clearly possible. Whether what's on offer now is, is up to the task I don't think I've got the expertise to tell you. In terms that the problems have been identified around verification of expenses, I do appreciate that if you want to do a line-by-line assessment of expenses according to, you know, what the person has declared, looking at various bank statements that that's probably a lot to ask as a manual process, but the number of times that we've seen gross differences between what their loan was assessed on and what the actual expenses are suggests to me that you would be, it just is not wise in any sense not to at least make some attempt at verification at the broader level, and when I say at the broader level, I mean looking at bank statements to look for undisclosed credit, for significant undisclosed expenses. We're talking about private school fees could be 25 to 35,000 a year per child. That's an enormous and significant expense you wouldn't want to have missed.

Looking at the broad equation, if they say they're spending this much and yet every month they're consistently spending twice that much just by looking at the aggregate amount and what's left in the account then you've got to be asking further questions. So I don't think it's necessarily about demanding that you've checked each line item against the bank statement, but whether the overall picture is largely consistent with what's been declared I think is absolutely essential.

MR HUGHES: Now, another thing that we've heard through the submissions on behalf of lenders is that at times customers can be unwilling to provide information particularly in relation to personal loans or credit cards around their expenditure patterns or habits potentially where the customer feels that the information being sought isn't true, so is that something that the centre has encountered?

MS COX: I haven't actually encountered it, no. We certainly haven't had that feedback from anybody. Look, I think as long as the people are clear on the use of the information. Look, I mean I have actually heard some strange suggestions coming from industry about whether they should be looking at that information to analyse whether someone's pregnant or whether someone's ill or a whole range of things and I just think that's completely inappropriate and I think that if people thought that was happening then there would certainly be resistance.

But I think if people can understand that what we're looking at here is a basic, one, it's verification, are the things you've said more or less true, and two, it's, really it's not about how much you spend on coffee or whether you go out too often, it's about when you look at your income minus your expenses how much is left and can you pay this loan. If people understand that's what it's being used for then I think people will be more willing to provide the information.

MR HUGHES: Thank you.

MS CHESTER: The HEM benchmark, Karen.

MS COX: Yes.

MS CHESTER: It's kind of interesting when you look at its history and where it came from and where it's gone along the journey and what it actually represents and colleagues reminded me this morning that it represented the 25th percentile of non-base expenses and the 50th percentile of base expenses.

MS COX: Yes.

MS CHESTER: A bit of a reminder. And lots of things not included. So what would you see as an appropriate role for the HEM benchmark in the application process say for a home loan?

MS COX: Look, I think the HEM or, you know, any other suitable benchmark can play a useful role but again, I think it's about plausibility. It's about saying does the amount that they have said sound more or less right. But even if it does, I don't think that should be enough. I still go back to saying I still think that you have to look at something, usually bank statements will be the easiest way of doing it and I appreciate it's not simple for every customer, but I think saying that sometimes it's difficult doesn't mean that we should never do it.

Sometimes you might take it to a certain level and go well, that's the best I can do in these circumstances but I do think you have to still do that basic exercise of saying okay, so yes, it looks like it's within the realms of plausibility but we still don't know what that means for this individual customer because as you said it's a perfectly statistical measure. It's not really, the actual individual's expenses can vary wildly from that amount.

MS CHESTER: So in your thinking then for its role in the application process, if a consumer's declared expenses are below the HEM, what does that then mean for you?

MS COX: More verification. I think you have to work quite a lot harder then. I think that's a scale-up situation where you're saying okay, that seems quite unlikely and then you need to ask for further verification to make sure that those expenses are what they've said. And I would also argue that you'd want to really think about applying HEM as a minimum even if you accept that the expenses are below because of the low base that the HEM is based on. I think there's a very good chance that someone with the low HEM expenses could find themselves in a circumstance where those expenses edge up for one reason or another.

MS CHESTER: Some submissions have suggested that the HEM level of spending could be an appropriate proxy for substantial hardship when giving responsible lending obligations. Do you have views on that?

MS COX: Not really. Certainly it, I mean in some senses it could work in one way of being well, it's at least that, but there are certainly scenarios where people might be in a position where they are in substantial hardship but they're, I'm just trying to get what I'm saying right here in terms of below or above, so - - -

MS CHESTER: I think what they're suggesting is that if someone's expenses are at or above the HEM, then they're sort of above that substantial hardship test.

MS COX: It's not quite making sense to me as a concept. I mean substantial hardship is where you don't have enough left to pay your expenses and that's relative to what your expenses are not to HEM necessarily.

MS CHESTER: So it comes back to sort of serviceability ratios and - - -

MS COX: I think serviceability ratios are definitely relevant. Yeah, sorry, I'm just - - -

MS CHESTER: No, no. No, no.

MS COX: I'm just not sure that I can - - -

MS CHESTER: No, no, that's - - -

MS COX: - - - relate HEM to a definition of substantial hardship.

MS CHESTER: No, no. We were trying to do it as well so that's why I thought you might have some insights.

MR HUGHES: Karen, do you think lenders are doing enough to explain to consumers about post-loan spending reductions?

MS COX: I'm concerned lenders are assuming too much about post-loan spending reductions for a start. This concept that people will change their habits after a loan, one, in our experience, yes, some people do. Some people also fail to be able to do that because wrong assumptions have been made about that ability, and once upon a time we would have said to people if you want to get a loan you go away and demonstrate a savings record of this much for this long. I don't really see why we can't say, well, it looks like your expenses are too high. I think you need to go away and demonstrate that you can reduce that for a certain period of time before you take on a liability of this size.

I mean, there are obvious things around certainly addictive behaviours where people are spending larger amounts on alcohol, cigarettes, other things where changing is not simply a matter of the desire to change, it's actually much harder to do that. But also around other more basic things. If someone is spending a lot on eating out it may well be because they're working 80 hours a week, they don't have a lot of choice, and it's going to be very difficult for them to do otherwise.

I think we have to be really careful around this concept of belt tightening and assuming that people will be able to do that. I think if you're looking at an expenditure pattern and, you know, more or less they're within the range most of the time, they go over sometimes, it's different, but if someone's consistently spending 50 to 100 per cent more than the amount they're going to be able to spend once they've got this loan then that's just down fantasy land.

MR HUGHES: So are you saying that that, in your experience with the clients that you see that that's more often an assumption on the part of the lender that that spending reduction will take place or is it - - -

MS COX: Yes.

MR HUGHES: And it's less about an active conversation?

MS COX: Yes. I'm saying it's definitely - - -

MR HUGHES: Sorry, I didn't mean to put words into your mouth.

MS COX: Well, the problem for me here is that what we've seen in the past is even worse than that, like, it's not even, there's no active suggestion of an assumption, it's just we're applying this is your expenditure. It has not relationship to your actual expenditure, it's just some figure pulled out of the air because of a benchmark or a percentage. So it's so far from an active conversation about belt tightening that it's hard for me to, to correlate and some of the expenses we've seen assumed are so low as to be ridiculous.

MR HUGHES: And so should our guidance contain some level of prescription around how a lender gets comfort that the borrower can tighten his or her belt?

MS COX: Look, I'd be very worried about even endorsing the concept of belt-tightening to be honest. I would worry that the lenders would take comfort for that to say, "Oh, it's okay that their expenses are high we've had a belt-tightening discussion."

MR HUGHES: Thank you.

MS CHESTER: I think the other, so there's this sort of trade-off area here where the requirements sort of explain the financial obligation that they're getting, that the consumer is taking on, and then an acknowledgement that your expenses are going to have to reduce post the loan for you to be able to sort of finance it. At times acknowledgements are required of the consumer, that that belt-tightening will occur, has that come across any of the cases that - - -

MS COX: No. I have not seen that specifically. I've certainly seen things where people have had to like sign something saying, "I can afford this", or "I can afford this without substantial hardship" which I think adds absolutely nothing. But I've not seen the specific thing that you've described.

MS CHESTER: So I guess what Sean was getting at, is there any element of prescription where we can say if it's a discretionary expense? What sort of comfort would a lender need to get that that is actually something where belt-tightening could occur as opposed to assuming some level of belt-tightening post the loan?

MS COX: Look, I think if you're going to allow it at all then it needs to be part of a specific conversation around requirements and objectives.

MS CHESTER: Yes. Okay. Thank you.

MS COX: Can I just give you an example of a case that we've got right now that might illustrate a little bit about some of the hotspots that you asked earlier?

MS CHESTER: Yes.

MS COX: A couple went in to get a loan, went through a broker. Their first loan application was rejected and then they put in another one to a different lender and they were put on interest-only for a start. They did not specifically say "we're going to have children", but they did buy a house that had several more bedrooms than what would have been required for them as a couple, and they did have a discussion about the availability of pregnancy pauses on the loan. Then subsequent to the loan, the same lender who had given them that loan, extended the credit available under a personal loan with the same lender.

Then after that the principal and interest, sorry, the interest only payments transferred over to principal and interest and now they are unable to afford the loan. So it's, it's a whole multiple pile of things, one on top of the other that have got us to that circumstance. And I'm not sure that any discussion about belt-tightening at the front would have addressed those issues. It's worse than that.

MS CHESTER: So what should have happened that didn't happen to avoid - - -

MS COX: Well, I mean, I question why they were put on interest-only in the first place. That was clearly an inappropriate thing in their circumstances. Two, I think, I don't think anyone should ever assume to be planning to have children or even assuming that that will change the income arrangements in the family. Plenty of people manage to have children now and actually maintain two incomes through a lot of the time. But I do think a specific discussion around that is, should happen particularly if there are triggers like talking about pregnancy pauses and talking and buying a house that clearly is big enough to accommodate children. And yet there was no discussions about what the plans were and if they were planning to drop income as a result.

And then the issue of the further credit offered by the same lender later is another thing that we see commonly. I know when people get additional credit from other lenders that the lender has no control over that. But repeatedly we see it where it's the same lender who is offering the extended credit. And I've noticed in some of the industry submissions they talk frequently about an exception being known customers that they're, you know, well across the circumstances of and, to my mind, its known customers that they often get into hot water. So it's not an area where I would be inclined to say they could any less. It's one thing to say you don't need to get external verification of things you already have verification of, but to suggest that you have to do less because you know the customer well or to have less information I think is erroneous.

MR HUGHES: So you've just talked and you said so in your submission as well that the situation of refinancing at a lower cost. What are some of the safety measures that should be put in place before a lower level of verification or assessment takes place in a refinance situation?

MS COX: Okay, well, the first one we've already talked about and that is about making sure that the credit is on the same or better terms. So that it's not actually going to increase the liability at all and it's not going to extend the amount of credit that the person has. And then obviously costs of transaction are relevant. If it's going to be expensive and to actually do the transaction, that's clearly something that needs to be taken into account. I still think you do need to do some responsible lending checks. I may have lost my job last week and still have a very good payment record. So I do think that you need to do the stuff to make sure that nothing significant has very recently changed. And you do need to look that they are paying that obligation comfortably.

I think if they're consistently late and catching up or missing payments, then that is not, that's a red flag obviously. But I think if they are meeting an obligation comfortably then it makes sense to say, that provided you've done those checks to make sure that there hasn't been any significant change of circumstances, that you could have a lower verification of the expense side of the equation.

MR HUGHES: And I think your submission distinguishes this situation that you've just described from debt consolidation.

MS COX: Yeah, debt consolidation is an area where we see huge problems. So someone who has a home loan and a number of credit cards may consolidate all of that onto another home loan. Sometimes that will be at higher interest, and in our experience that usually lasts about a year and then they can't pay the home loan at all and the whole thing falls over. In other cases, it's not put at higher interest, it's just a matter of piling more and more unsecured debt onto the home loan which eventually tips the balance. And I've seen a number of cases where that's actually done by the mortgage lender where they have extended unsecured credit. The person's got into a bit of trouble with the unsecured credit so they've consolidated onto the home loan and then allowed them more unsecured credit and done the whole process over and over. So in the end they're in a situation where they actually can't afford a home loan that was quite comfortable in the first place.

MS CHESTER: So really the debt consolidation just scaling up - - -

MS COX: Scaling up.

MS CHESTER: - - - what's required to get comfort about responsible lending as opposed to debt consolidation can be good as long as it's done responsibly?

MS COX: That's right. I think that the real issue with debt consolidation is that it, one, it can be expensive. Two, it increases risk because people are putting more against their home. But, three, it can mask some really poor lending decisions that were made before. And I think that's a real danger where someone needs really to be looking into the initial lending decision not just exacerbating the situation.

MS CHESTER: Kicking cans down the road.

MS COX: Yes.

MS CHESTER: Karen, we've covered quite a lot of ground. I think they're all the questions that we had. Is there anything else we haven't got to that you were hoping to get to?

MS COX: Look, only to say that obviously we haven't talked about other payday lending. Consumer leases are an enormous area of problems for our clients. And in recent times, not just the SACCs but also the MACCs. So lots of fast lending online that is causing huge amounts of trouble. That would be nice if we could have a slow lending revolution like a slow food revolution I think. The speed at which people can get themselves into difficulty has become an issue in itself I think. So I just wanted to make that point that there's been a very big focus and rightfully so on, you know, some of the big lenders and some of the problematic lending that's gone on in the home loan sector and credit cards. But we do see huge problems in the smaller amount loan and consumer lease area. That would be good to have that specifically addressed.

MS CHESTER: Yes. And in the context of what we're looking at here today as well, are there instances where those forms of credit are not being captured through the application process- - -

MS COX: Look, I think that's quite - - -

MS CHESTER: - - - in terms of credit assessment?

MS COX: - - - yeah, yeah. Look, I think it's quite possible that that's the case. Although they're pretty much always done by direct debit. So looking at bank statements would actually show that most of the time. And I think that that's important. But it's also the sort of thing that people do once they're already in trouble is that they will then get those sorts of loans in order to try and meet other liabilities. So in that refinancing scenario, for example, that's a really clear indicator that someone's already in trouble.

MS CHESTER: Great. Thank you very much, Karen. That's been really helpful.

MR HUGHES: Thank you, Karen. And I just wanted to endorse Karen Chester's remarks before we acknowledge the effort that your team has put into producing submissions of this duration and the work that you've put into that, so thank you for that.

MS COX: Thank you.

MR HUGHES: We'll now adjourn the hearing for luncheon. And because we're running slightly ahead of time we'll resume at 1.10. Thank you very much.

LUNCHEON ADJOURNMENT

ILLION OPEN DATA SOLUTIONS

MS CHESTER: Good afternoon, folks. We'll resume our hearing here in Sydney and I'd like to ask our next participants to come and join us up at the table, from the company Illion Open Data Solutions. Gentlemen, thank you. And if you wouldn't mind just stating your name and organisation for the purposes of the transcript recording and then if you'd like to make some brief opening remarks, one to two minutes if possible.

MR BLIGH: Absolutely.

MS CHESTER: And definitely take your submission as having been read. Thank you.

MR BLIGH: Thank you. Simon Bligh, CEO of Illion.

MR HOWES: Luke Howes. I'm the CEO of Illion Open Data Solutions, a subsidiary of Illion.

MR BLIGH: So, thank you. So I'm Simon Bligh, the CEO of Illion and my colleague Luke Howes is the Managing Director of Illion Open Data Solutions. And thank you for the opportunity to participate in today's hearing. Illion is a data and analytics business, operating in Australia since 1887. We use extensive credit and commercial databases, assisting banks and other financial services providers and other businesses to make credit and risk management decisions. We also help consumers access their personal credit information.

Our data assets, combined with our end-to-end product portfolio and proprietary analytics capabilities enable us to deliver trusted insights to our customers in the banking and finance industry and to facilitate confident and accurate decision making.

Illion is highly invested in the Australian market with over 130 years of data history and experience and this experience, combined with in-depth research, advanced analytics capabilities and a comprehensive view of the data landscape have made us the market leader.

Illion Open Data Solutions, led by Luke, is the leading aggregator of banking data in Australia. It specialises in digital data capture, delivered to a wide variety of customers, including banks and credit unions, other lenders, broker groups, online retailers, fintech innovators and others.

We believe that changes in technology and the public policy environment, particularly recommendations flowing from the Hayne Royal Commission, mean that this review of responsible lending guidelines is particularly timely. And from our perspective, the substantial expansion in data sets over recent years, the enhancement of comprehensive credit reporting and new technologies, such as digital data capture, mean that it's now both highly efficient and inexpensive for credit providers to obtain the insights they need to make responsible lending decisions and we'd be happy to answer your questions.

MS CHESTER: Great. Thank you very much, Simon and Luke, and thank you for your submission. We might just kick off first with, you kind of talked at a higher level about what the services that you provide help in terms of lenders and credit providers in Australia. Could you just talk us through some tangible examples about how those services, data aggregation services, help them meet their responsible lending obligations, which is kind of the focus that we've got today?

MR HOWES: Sure. So we provide services to over 4,000 clients in Australia and New Zealand, so banks, lenders, brokers. Simon gave some examples. So a tangible example would be almost any credit application a consumer is required to verify their income and expenses. And so when they're applying – and it may be an online application or it may be in person with a broker or a, or some form of lender – they would typically fill out the application details and then be asked to provide their, their proof of their income and expenditure. Our service provides a technology layer which allows a consumer – and when I say consumer, it could be a small business or a business as well – but allows a consumer to share their banking transaction data with the credit provider in a really simple, easy way. It's secure and it's fast for them to retrieve their data through a service like us. Typically takes about 30 or 40 seconds for them to initiate this from any web-enabled device.

And so they would initiate that through us, where we retrieve the data from their online banking, so with the consumer's permission, we retrieve that data and then send it back to the credit provider who they're applying with. And it's categorised and, in a way that, a standardised format so that, for example a broker, let's take that as example, would be able to look at it with the consumer and say, “Okay, it looks like you earn X amount per month and you spend this amount on your mortgage or rent. Your grocery spend is so much,” and they can then discuss that and prepare the application. And likewise, that could happen in an online application, rather than a broker stepping through the process where the customer can submit that data in a very easy way.

MS CHESTER: Before we get to some of the issues that have been raised in submissions about data aggregation services, we’d like to talk through with you, of the 4,000 clients that you’ve got have any, sort of, done the after the event assessment that you’re aware of, to look at where they were doing it previously themselves, relying on the consumer to sort of gather the data and provide it to them or gather the transaction statements, versus what they’re doing through your service, what the quality outcome is or is this an investment that’s worth their while for the consumer?

MR HOWES: Absolutely. We, once a credit provider makes the decision to start using a service like ours, I can’t think of any that ever then go backwards. They start using it and it’s revolutionary for their customers because it’s so simple for them to provide the right information the first time, so there’s a great consumer benefit. It helps the consumer provide accurate information rather than just guessing at what their living expenses are. And then for the business themselves, the efficiencies are immense. So fairly typically, the application assessment time can be reduced by about two thirds, from, so it becomes a great efficiency exercise and consumer benefit. And so once people start using it, it's a new technology that, yeah, going back to paper-based processes, just don't make sense for them.

MS CHESTER: And I can see it from the perspective of efficiency in terms of the transaction costs of doing the assessment but in terms of, from our perspective, the responsible lending obligations and the quality of the outcome, what sort of assessment are they able to do about how much of a better sense they're getting around total expenses of the consumer versus the guesstimate and comparing it to the HEM and like?

MR HOWES: So if you compare it to, I think, HEM, it's in a different world what we can provide because it's granular and it's specific to the applicant themselves. You can see every - - -

MS CHESTER: Sorry, I'm taking you off course with HEM.

MR HOWES: Oh sorry, oh, okay.

MS CHESTER: Let's just keep it to compared to the information they would have had previously versus what they now get through going through your service, how do they get a sense of that is actually giving them a more accurate assessment of the, the total expense exposure for the customer?

MR HOWES: Sure. I think, just two sides that I think of immediately with that. One is, previously they were asking for less information. They might just ask for a payslip and then customer declaration of expenses, where now they can actually get the real expenses for the customer and that is very useful in making accurate assessments of a much higher standard.

The second, I think, scenario would be, if they previously were asking for bank statements, they're still getting the same information but rather than getting 30 pages through for an assessor to pull out highlighters and then try and work out individual granular expenses and group them together, which is fraught with error, that they're getting a consistent output with algorithms that can group data together that help them. It doesn't take away the need for humans to be looking at the statements but it eliminates a lot of the manual work and simplifies that process to them, more looking at exceptions rather than starting from scratch.

MS CHESTER: And so the algorithms help them go through that process more quickly and does it help them also distinguish between what might be considered to be a discretionary versus a non-discretionary expense?

MR HOWES: Absolutely. And we work with the credit providers who use our services to determine what they consider discretionary and non-discretionary. So that, a lot of that comes from the lender themselves and the format of the reports is customised to what they want to see so it match their credit criteria and processes.

MS CHESTER: And Luke, do you know from any of your clients pre and post your service – so we heard this morning some different numbers around total expenses declared by consumer being above and below the HEM. And so one example was 40 per cent of expenses declarable below the

HEM and another was 11 per cent with the suggestion perhaps that they were going through a much more robust process. And I'm not saying whether that's right or wrong, but have any of your clients done that assessment about, pre and post your service, what percentage of the expense amount was above or below the HEM?

MR HOWES: No, I haven't heard any specific numbers. I think the consistent anecdotal feedback is that generally when customers declare expenses, they declare them, they under-declare, so I think that's just consistent feedback we're getting.

MS CHESTER: And do you have any data around that?

MR HOWES: I don't think we do because ours is a clean-pipe service, so we retrieve the data and pass it through to the lender to make their decision, but we actually don't store any records on the applicant or get feedback if they are approved for a loan or declined or how their performance is ongoing.

MR HUGHES: Luke, just a follow-on question if I may. When you were talking before about the delineation of discretionary expenses really being at the behest of the customers, they define what that label is and what sets within or outside discretionary. How broad is that variation across your client base?

MR HOWES: I think we've seen it starting to converge into something that's fairly consistent, but I guess just an example like telecommunications spend or internet or something like that, which is that part of the actual, I guess is it, is it needed to be spent or can the customer adjust it if the loan was granted I think are some of the questions that lenders grapple with. So we are seeing just a more holistic view of expenses and I think it's, it is, is becoming sort of clearer. We have more of a, I think the LIXI standard in the industry is, is shaping a lot of what happens in certain sectors of the industry.

MS CHESTER: We might then turn to a couple of the concerns that you'd be aware of that some folk have raised in submissions around data aggregation services, and I'm not sure how much of them are sort of dated concerns versus contemporary. Things around data security, risk of password sharing and privacy. Perhaps if you could just give us a quick run through where you feel – are those concerns still legitimate and how are they being addressed?

MR HOWES: Sure. So digital data capture is a secure service. We have processed, in the past six years since we launched the business, we've processed over 14 million retrievals of data for consumers and businesses. Currently processing over 700,000 per month. So millions of Australians have securely used the service, so I think much of the perception is around, if there was any security issues, is perception and around password sharing there's no reality in fact to really what we see. We expended a lot of time and effort in, in security and ensuring that we employ best-practice security, security audits and penetration testing, to ensure that customer credentials are securely handled and then discarded appropriately. And so these services are really helping consumers and the credit industry, including 15 banks who we now work with as well, so it's usually banks who have more concerns with this, with digital data capture, but there are many banks now using the technologies as well in a secure way and they, they go through a high level of due diligence on our service to ensure that it's safe.

MS CHESTER: With the clients, how much tailoring do you do or not do with the service that you provide for them?

MR HOWES: There is customisation available, so we, we have APIs where they can create the user experience by using our underlying technology. We can host the service. We can create white-label services. So that's on the customer experience side, so there's a lot of flexibility, so lenders can start using the service within a day. In some cases we have brokers, hundreds of brokers a month, who sign up to our service and are using it immediately. So the cases where there's sophisticated online lenders or banks who may take weeks or months to do a full integration into our service, and then in the back end there's a lot of customisation around the data they retrieve and the format and the layout of that so it can adequately meet their, their credit criteria, what they're looking for.

MS CHESTER: So if we wanted to get a handle on an assessment of the quality outcomes as opposed to the efficiency outcomes, how would we best go about that? Would it be asking some of your clients for, or what reviews they did to assess what they got from your service and the reports versus what they got previously, and then also things like declared expenses above and below HEM, pre and post services? Are they the sorts of things, if you're trying to ask and answer the questions that we are, that you would ask of them?

MR HOWES: Sure. Let me start with that, and you might have some thoughts, Simon. I think one of, one of the other advantages other than efficiency and quality of lending outcome is also our service almost completely removes the fraud aspect of bank statement fraud. And so in terms of quality and relying on data, that's been a big one for the, the banks and lenders who use us, because bank statement fraud is so prevalent. I think, yeah, that is the type of question to ask is, so you're using a service now that you weren't before. How, are you approving more or less clients? Are you getting a better picture of the clients? And how does it differ in what you understand from your clients to what they were self-declaring before you had some third-party information to verify?

MR BLIGH: I think that's right. It's, you know, it's moving from subjectivity to objectivity, where you're making an estimation of your living expenses to there is no need for guesswork because it's analysing 90 days' worth of your bank statements. So the banks would be best placed to make a comparison, but the, the, the algorithms, the categorisation groups expenses in ways where, you know, human beings don't need to interpret, and it also helps point out areas of potential risk. So, for example, you know, I might have filled in an application form and being asked if I have any other loans, and I say no, but by analysing the bank statements and by doing that in a highly accurate and predictive manner, you might see payments to another financial institution, and that then helps point the person not at grouping things but at really assessing where the risk in the data may lie or where further follow-up questions should be rendered.

MS CHESTER: Okay, thank you.

MR HUGHES: Given your past experience or continuing experience as a credit bureau, what do you think the limitations on the content and use of credit reports ought to be? And what other evidence of liabilities should lenders be relying on?

MR BLIGH: So I think the interplay of credit information and bank transaction information is really where, where the power sits. So, you know, for example on a credit bureau you might see that I have a credit card from institution 1 and institution 2, and from my bank statements you only see payments to institution 1. My second credit card is therefore probably an emergency credit card. That's interesting because I will have capacity that I can draw down in extremis from that bank, but it's not something you would see a cash flow about.

So we're of the view that it is the interplay of credit and bank transaction information, which is critical, and in particular we'd like to see the comprehensive reporting regime expanded to be more explicit in two regards. One is it's a multi-bureau world, so no one database is ubiquitous, and if you want to know everything that you can about Australians, you need to use multiple databases. And, secondly, Australia does not permit the use of balance on the bureau. So I can, if you look at my credit file, you can see I have a limit of $20,000 on a credit card, but you can't see whether I have a $20,000 limit balance or a $50 balance. And ASIC, in your Report 580, drew some conclusions about risk and balance in relation to credit cards and in relation to multiple credit cards with which we agree, but there is no database of record that one can look at to see that.

So you're asking banks on the one hand to lend responsibility and on the other hand, because of the lack of a database of record with balance on it, their hands are tied behind their back. So we think that consistent with overseas jurisdictions, expanding CR to incorporate balance would be a good thing for the system.

MR HUGHES: And what about any other liabilities or evidence of liabilities that you think could be pointed to? So, for instance, transactions outside the mainstream banking system.

MR BLIGH: Yes. So, you know, New Zealand allows telco and utility to, telcos and utilities to participate in CR, and they also have slightly more relaxed rules in relation to insurance and rent, and, and there's no doubt that they would also be positive for just developing a holistic view of somebody's financial health and therefore enable better decision-making.

MR HUGHES: And you touched before on the effect of CCR on data available. So in your view, what would be the use that CCR can be put in terms of an expanded use for responsible lending?

MR BLIGH: So I think CR is, we're still very early days. You know, most of the big banks will load their mortgage portfolios in the next four to six weeks. But, credit cards is perhaps a good example, there are over 95 per cent of credit cards now loaded on our bureau and we can see that there are over 10,000 people who are bankrupt who have credit cards. There are several thousand, several tens of thousands of people who have five credit cards. Now, they may not be using them, they may have just, you know, they applying and leaving, you know, surfing to the next card, or they may all be maxed out. What we can see is that people with five cards with five financial institutions are 10 times more likely to be a bad debt than those who have one card from one financial institution.

So there's no doubt that the, you know, the increasing prevalence of the information is enabling financial institutions to make better, quicker decisions and fundamentally, you know, if that person is in a situation where they shouldn't have further credit extended to them, that can be seen and the financial institutions can work with them.

MS CHESTER: The Consumer Data Right has now made its way through the Senate. What does that mean and how would that impact your services going forward?

MR HOWES: So we welcome the CDR. Effectively, we, like CDR at the heart of it is for a consumer to be able to authorise their data to be shared with a third party. And that's what we've been doing for six years, is helping consumers share their data securely with a third party who they choose.

And, so, with CDR leading to open banking as well, this will also lead to banking APIs, which we think is a great thing for the industry and we will incorporate into our service as soon as the APIs are available for us to consume.

Whilst the framework's there, a lot of the specifics are still missing. And so, I think, we very much see a world and a market where the current digital data capture technology exists alongside open banking and whilst the specifics are being worked out and that really open banking is another technology and that both should continue to exist and provide the best service that they can as needed.

MS CHESTER: And do you see, as that evolves, it's sort of changing the incidence or the appetite for the consumer to be open to these types of data aggregation services?

MR HOWES: I think it will, I don't think the consumer is that discerning. I think, we have currently with our service currently, we have uptake rates of typically about 75 or 80 per cent. So, consumers see utility and benefit from our technology and they use it, because they want to save themselves time and they want to do it efficiently.

What CDR will probably allow is more institutions, government, more banks and give more customers the access to services, like open banking. So, yes, I think more will use it, but I don't think it will be clear enough to the consumer, really a difference between an open banking connection and the current technologies.

MR BLIGH: And I think the consumers like choice, so, you know, we find the uptake of digital data capture is highest when, for example, you might offer a customer, you can come into our branch and give us the, you know, three months' worth of bank statements, you can upload a PDF, or you can use digital data capture. So, consumers take comfort from choice and when given a choice, they usually go to the most friction-less method.

MS CHESTER: And so that's the 70-80 per cent uptake - - -

MR BLIGH: Yep [indistinct]

MS CHESTER: - - - that you were talking about? And how much is sort of the credit consumer experiences getting that choice?

MR BLIGH: I think the vast majority of applications still go through a more manual process. So, we've seen very rapidly the adoption of Illion Open Data Solutions. But the vast majority of the market is still following a more manual and subjective process.

MS CHESTER: Okay. This might be a bit cheeky setting homework. But, just coming back to that earlier question about, have any of your clients have done that sort of, after the event quality assessment of what outcomes they're getting, using your services, digital data capture, I'm going to use that term going forward, Simon, I'll try very hard, versus doing the old manual process. So, if you could steer us in the direction of any of your clients that have done that work, would have done that sort of analysis and to give us a bit of an assessment as to what that meant in terms of the efficacy of the, especially the expense assessment, but also how that might have sat against where they were on the HEM?

MR BLIGH: Yep.

MS CHESTER: That'd be very helpful.

MR BLIGH: Be happy to do that.

MS CHESTER: Thank you.

MR HUGHES: And, Simon, you mentioned before, and I'm gathering, but you're not from Sydney. That, you know, other countries potentially have, there's a faster take-up of your services. So, can you point to any examples of where other jurisdictions are perhaps utilising your services, or like services, more effectively?

MR BLIGH: Yep. We can, utilising the like services, absolutely. We're predominantly an Australian - - -

MR HUGHES: Yes.

MR BLIGH: - - - and New Zealand based basis. But, yes, we can do that.

MR HUGHES: Thank you.

MS CHESTER: Do you have anything else? No. Simon and Luke, they're all the questions that we have for you this afternoon. Is there anything that we didn't touch on that you were hoping to get to as we asked our questions?

MR BLIGH: No, I think just, probably one thing we didn't cover is, is the cost of these services. So, you know, software is eating the world and the cost of the technology and data-driven solutions, is significantly cheaper than using labour. So, I guess, we would, you know, probably haven't touched on that point, and that's probably worth mentioning.

MS CHESTER: So, again, and maybe it comes back to the point of what sort of savings your clients are making at the end of the day, but I note that earlier on, you did make the point that there still is that sort of overlay of, still someone making the human judgement call, with your reports against.

MR BLIGH: Clients will typically think about cost holistically in three dimensions. So, you know, firstly, there's the cost to the human being. So, you know, I could go and re-mortgage my house on a Saturday morning, or I could spend the time with the kids, and the quicker the process is, the more likely I am to do something. So, customer experience generally equates to conversion. Generally that equates to adoption and, you know, consumers being able to shop around. That's a good thing.

But there's obviously the cost of the process. So, with the technology or the and the human being who's doing things, but automating things wherever possible and then there's obviously the accuracy of the decision and pricing for risk, or avoid bad debt, taking a customer who you wouldn't have otherwise done. I think all three of those are enhanced with, you know, data-driven, automated processes.

MS CHESTER: Okay. And it's probably that accuracy of the decision, the third one, that's probably the crucial one for quality outcomes [indistinct]

MR HUGHES: And I think you also mentioned a lower incidence of bank statement fraud as well?

MR BLIGH: Yes.

MS CHESTER: Is there a metric you mentioned, Luke, that there was a – I said we'd finished our questions and I've been proven to be false and misleading in my own statements now. You mentioned before the prevalence of bank statement fraud. What is it? Is there a metric around that?

MR HOWES: The only example I have from, is probably not even a specific number, but that when digital methods are available to upload and people choose a paper-based or a scan-based upload, that that percentage the remaining who choose not to do the digital process, the prevalence of fraud is very high in that case, I think. But I don't have any specific numbers for you - - -

MS CHESTER: So no metric?

MR HOWES: Sorry. No.

MS CHESTER: Okay. No, that's all right. Okay. That's great, gentlemen. Thank you very much.

MR HOWES: Thank you.

MR HUGHES: Thank you.

TIC:TOC

MS CHESTER: We might ask our next participants, if they're here, from Tic:Toc to come and join us? Good afternoon and thank you very much both for your submission and for being able to participate in our hearing and join us this afternoon. Just for the purposes of the transcript recording, if you could each just sort of state your name and organisation and then if you wanted to make some very brief opening remarks?

MR BAUM: Thank you. I'm Anthony Baum, I'm the founder and CEO at Tic:Toc. We're a financial technology company. And I'll make some more remarks once my colleagues introduce themselves?

MS BROCKHOFF: I'm Faith Brockhoff. I'm the Chief Customer Officer at Tic:Toc.

MR PRICE: And Daniel Price, the Chief Enterprise Officer at Tic:Toc.

MS CHESTER: Thank you.

MR BAUM: Firstly, thank you for the opportunity to speak with you today. We have a passion for utilising technology to create better customer outcomes and that includes a full assessment of a customer's financial position. What we agree with is many of the statements made in the prior discussion particularly around the use of credit data plus financial transaction data to give you a holistic assessment of a customer and our technology is able to achieve us doing that to a high standard consistently.

We've been in the market two years. We've had over $3 billion of fully submitted home loan applications through our platform and the fastest time from a customer starting an application to being fully approved with their loan documents in their inbox is 58 minutes. That was for two customers and that included full digital financial validation of their financial position.

We can obviously test that a little bit more in this discussion today but really what we would like to present is that, you know, in reality the technologies that enable a rigorous full assessment to occur are already here. So they were the opening comments we'd like to make.

MS CHESTER: Thanks very much, Anthony. So we might just start with perhaps a simple question. How good are customers themselves at estimating their own expenses without the use of technology [indistinct]

MS BROCKHOFF: So as part of our online application process we require all customers to give an estimate of their expenses. We do break that down into different categories and we also make some of those mandatory so the customer must fill them in. We still find that through no fraudulent action of the customers that they consistently understate their living expenses and I would say we see that all the time.

MR PRICE: And conversely to that, when we used digital, digital validation, the information that we'd come, that we obtained through that validation tends to state the opposite picture, that there are, that they are higher than what, what would otherwise be indicated by either a benchmark or a stated figure.

MS CHESTER: So let's try to unbundle that a little bit because that's really helpful for us to get a handle on. So you were saying even when it sort of prompted with different categories and like, there was still a level of understatement of expenses or financial transactions. What sort of metrics on average across the - - -

MS BROCKHOFF: So we found that through digital, once we digitally validate a customer's financial position, taking into account that not every transaction that a customer makes would be considered an ongoing living expense, but after we work with that customer and work out with them what's actually reasonable that they could reduce in that expenditure we're still finding on average it's $900 more than what they were putting in there. And I don't think that's because they deliberately - - -

MS CHESTER: Of a month 900 more?

MS BROCKHOFF: Yes. Sorry. I don't think that's because they're trying to deliberately understate their expenses. I think a lot of customers until they're actually presented with a discussion about, well, we can actually see that your spending is X amount, they hadn't really given it the true consideration that they need to as part of their application.

MS CHESTER: And then how did that also then relate to experience around the HEM benchmark?

MS BROCKHOFF: So we found that if we took the, the raw data from the data capture as opposed to what the customer stated and looking at the HEM, the customer's raw scraping of their expenses was a ratio of five times higher than the HEM.

MR PRICE: So to give that the context it needs, the five times higher includes all of the one-off transactions that might occur over, over a reasonable period in a customer's life. So the five times there's usually, includes maybe a car purchase or large expenditure on travel or all of those sorts of things which starts driving down into that conversation around what, what, what of the expense base is a true reflection of the ongoing expense base as opposed to what information can you get directly from data aggregators and by the digital pathways.

MS CHESTER: So just so I understood that number. So it means that they're five times more likely to be higher than the HEM than they thought or the actual quantum was?

MR PRICE: The average monthly quantum is about, on the median is five times more than what, what they actually think. Now, that is not, the base figure around the $900 is a more accurate figure because the five times figure is skewed obviously to the upside around that, around those one-offs but what, what we do see is that if you, if you analyse someone's, someone's expense base over a period of time, you need to be able to drill down to the individual level of expenses as opposed to taking aggregated views because the aggregated views are sometimes misleading.

MS CHESTER: And I know when we're looking at total expenses first as HEM we're comparing sort of apples and zebras because there's things that aren’t in HEM that would be in total expenses. If you can do the apples and apples comparison, after you've gone through your processes, what percentage of the consumer would be under the HEM in terms of validated expenses on an apples and apples comparison? Sorry, that’s a very triage - - -

MS BROCKHOFF: I don’t actually have the exact number but I can say that we’ve definitely seen customers that after we’ve gone through the full financial validation, pulling out the things that are not ongoing, there are some customers that fall below the HEM and when we’ve had a true discussion with them about whether it’s actually reasonable that they sit there we can find some but that would be a handful of customers.

MR BAUM: It is not a consistent thematic.

MS CHESTER: That's helpful. Thank you.

MR HUGHES: Can you talk to us about the efficiencies which arise from, you know, scale investment and technology such as this and how that will impact lenders in terms of instituting changes which give rise to stronger review processes? What are some of the metrics that you've identified in terms of those efficiencies and savings?

MR PRICE: So without going into the, into the specific metrics, let me talk you a little bit through the process and I can give you some, some indication of those, of those efficiencies. So I, I relate back to I think it was Nathan’s comment from Athena which said that the services that data aggregators provide tend not to be the silver bullet. They, they are very, very powerful and we're very supportive of, of them but there are millions of different transaction narratives that we see come through our system and being able to classify all of those using, using AI algorithms at the back end is very, very hard.

So what we discovered was that although the data we received was very powerful and there are large amount of efficiencies from that process, what they weren't were true insights at a customer level and they weren't a true assessment process. So what we did was we built, it's, it's a web interface. It's essentially a layer that sits on top of all of that data that our assessors and our, our, our staff can use to inform that conversation and to manage that data to a point where they have a very acute understanding of what a customer's actual expenses are.

So the guys who developed this and the designers who helped build it will hate me for saying this, but if you can imagine an Excel spreadsheet that sits on top of all of that data so you can easily swap it by transaction description, you can group it, you can filter it, you can do everything that you need to do to have that conversation with the customer. And so what that means is you get a very accurate picture which you can do in a very, very fast amount of time.

Now, the reason why it's so fast is because the interface is supported by a number of AI models that sit in the background that do a lot of the things that, that were discussed here today. So Karen's point, high-risk lending, lending with high-risk lenders – so your paydays, your SACCS – is something we've got to be very conscious about in the home loan lending space that if someone has payments out to someone to, to institutions like this, we need to know about it. And so the models will flag that for the assessors. They'll flag undisclosed liabilities. It will flag excessive use of online gambling sites. All of those sorts of things.

So what, what that ultimately means is that an assessor can have a conversation with the customer at a, at a transaction level, determine with the customer whether or not there's a discretionary and non-discretionary element to it, remove those, remove those items from the analysis if needs be. So if it's the purchase of a car just go we don't want to include that on an ongoing expense base. And what we end up seeing is that a full analysis of a customer's expense base can be done in somewhere between five to 20 minutes, and the majority of that time is actually spent on the phone with the customer just working through, working through the bits and pieces.

To talk to metrics on efficiency, our understanding through qualitative research of some of, some of our partners who use traditional methods, they reckon it's anywhere between two to four hours is what they will do, sitting there highlighting, highlighting bank statements to come to the same outcome that we can come to in 20. So there's, that's sort of the efficiencies that we're picking up by using a combination of the data aggregation technology and an investment that we've made in technology over the top of that information.

MR HUGHES: And open banking will potentially add further efficiencies?

MR PRICE: Continue to add efficiency on that. So from our perspective, from our perspective open banking is the next step or the next evolution with regard to data aggregation, and we think that more uptake and more understanding from the customers of, of its use and its prevalence in the market will continue to support the quality of the data that we get, so there's less work that we have to do, but also make them more, more open to its use. We see, though, that the use of, the use of data aggregation in our process, because I'm sure it's likely to come up in this questioning, is on average between 60 to, 60 to 65 per cent on a month-to-month basis, and that's been consistent for two years, and we run a very similar model to the one Steven talked about from Illion, where we offer the customer choice about being able to either upload the documents manually or whether or not they'd prefer to use the data aggregation service.

MS CHESTER: Sorry, what was the 66 – 60 to 65 per cent was in respect to?

MR BAUM: Choice. So we have choice of pathway. You can upload your bank statements or you can choose the fast pathway and utilise the aggregation service. 60 to 65 per cent of customers holistically since we commenced have chosen the fast way and provided access to their bank account data through the aggregation service.

MR HUGHES: And are you also measuring, as part of your metrics, you're measuring customer satisfaction and stickiness in terms of their experience of going through these enhanced processes?

MS BROCKHOFF: So we've only really received – if I look back at the reviews that we've got across Trustpilot and ProductReview, we don't have many reviews that talk specifically to our use of data aggregation. They talk to our use of technology as a whole. What we're finding is that, being an online lender, customers are sort of expecting us to be using some sort of technology to validate their information, and the overall response we've got is that they're impressed with our use of the technology and the, the speed with which we can look, speed and ease with which we can assess their application.

MS CHESTER: You know where I'm going next because you were here a little earlier, but so clearly the efficiency and the transaction costs are lower. In terms of the quality of the decision-making at the end of the day for the person providing the credit and meeting their responsible lending obligations, what sort of review is done, has been done to make that sort of assessment that we are getting, that the credit provider is actually getting the quality outcomes?

MS BROCKHOFF: So I can't talk to what it would be like if we weren't using data aggregation services because we've been using them since launch, and we made the decision that we would ask for – we didn't know how you could validate a customer's financial position only looking at income when there's the other side, being expenses and liabilities, and so for all of our customers, whether they choose to go digital or not, we're asking for bank statements so that we can quickly validate income and expenses, getting the full picture.

And what we've found is that we've got arrears rates that are much lower than you would find in other areas of the industry, and whilst we've talked to the issue that it could take longer to do this, we have 12 operational staff within Tic:Toc and they handle the customer from questions before they've even started an application - - -

MR BAUM: So webchat.

MS BROCKHOFF: Helping them through - - -

MR BAUM: Phone.

MS BROCKHOFF: - - - the whole way, getting them approved by a credit assessor and helping them all the way through till settlement. So I think we're getting wins on both, both sides there.

MR BAUM: And to put that in context that, that employee cohort, so those 12 people, are able to help customers through that entire journey that constitute approximately $250 million a month in home loan, fully submitted home loan application flow. And obviously being an online lender, not everyone who inquires fully submits an application. So the technology certainly drives significant operational efficiency as well as what we believe are much more rigorous lending practices.

MR PRICE: And there's probably two other points I'd add to my colleagues as well. As part of our process, because we're obviously backed by one of the larger banks in the industry, we have, we continually get audited with regard to our responsible lending practices by one of the big four auditors, and we continue to not only impress them but continue to outshine any other practice that they see with regard to responsible lending.

MR BAUM: I think, sorry, Dan, I think the statement there we can make is we continually get completely clean audit reports is probably the factual statement.

MR PRICE: Is, is the way, is the way that we work. Yes.

MS BROCKHOFF: Sorry, you did, I did miss the point that you, you asked about feedback on data aggregation. Whilst we've not gotten a lot of feedback, there is one common theme that we do get from some customers, which would be around security. And so we know that the competitors in the industry have got really high levels of security to make sure the transmitted and stored data is all safe, and we just try to combat this with customers with, you know, offering choice, so if they're not comfortable they can manually upload their bank statements. Pointing out that, you know, emailing bank statements is probably less safe than using data aggregation service. And having a lot of collateral about how the processes work on our website so the customers can interact and get a bit more information about what we're asking them to do.

MS CHESTER: And, Faith, you mentioned some arrears metrics, without saying the metrics. Are they in your submission or is that information you could share with us?

MR BAUM: We could certainly share it with you. I can't recall if it was specifically in our submission. I don't think it was.

MS BROCKHOFF: It's not in the submission.

MS CHESTER: I didn't think it was. I didn't recall it, so - - -

MR BAUM: Actually, Bendigo have made a statement in their results dec today with respect to the arrears on the Tic:Toc portfolio versus their portfolios. It consistently outperforms from a loss or arrears perspective, but we'll take that on notice and see if we can work with them to get you some data with respect to channel specific portfolios.

MS CHESTER: That'd be really helpful, thank you.

MR HUGHES: Just going back to your point, Faith, around some of the concerns that have been expressed about data aggregation services from some of the other submissions. What do you think could be done to address some of those concerns in terms of differences in consistency and quality, and the privacy and security issues? Where's this market going to address those concerns?

MR PRICE: Do you mind if I take that, Faith? Sean, I, the market's still a little bit divided, as, as I'm sure you'll, you'll see and I'm sure you've seen through these hearings. Ultimately what we see is some lenders, some lenders out there that are very, very security conscious and so are sending a, sending a form of messaging that is please be careful about the security because we don't, we don't trust, we don't trust essentially this data aggregation technology. And they had good rights to maybe in the past, but in a contemporary world, especially with the passing of the legislation and the Consumer Data Right coming in, this is, this is a, this is an area that we're going to need some consistency, consistency of.

What we would, what we would really like to see is, is standardised messaging, is the facts of these data aggregation services. Luke spoke to them quite eloquently but we did a full due diligence across all of the providers in, in the market and there was no risks that, well, I take that back, there were very minimal risks that if carefully managed could be easily mitigated across all providers. There are not, there are not any ghosts in the closet here. To Faith's point, email communication is actually now less secure than what, what some of these services provide. So realistically what we'd like to see is that the messaging is made consistent through the market if possible. What we will continue to do is be fully transparent with regard to our use of these providers and continue to provide all the facts that we can where possible on the use and the security of them.

MS CHESTER: Well, we've covered a lot of ground from our perspective, thank you and the questions that we had. Anthony, Faith and Daniel, is there anything else that you were hoping to cover with us this afternoon? Not just to do with your own submission but any issues raised in other submissions that you wanted to address or - - -

MR PRICE: I'm okay, thanks.

MS BROCKHOFF: I'm okay.

MR BAUM: No, I think, I think we've covered the areas that we feel we can add information to the discussion.

MS CHESTER: Great. And we very much appreciate you offer to follow up with those other metrics for us around the arrears and what's been announced today. Thank you very much.

MR BAUM: Thank you.

MS CHESTER: Thank you for your submission.

AUSTRALIAN RETAIL CREDIT ASSOCIATION

MS CHESTER: I might just check with, building on the theme of efficiency, we're actually running ahead of schedule. So Tic:Toc's kept us on time and even ahead of time. Just good to see if our next cabs off the rank from the Australian Retail Credit Association are here, and if they're happy to get underway, that would be terrific. Thank you. Good afternoon and thank you very much for your submission and for being able to join us here as participants in our public hearings in Sydney this afternoon. If you could each just state your name and organisation just for the purposes of the transcription recording. And then if you'd like to run through some very brief opening remarks. Thank you.

MR BLYTH: My name is Michael Blyth. I'm the Head of Government, Regulatory and Industry Affairs with the Australian Retail Credit Association. Apologies from our CEO, Mike Laing. He is stuck on the airport in Queenstown with a broken plane, so he was unable to come today.

MR HUGHES: There's worse places.

MS CREMIN: Geraldine Cremin, or Geri Cremin, Head of Compliance and the PRDE at ARCA.

MS CHESTER: Thank you.

MR BLYTH: So thank you for the opportunity to appear before the hearing. ARCA has made a detailed submission in relation to CP 309. Just from that submission I wanted to highlight our support for principles based for guidance and we believe that responsible lending guidance would benefit from a common understanding of what is meant by substantial hardship. We think that that understanding would provide context to the enquiries and verification steps that are reasonable under the NCCP and particularly in relation to consumers pre- and post-loan expenditure. I note that's been a topic of conversation a lot today, the expenditure.

In terms of CCR I thought it would be helpful to make a short background to the introduction of comprehensive credit reporting or CCR in Australia. In 2014 changes to the Privacy Act allowed new data fields to be reported in the credit reporting system, including consumer credit liability information, which is CCLI, and repayment history information, RHI, are collectively known as CCR. These changes followed a recommendation from the Australia Law Reform Commission report from 2008. Importantly, this may have been lost in time, that report recommended the introduction the RHI conditional on there being a legislative responsible lending requirement. So that was introduced through the NCCP so there is a, there was a definite tie between the introduction and the responsible lending obligations.

Our transition to CCR is now world progressed. As at the end of July this year CCR data has been supplied for 55 per cent of all credit accounts in the market. By the end of the year at least 80 per cent of all credit accounts will be reported. CCR has been adopted by a range of credit providers from the four major banks to mutual, fintechs and startups. But ultimately the achievement of the benefits of CCR for both lenders and consumers will be maximised the more product types and credit providers join the system.

MS CHESTER: Great. Thank you very much, Michael. And thanks for covering off on CCR so fulsomely which can get me off to another question to begin with. Why don't we go to expenses first, then? It would be good to get your sense of – one of the sentiments in your submission was the limited value of some expenses and their enquiry and verification. It would be good for you to just to unbundle a little bit why you see them to be of limited value and then what expenses you consider to be discretionary and how do we - - -

MR BLYTH: Excuse me, if I go back and forth a little bit. It's a complex topic and it requires sort of - - -

MS CHESTER: Sure.

MR BLYTH: - - - so, one of the main points that we did make in our submission was that there wasn't a definition of "substantial hardship." That there was no objective set test. And we raised the question of whether or not substantial hardship was an objective test or a relative test. So relative test we described as a person whose lifestyle is reduced significantly, would that be substantial hardship even if they were still able to afford the necessities of life, versus an objective test where, provided a person had enough money to pay the necessities of life, they would not be experiencing substantial hardship. So a separate question of whether or not they would be comfortable with the reduction in their lifestyle.

So that's why we have noted sort of the – we've questioned the relevance of a consumer's prior expenses and expenditure to the question of what they are spending after the loan. So we haven't said that enquiries is, about expenditure is not necessary, but what we've said is the focus should be on what the customer needs after the loan and whether or not the history of expenses that they have had in the past is actually relevant. To what extent, they, will they reduce it? Can they reduce it? That was sort of what we were saying about the expenses. We've also sort of commented that in terms of expenses - - -

MS CHESTER: Sorry, in terms of drawing that line in the sand, then, pre- and post-loan, to work out what adjustment that a consumer could reasonably make without experiencing hardship, is it a matter of delineating between discretionary and non-discretionary expenses? Is that where your thinking's going there?

MR BLYTH: We've actually identified three types of expenses. One are fixed expenses and things like your loan repayments, council rates – that is regular expenses that which the consumer has little control, which will continue after the loan. And then two other expenses, both of which are variable, so it's an extra element of discretionary, non-discretionary is recognising that there is also a variability element to it. So variable non-discretionary expenditure, such as food, clothing, power bills, that is regular expenses that are necessary for living but over which the consumer has some control to a varying degree. And variable discretionary expenditure, such as travelling, entertainment and travel, that is expenses whether regular or irregular, that are not necessary for living and to be pared back. Sorry, I forgotten your question. Do you mind?

MS CHESTER: No. No. So just trying to work out, how then do you arrive at where you draw the line in the sand for the individual consumer who's applying for credit? In assessing, so your starting point would be what their current total expenses are but then what you would consider to be the expenses post the credit position against a hardship line in the sand?

MR BLYTH: What we commented was that if there was a benchmark that could actually benchmark a consumer's required expenditure, then that is, that would be an objective measure of whether or not the consumer can actually, would experience substantial hardship. So if they had enough available funds to meet that objective benchmark, then they would not be experiencing substantial hardship. It would be a separate question as to whether or not they were comfortable with that reduction in their expenses. But we, we supported a pragmatic approach that focuses on the things that matter and can't readily be changed. So one example is, focusing on whether or not one of your dependants has medical needs. Then a benchmark figure for that, you know, a benchmark figure and a HEM benchmark or something which looks at medical expenses, is not going to be relevant for a person who has a child with specific needs. So you focus on that and get the information about that.

MS CHESTER: So how does your thinking around limited value for expenses, total expenses pre-loan versus a line in the sand for an individual consumer based on some hardship, objective hardship measure – how does that then figure into changes to responsible lending guidelines, which is what we're focusing on?

MR BLYTH: As I said before I think the responsible lending guidelines should focus on those, the guidelines should have lenders to focus on the things that are significant that are material to a consumer's life and things that can't be changed. So there are certain things that, you know, a consumer spending the, you know, the UberEats example, there should be less focus on that because a customer can, you know, the customer will reduce that, and rather than having to go through a an individualised, itemised list of expenses that, you know, can and you can't reduce, if the customer understands that they will, you know, if the message to the consumer is you will need to reduce your overall general living expenses by a certain amount, the customer can then assess whether or not that is consistent with their, their needs.

MS CHESTER: So again, how do you see that translating across to the responsible lending guidelines?

MR BLYTH: So the focus, so if we're talking about the, using open banking to assist with responsible lending, then the focus should be looking for the larger expenses, the unexpected expenses, the expenses that can't be changed and that would be where that data is used, that would be a much less need to, sort of, look at the detail of the customer's, you know, day-to-day expenses and living expenses and the line by line, you know, assessment of, of, of their, of what they have spent in the past.

MS CHESTER: I guess hardship is a very subjective thing for individual customers. So in terms of explaining the financial obligation that the customer's taking on, a sense of total expenses today verses where the expenses would need to be post-loan, the order of magnitude of that would still be quite important in terms of - - -

MR BLYTH: That would be important, yes, yeah.

MS CHESTER: So you still need to get a handle on the total expenses?

MR BLYTH: Yep.

MS CHESTER: And then where they might need to go to, post-loan, for responsible lending to occur for them to meet those obligations and then as assessment of unbundling the difference between the two and understanding whether that's across your three categories?

MR BLYTH: Yes. Yes. So fixed expenses, I think, well by their nature will be fixed. They will be, you know, you will have that expense before and after the loan. The variable expenses, it's a matter of degree and it's a matter of degree and it's a matter of scalability. So if you, if you're, if you're able to lend to a customer and you understand what they have spent in the past in a broad sense and they still are able to afford the loan then the need to then talk to the consumer is much less.

MR HUGHES: So can you help us with some practical examples? What do you think some post-loan reductions in spending would look like, that are shy of creating hardship for the borrower?

MR BLYTH: Possibly start with the ones where I think, and I think maybe a lot of people do agree with this, where it would be, it would be unwise to assume an automatic reduction in private school fees. I think that would be, you know, without talking to the consumer, it would be, it would be – a reduction of that magnitude would probably require a discussion with the consumer. I think the examples that were in CP 309 where I think they are probably, you'd be more, would potentially open to assume an overall reduction would be things like the pay TV reductions, gym reductions, gym membership reductions and things like that. And then we get to the very, the, the discretionary expenses like UberEats, I think it would be, it would be able to assume no reductions in those types of expenses.

MS CREMIN: For those two discretionary categories that we've identified before, just to try and put some of those into those different places as well, so as an example of variable non-discretionary expenditure, we've got things that are variable, such as home, food, clothing, there is still – so they're non-discretionary as actual categories but they are open to some variance there. So for example, there's a difference between being able to afford designer clothes and therefore buy designer clothes versus post-loan approval, changing the way you shop. The same can be said for things like even power bills. People do scale back as needed. So we've got a few different things in those categories and then when you get to the full discretionary expenditure, is when we start looking at things like holidays or pay TV.

MR HUGHES: So I think in your submissions, you indicate that, and this is around pages 15 to 18, that although HEM is not the full answer, it's a guide as to what post-loan expenditure might look like. How does a lender then take into consideration, say, a low-income household? That may put them into sort of a hardship position through the application of that level of expenditure? In other words, for lower income households, could the HEM figures take them below the Henderson poverty line?

MR BLYTH: When we have talked about the benchmarks, we, we're not actually necessarily referring to the HEM figure. Our submission was quite an academic sort of, in theory submission, so we're not, we weren't necessarily talking about HEM as being the right, the right figure. I mean, we see, HEM does obviously have, you know, there are limitations with HEM. It doesn't cover things, certain things. It's also, it's also, with HEM, it's, it's not necessarily categorised, there is not necessarily the level of categorisation which you can itemise for a particular, particular customer. So some people who were sitting in that group, at that figure, they may spend less and other people may spend more. So we actually, we do see potential for improving HEM. So we wouldn't say HEM was the answer in all cases.

MS CHESTER: So who's deciding this sort of objective hardship benchmark for the individual customer then?

MR BLYTH: It would be something that needed to be developed. So, yeah.

MS CHESTER: And how do you see it working at the moment in terms of the pre- and post-loan? Under the current responsible lending guidelines, there's obviously a discussion about what adjustments folk might be able to make post-loan and whether or not that's reasonable and some acknowledgement by the customer. Why is that not enough going forward in terms of making that assessment of – because you're focussing on this pre- and post-loan expense scenario. I'm just trying to work out what's wrong with the current arrangement such that you want to move to this objective benchmark of what's a hardship consumption line in the sand that would then be applied to that customer and that's what you can just assume? And please correct me if I am articulating this - - -

MR BLYTH: No, no. Sorry, it's a very complex issue and what we noted was that there is a concern that a consumer, just because they have spent UberEats in the last 12 months cannot get a loan, if they had been spending money at the horse races, they can't get a loan. So it's, it's the recognition that what you have spent in the past on certain items is not, doesn't necessarily mean you are going to spend it in the future. So I think the, sort of, the, the way we would describe – I think industry experience shows the consumer, customers can change, can change their spending behaviour as necessary post-loan. And the experience of any Australians who have credit to, to make milestones will support the same hypothesis. People will, people will change. So it's working out what's reasonable to change and we have identified that a consumer's, for some, in some respects understanding a consumer's prior history is a shortcut to understanding what they will need in the future but it's not the only way, and it may be the best way at the moment to be able to do that.

MR HUGHES: And you've used some interesting words there, Michael, because you've talked about hypotheses and assumptions and then predictors of what the future spending might look like post-loan. I'm not going to paraphrase an earlier participant but we have heard evidence this morning that there seems to be an absence of actual conversations taking place with borrowers as to what they believe their post-loan expenditure would look like. Is that something that you have reflected on in terms of formulating your submission?

MR BLYTH: I think what we would say is that the conversations, there, there may need to be conversations but they should focus on the larger issues and there will be a trade-off that lenders will take to, you know, some lenders will want to have those conversations. They may be able to take a more, they may, you know, a lender who, a person who's offering a home loan, it would be, it may be worthwhile to have those conversations so that they can assume the lower, you know, a lower expense line to be able to afford the loan versus a lender who is offering a unsecured credit product, they may not assume. They may take a more conservative approach and not assume a reduction in expenditure.

MS CHESTER: But there's nothing under the current guidelines or what we're proposing that precludes either scenario, it's just who makes the assumption, and at the moment that should be something that's made jointly by the lender in consultation with the consumer who has applied for the loan in terms of what's reasonable to assume that they can reduce their consumption to after all. You're wanting to step away from that and have - - -

MR BLYTH: That would be a scalable approach so it would depend on, and it would also depend on the types of expenditure that you're, you were assuming a reduction in.

MS CHESTER: Risks around product type. So we've talked about, we focused on what we can assume total expenses, pre-loan expenses, post-loan and whether or not there's scope for an objective benchmark around hardship. Risks around product type and whether or not there's scalability for credit assessment and responsible lending guidelines upon a credit card versus a home loan, those sorts of things.

MR BLYTH: I think we made the comment in our submission that, because there is this, there's some, the current RG 209 does talk about scalability and the issues that can go towards scalability. I think we made a comment in our submission that we thought that it was confirmation that those, those elements of scalability are looked at as a whole so that one element is not given priority over everything else. That you can, so you can look at the size of the credit, the impact to the consumer, I can't quite remember the other elements, and as a whole, so you can develop your, you can develop your processes with more confidence that one element of those, those scalability issues won't sort of throw you out.

MS CREMIN: Correct me if I am missing anything, Michael, but I think of it as well as balancing the product, the limit and the actual person rather than making specific rules for those different categories. I think there's also a risk when it comes to setting different standards for different products that you can fall into a trap where the minimum standard is actually the maximum standard for that sector of the industry as well.

MS CHESTER: Do you have an example that you have in mind there?

MR BLYTH: I mean, I mean I think the payday lending space is an interesting space where the, where it's become very, you know, where the requirements are very prescriptive, but that's, that's, that's the limit that, that seems to happen in, you know, in practice.

MS CREMIN: That's our observation is that that minimum standard is becoming the, what we must do to kind of get by rather than setting a true minimum standard that is then, you know, the processes go above and beyond as required when you balance those factors of product balance and person rather than just taking the base.

MS CHESTER: One other quick question before I see if Sean has any other that he'd like to cover. So you mentioned before that HEM wasn't your go-to benchmark that you were suggesting in terms of this hardship line in the sand going forward. What role do you see HEM playing in the application process at the moment?

MR BLYTH: I mean, HEM's the figure that we have at the moment. It's, I think it will, I'm not sure I actually know how to answer that question so - - -

MS CHESTER: Oh no, just what role do you see it playing in the inquiry and verification process?

MR BLYTH: It, as I think people have said before, it provides an idea of whether or not the expense figure is reasonable and it helps, it provides whether or not it's realistic. I think that's, I don't disagree with what the RG, the CP 309 describes HEM as.

MR HUGHES: Just a quick question on refinancing, which you've touched on in your submission. What do you think are the concrete steps that we should articulate in our revised guidance on either lower verification, lower inquiry steps and also what can we do to assist on portability of lending arrangements?

MR BLYTH: I think the comments I've heard before from other participants I agree with. Where there is no additional finance and someone is refinancing to, porting a loan to achieve a loan there should be allowance for a lesser standard. I think understanding the person's performance with the existing loan would be an important factor, and to have confirmation of that would be, would be beneficial, including through the CCR regime, but otherwise I would support, yes, confirmation that the, a lesser, sorry, less inquiries and verification may be required because of the existing liability.

MR HUGHES: Thank you for that. What are the base level of inquiries that a lender should undertake though on a refinancing application?

MR BLYTH: I think our submission was making the point that it's very scalable. It would, it would require the lender to make that decision. I am not in a position to sort of say the steps.

MR HUGHES: Sure. Nothing else.

MS CHESTER: That's great. And look, we do appreciate that you were hoping to have one of your other colleagues here today but unfortunately the weather gods and airlines got in the way yet again. Michael and Geri, we've covered some good ground here this afternoon and we thank you for that. Is there anything else that you wanted to say that our questions didn't give you an opportunity to get to?

MR BLYTH: No, I don't think so.

MS CHESTER: Terrific. Well, thank you very much.

MR HUGHES: Thank you for your submission.

MS CHESTER: Thank you. Folks, we're going to take an early pause and break. We're efficiently running way ahead of schedule so I want to check that our next participants are here and there was also the potential for maybe another technical participant but we'll check on that. So let's regather at quarter to, 2.45. Thank you.

SHORT ADJOURNMENT

WESTPAC

MR HUGHES: All right, for the purposes of the transcript, we will get started again, and we'd like to welcome to the table Mr Will Ranken and Ms Amy Gleeson. Before I ask you to introduce yourselves, I do want to make a few opening remarks before these participants in particular. As is well known, there are current proceedings before the Federal Court – under file number NSD 293 of 2017 in the New South Wales registry – between ASIC as applicant and Westpac as a respondent that relate to responsible lending. I want to be clear for all the attendees here today and listening on the audio that we do not intend to traverse with Westpac matters that are before the Federal Court, and we believe it would be inappropriate for us to do so.

Today's discussions will instead focus primarily on matters related to the role of brokers and loan origination, including the provision of material in the support of applications and how this affects Westpac's compliance with its own obligations. We also intend to touch on products and circumstances where fewer inquiry and verification steps may well be reasonable and the effect on access to credit. We will also look at risk factors that enable an appropriate assessment of what measures are reasonable to undertake for applications by individual consumers. With that introduction and clarification as to the scope of these questions, we now ask representatives from Westpac to introduce themselves, their roles, and to provide a brief opening statement if you wish to do so.

MR RANKEN: Thank you. My name is Will Ranken. I'm the General Manager of Home Ownership at the Westpac Group and I'm responsible for home loans business within Westpac, St George, Bank of Melbourne, BankSA and RAMS.

MS GLEESON: My name's Amy Gleeson. I'm the Chief Risk Officer for the Consumer Division, responsible for risk management and compliance across the Consumer Division.

MR RANKEN: In terms of opening comments, I'm keeping it very brief, just to say that Westpac welcomes the opportunity to participate today. We recognise the importance of guidance in regards to responsible lending. We take our obligations very seriously. Consultations such as this one provide the opportunity for us to discuss the various perspectives and work together, so we're very happy to be here.

MR HUGHES: Thank you.

MS CHESTER: We might kick off, then, in terms of stepping back and looking at it from the customer perspective. At what stage in the application process does Westpac look at the specific circumstances of the customer?

MS GLEESON: Yeah, well, we look at two things in relation to lending to our customers. The first is the risk of the product and the second is the customer's circumstances. So in our view, complex products would require additional inquiries and verification steps, and less complex products would then follow. Generally they would require less steps. In terms of the product risk, if I can just touch on that to start with.

Complex products, we determine a complex product based on the complexity of the terms of that specific product, the limit or scale of that product, and then also the tenor of the, of the product, how long the term of the loan is. And then a less complex product would be one that has relatively simple terms that our consumers can easily understand.

So in answer to your question, we, we get to the assessment of the customer risk as a next step to the, to the overall risk assessment that we're, that we're completing. And there we've got some specific examples of things that we would look at in order to determine the customer risk itself. Would you like me to go through those?

MS CHESTER: Yes, thank you.

MS GLEESON: Okay. So, so our application process, if I split it between our secured process and our unsecured process, starting with the secured process, some of our risk factors that we would consider, we'd split between financial situation queries that we would make to a customer, and also the requirements and objectives assessments that we, that we complete. So in terms of the financial situation questions that we think are, are indicators of risk, things like level of gearing, whether mortgage insurance is required, level of deposits for a home loan as an example. We also look at adverse bureau records, things like default judgement, bankruptcy, et cetera, in terms of indicators of past performance. And then we look at stability in employment, so, or lack thereof, and then, and then those factors would then determine a further conversation that we would then have with a customer.

On the requirements and objectives side of the assessment process, there's various risk factors that we'd consider there. A good example for us that has a tendency to then result in further inquiries on a customer would be the age of a borrower, so if they're approaching retirement age, we think that that's a, definitely a risk factor. Doesn't mean that we can't lend them money, but obviously requires some additional inquiries and, in some cases, additional verification.

Similarly on the unsecured side for our customers, we would look at what we think are the high-risk factors for, for unsecured lending. Again we'd look at the existing unsecured loans that the customer already has. We think that's an indicator of potential high stress. We also have, similar on the secured side, a number of bureau inquiries. In particular, where there's a lot of activity on the credit report that would indicate a customer is going around to different institutions and, and trying to get some credit there. And again, finally, we'd look at liability discrepancies, so where, where there's a difference between what the customer is telling us is their liabilities and where, where we, we have independently verified those liabilities.

MS CHESTER: Amy, thank you very much, and a lot of what you've unbundled for us has focused a lot on sort of the credit assessment side of the liabilities, and you touched on income earlier on. What other flags might there be, given at the end of the day what we're trying to do with responsible lending is trade off credit access to good consumer outcomes, that we avoid the risk that after a home loan or something that that consumer is at greater risk of significant hardship?

MS GLEESON: Yeah, we would look at, we would look at the two factors together, so we would look at the risk of the product and the customer's circumstance. So, so an example would be if the customer has a high level of surplus in terms of servicing their loan or a low level of surplus in conjunction with the limit that we're approving for them. So, so we would see that as a, as an indicator of, of potential hardship in the future.

MS CHESTER: So focusing then on the expenses side in making that serviceability assessment?

MS GLEESON: Yes, correct.

MR HUGHES: Can you talk about the information gathering process where the loan has originated through a broker? So what sort of information is secured through the broker and to what extent does Westpac rely on that information without undertaking further verification of its own?

MR RANKEN: So I might take that question. By and large the information we obtain from a broker for an application is the same as what we obtain via our proprietary or our first-party channels as we refer to them. They come in two parts. Obviously we've got a record of the interview around the requirements and objectives of the customer, and then secondly we have the information around the financial situation and then the documents that support the verification of key items within that. While the information is the same, there are some differences in our oversight and our governance around the broker channel as a result of the fact that when a customer chooses to go via a broker, we're one step removed, so there's another layer of oversight and governance on the broker channel.

MR HUGHES: And do you receive any preliminary assessments from the broker explaining the basis on their view as to whether the loan is suitable or not suitable for the borrower?

MR RANKEN: In the requirements and objectives, the way that works through, it gets to the point where there's a recommendation for the product, why the product's not unsuitable.

MR HUGHES: And does the borrower have an opportunity to challenge that suitability assessment of the broker and essentially appeal direct to you?

MR RANKEN: In our loan documents – obviously customers can always contact us directly, and I'd probably just, talking to a proactive step in that situation is where on our loan documents, which are following the assessment of the loan, loan documents are then forwarded to the customer to sign. There's a playback on the front of that loan documentation saying, you know, you told us the loan was for this purpose on the basis of these categories of information. We're making that assessment. This is why the loan, we're happy to extend it.

MR HUGHES: Do you have a view on the submissions that have been made by a number of brokers that the type and volume of information sought by various lenders is quite inconsistent and that there's variability? Do you have a view on that submission?

MR RANKEN: Only to say that I think that each lender should be able to set their risk appetites and adjust their policies and procedures to the extent that it would meet their risk appetites.

MS CHESTER: In terms of what's coming through to Westpac, Will and Amy, from the brokers, what's sort of the qualitative overlay that you do through those applications? What's a good quality application for you coming through from a broker?

MR RANKEN: So, a good quality application, really looking at both those two components of the information, would be a completed R&O record, or checklist, that is not inconsistent in any way with the final product that's submitted. And then in terms of the application information that supports the financial situation, that it's clearly in surplus, there's adequate documentation to verify the key components of that and then in terms of other factors we take into account, around our credit checks, the quality of the asset that we're actually lending against, so the valuation, et cetera, of the underlying asset. All of that sits within our policies and procedures, then that would be a high quality application. Particularly one where all that information is submitted in its correct form in the first instance. Because there's, with broker, all loans, broker and proprietary loans, there can sometimes be a bit of back and forth to ensure that if we have all the information we require to make a decision.

MS CHESTER: Okay. So we might just go through those, the back and forth. So, of the numbers that come through from the brokers, how many need to go through the process for you to get comfort that the quality of the applications meets?

MR RANKEN: I'd have to take that on notice, I'm afraid, the rework rates, they do vary at different times, they're not a steady, they're quite volatile month to month and they can vary by brand and channel. I'd have to say - - -

MS CHESTER: On average, what would you expect them to be across the applications from the different brokers?

MR RANKEN: It's hard to say, because with a proprietary channel relative to a third party or broker channel, the proprietary channel, you go back, saying we require information, you might, you'll get that extra information, but the broker channel, you may go back and say, actually, we require further information, and then you don't necessarily hear anything else, as the broker may approach another lender. So, you may not see the next phase of that application.

MS CHESTER: Well, it may be a metric that you would know, I hope so. Of the applications that do come through from a broker, those that even after [indistinct] processes, are declined by Westpac?

MR RANKEN: So they're roughly consistent with the first party channels and our proprietary channels, but I would say to that same point, they're the ones that are submitted, we go back, and they're submitted again, we declined for a specific reason. We may ask for more information and still not see anything. So, it's not a clear metric, because we don't necessarily see each one resubmitted back if we've asked for further information.

MS CHESTER: Okay. But of those that make it through to you to make a call on whether to accept or decline, is there a decline rate?

MR RANKEN: I don't have that to hand, I'm afraid, so - - -

MS CHESTER: Okay.

MR RANKEN: - - - I'll take that on notice as well.

MS CHESTER: Okay, all right. And, similarly, you may not have this to hand, you might need to, what would be some of the reasons that you might still decide to decline?

MR RANKEN: There's probably three or four key reasons. One, it could actually just be under the quality of the underlying asset, it doesn't meet our policies around the quality of the asset. The second could be, it doesn't meet serviceability, once we've looked at the application material. Thirdly, it could be insufficient documentation to support items of the application. They're the main ones. There could be something in the credit check where the risk profile of the underlying customer means their credit score doesn't meet our minimum cut-offs.

MS CHESTER: Okay. And do you know across those factors, what sort of the rate of attribution would be of the decline?

MR RANKEN: No, not at all, sorry.

MS CHESTER: All right. We might leave you with some homework if that's - - -

MR RANKEN: Yes, that's - - -

MS CHESTER: It's very cheeky you're going to have to do so.

MR HUGHES: So what additional value do you think the broker-originated loans as opposed to proprietary? What value do those originated loans bring to you as an institution in terms of meeting your responsible lending obligations?

MR RANKEN: So the value of the loans, are you meaning - - -

MR HUGHES: What value does a broker-originated loan bring to Westpac in terms of Westpac meeting its obligations? Or does it bring any value?

MR RANKEN: As I mentioned earlier, a broker-generated loan brings an extra layer of oversight and governance. The value would be more at the customer level given the brokers provide a service to customers, it's very highly valued by a number of customers, both the independence of going to a range of providers and also just working through the complexity of a loan application, providing guidance in the overall process.

So, the benefit of the broker channels felt more in the customer level than at the provider level. With the exception, I should say, so there's probably a bit of an exception, I say that from an institution that has a national branch network and has large distribution capabilities. If

I was representing a lender that didn't have those national distribution capabilities, then a mature broker market gives me instant distribution.

MR HUGHES: So, am I right in assuming that you don't think there's much difference between loans originated through brokers and direct, when it comes to the value that they bring?

MR RANKEN: So I suppose in terms of the range of metrics we could measure that on, one could be performance, so if I look at the, and particularly the metric around the 90-day delinquency, they largely sit the same with our proprietary channels, there's no meaningful difference between those channels. In terms of tenure of loans, I think, on average, it's measured in months, rather than, you know, even quarters in terms of the difference, it's one or two months in terms of average tenure of a loan with us. As an indication of how much revenue we would earn off that loan over the period.

Size of loan, I mean, if you were looking at averages, and averages can be a little bit misleading, the average size of a loan through the broker channel is a little bit larger, that's probably more the case of the smaller loan sizes, customers are happy to deal with a branch, but for larger, complex lending requirements, there's a greater propensity for customers to go to a broker.

MR HUGHES: And do you think that your responsible lending obligations as an institution should differ depending on whether it's a proprietary loan or a broker-originated loan?

MR RANKEN: So, I think to the extent of, the great driver of what our obligations are is really around the customer circumstances, but having said that, your question is more about, do we change our processes for a broker loan versus a proprietary loan. We collect the same information and then we layer over another layer of oversight. So to the extent probably, to give you an example of that. All broker applications are sent to a central team where they are manually verified, so the components of the FSV, which require verification, we have our own team sight those documents and manually verify those.

Then again, 20 per cent of those loans through the broker channel have a hindsight check, where we compare the R&O, make sure that's consistent with the final product, make sure the FSV of that application, the financial situation verification of that application meets our policies and procedures.

And then even over on top of above and beyond that, there's other layers of governance and oversight we have for the broker channel. Particularly we do individual broker reviews, where we'll take a number of files from an individual broker and they are really selected on a risk-based perspective. And even on top of that, we have reviews of aggregators and broker accreditation processes and those sorts of things. So there's an extra layer of oversight and governance that we apply to that channel.

MR HUGHES: And does that oversight and enhanced governance apply to things such as understanding post-loan spending behaviour?

MR RANKEN: No, there's not, there's not a process about post-loan spending behaviour, other than to ensure that the customers are meeting their loan requirements.

MS CHESTER: Just coming back to that point. There was a lot of discussion earlier today around the value of pre- and post-loan view of what expenses would be reasonable through the lens of the consumer avoiding substantial hardship by taking on the loan and meeting those repayments. Some folk were suggesting that there could be assumptions around what could be a post-loan reduction, say, for a home mortgage. Is that something that Westpac contemplates when going through the credit application process? Or are you just taking sort of total expenses pre-loan as having been required upon and verified and thus? That's the basis upon which you do the assessment and then obviously any assessment of the risk of substantial hardship?

MR RANKEN: I'll start. You can add in. I'd say we take the customer's stated expenses and obviously the number of expense categories that most providers have expanded on to assist that conversation with customers, so that their customers are really thinking through each component of their expenses. Then the key parts that are fixed and recurring we verify those and obviously we have reference to the benchmark for an assessment as to whether those expenses, that total expense level of plausible. But that's the full extent of the procedures.

MS CHESTER: No, that's just interesting to know because others will do that pre- and post-assessment, we've heard earlier in evidence today, so - - -

MR HUGHES: I just want to take you back quickly to a question I asked before. I understood your answer to be that you don't believe that there's a difference in the application of the responsible lending obligations depending on whether the loan has originated indirectly through a broker or through the proprietary channel. My question actually to you was, and I'll repeat it, do you think there should be a difference in the responsible lending obligations depending on whether, how the loan is originated?

MR RANKEN: There are some recommendations that have come out of recent activities in the markets. So there's recommendations from the Hayne Commission report around the broker channel. I would say, in providing additional guidance on one channel over another, it would just be important to take into account the very valuable contribution that brokers do make to the overall market. And specifically I talked to the level of competition that they facilitate in the market, either by through providing independence and access to a multitude of lenders as well as the service they give to customers in terms of assisting them with complex needs. So to the extent that guidance may require additional steps or, either on the lender or the broker themselves, we just want to balance that with ensuring that it maintains a, a viable and dynamic broker channel.

MR HUGHES: And do you think that additional guidance should have an additional level of detail around what's required?

MR RANKEN: We're comfortable with the policies and procedures that we've got in place around the broker channel and so it's hard to comment on guidance without seeing – the devil's in the detail with, with these things. It really depends on, sort of, what the detail of the guidance would be.

MR HUGHES: All right. Well, was there anything else that you wanted to raise with us which haven't come out of the questions, that you think could be useful considerations for us in revising our guidance?

MR RANKEN: I think just the, there's some comments that we made in the letter attached to our submission that really talked to the point that we support a more principles based approach to responsible lending. Just as a, to ensure that it allows credit providers to exercise a level of judgement. It can still allow us to adapt to innovative new procedures and new developments in the market and can maintain a level of competition in the market.

MS CHESTER: So other folk, including your sort of competitive brethren, are calling for greater prescription along with principles, especially around some of the, sort of, de minimis areas of inquiry and verification. What's your view on it?

MR RANKEN: Our position would be we still support the principles based and actually, in terms of additional guidance, more around the application of scalability. We think scalability is an important concept in the application of the responsible lending legislation and the guidance but if there were, and our submission put up the possibility of case studies to give further guidance as to how different aspect of scalability could be applied, that would be welcomed.

MS CHESTER: And where do you see the, sort of, the trigger points for scalability from Westpac's perspective, that the current guidance doesn't deal with that you'd like some further guidance through case studies or whatever?

MR RANKEN: Do you want to grab that one?

MS GLEESON: Yeah. So, so we've got some examples where, where we think scalability should apply and I know that some of the other submissions go to similar points. Having said that, I think, certainly I concur with Will that the devil is in the detail here. So just because we, we think a product or a customer situation is lower risk, doesn't mean that that's a one size fits all approach and that's important in terms of the application of scalability, to state the obvious. But, but we do think that there are circumstances under which it would be reasonable to take fewer enquiries and verification activities and that's why we, we would propose that dealing with these two specific case studies would be a good way to, to solve this industry issue and create a little bit more, more definition in terms of what the scalability process should be, on reasonable terms. Again, we've got some examples that I can just briefly run through if that's - - -

MS CHESTER: If you could run us through those circumstances that you've got in mind, Amy, that would be really helpful.

MS GLEESON: Yeah, sure. So, again, we talked earlier about product complexity. So again, whether, where we, where we see a product is less complex, we think that that would be a reasonable reason to, to take fewer steps. So as an example, a credit card with a low limit in conjunction with the assessment of the current customer's financial position versus a fixed rate mortgage that's a long-term and has complexities around break costs as, as an example. We have other examples of when no new credit's being provided. I know others, others have raise this same point. I would just overlay, on that point, we would still want to take some enquiry steps in relation to situations like that. So again, it would be a, a case study example that we could then use to determine what, what would be our process and policy to, to apply to those sorts of situations.

The other one for us is relationship managed customers. Again, where we already have an informed understanding of the customer's requirements and objectives and financial position, we think that that would be a reason to adapt a scalable approach. And then we have a couple of examples in terms of more practical application. So as an example of a natural disaster, where we know our customers well but they don't have access to the usual documentational process that we would normally put them through. So again, it's, it's really case studies like that, that would then, obviously we, we understand the onus is on us to, to comply. So it would be case studies only but it would, we think that that would be helpful and we think that would be in conjunction with the principles based guidance. So I think it's, it's both that we're, that we're really after at the moment.

MS CHESTER: And of those circumstances that you took us through, Amy, and I was trying to mentally see if they were scaling up or scaling down, they all sounded like probably requiring less than say the sort of process that might be required for, you know, a, a new home owner taking out a mortgage. So you're talking about scaling down. And for the case studies, what sort of scope would you see them covering? Like apart from saying the circumstances, what else would you want the case study to cover in terms of providing that guidance, that would be helpful to yourselves and others?

MS GLEESON: Yeah, I think also product type would be, would be helpful. So as we've discussed it's the combination of the customer's position and product type. Also the requirements and objectives conversations as well, which obviously are very important in the, in the customer, the customer assessment process. So I think, I think those two elements would be, would be helpful as well. And as I say, we would be very happy to continue to participate in an active dialogue on that if that's possible because I think that that would, that would, that would assist the industry as well.

MS CHESTER: And how do you see the current guidance not giving you what you need in that sense, which you'd get from the case studies?

MS GLEESON: Yeah. I, I think it's just additional case studies. Like, I do think that the, there are newer examples of where we would apply, not just less enquiry steps but different enquiry steps and, you know, the products sets are evolving over time and processes are evolving over time. So I think that, I think that the case studies would be relevant to be, to be kept up to date in that regard as well.

MR HUGHES: And just to pick up on an earlier point you made. The scalability, does that depend also on factors such as the object of verification of the information as opposed to information that is dependent on the customer's own estimate of their future spending habits, for instance?

MS GLEESON: Yes, I think it would. I think, I think that would be a factor that would need to be considered as well.

MR HUGHES: So just to be clear in terms of the response you gave to Karen, you're looking for more case studies and more modern case studies, is that correct?

MS GLEESON: Specifically in relation to the adaptation of scalability, yes. I think you'll note that in our submission, we've sort of baulked a little bit at some of the, the two appendices in terms of the templates et cetera and that's not so much that we object to the contents of those, but really, we do want to maintain a level of flexibility where we can, where there are elements that we think are, are adaptable and flexible versus some, some specific guidance and examples of scalability.

MS CHESTER: And that's been helpful because we can now see the four or five aspects that you want covered in the case studies and, indeed, I think some folk have called that prescription in their submission.

MS GLEESON: Yes, I think so.

MS CHESTER: So we're probably just in a world of semantics but case studies or prescription, a bit more guidance. So, that's very helpful, thank you.

MR HUGHES: Anything else, Will or Amy?

MS GLEESON: No, thank you.

MR RANKEN: No.

MR HUGHES: Well, thank you very much for your attendance and for your submission.

MR RANKEN: Thank you.

MR HUGHES: And look, just as you're - - -

MS CHESTER: Very efficient, thank you. Sorry.

MR HUGHES: As you're leaving, I'd like to, on behalf of the Commission, thank both representatives from Westpac and indeed all of the participants for attending today. We appreciate your time and submissions and we also appreciate anybody who's travelled to attend the hearing. We want to thank our venue hosts and those who have provided recording transcription and other services. Today has, as Karen just mentioned, been very valuable in gaining a greater understanding of business operations across the credit industry and the experience of consumers accessing and obtaining credit. We are very confident that this consultation process will lead to ASIC producing guidance that is clear, relevant and succinct. This hearing Sydney is now concluded for today and the hearing process adjourned until resuming in Melbourne next Monday, the 19th of August. Thank you very much, everyone.

ADJOURNED