LOMAS, Phil

From: BLACK, Susan
Sent: Wednesday, 22 May 2019 5:58 PM
To: KENT, Christopher
Cc: KOHLER, Marion; CONNOLLY, Ellis; SHANAHAN, Ben; DM - IMS Management
Subject: Proposed APRA serviceability guidance [SEC=UNCLASSIFIED]

- Maximum loan size estimated to have decreased ~20 per cent over the past three years (b/c of previous changes to loan serviceability assessment practices and increased focus on responsible lending obligations). Proposed change in serviceability assessments would partly unwind this; by around half for OO PI.

- But, most households borrow much less than the maximum, and are not likely to be affected by the proposed changes to guidance. Estimated 10 – 20 per cent of borrowers take out loans close to the maximum. (NB: also need to have an interest rate less than 4.75% to have increase in max loan.)

From: WRIGHT, Michelle
To: HATZVI, Eden
Subject: RE: ASIC Guidance on responsible lending obligations [SEC=UNCLASSIFIED]
Date: Tuesday, 2 July 2019 12:48:00 PM

Thanks Eden.

From: HATZVI, Eden
Sent: Tuesday, 2 July 2019 12:16 PM
To: FS - HBC Management ; NORMAN, David ; SHANAHAN, Ben
Cc: BLACK, Susan
Subject: FW: ASIC Guidance on responsible lending obligations [SEC=UNCLASSIFIED]

FYI

From: HATZVI, Eden
Sent: Tuesday, 2 July 2019 7:18 AM
To: KENT, Christopher
Cc: KOHLER, Marion ; BRISCHETTO, Andrea ; DM - IMS Management
Subject: FW: ASIC Guidance on responsible lending obligations [SEC=UNCLASSIFIED]

Hi Chris

ASIC released the submissions it received on its proposed updated guidance on responsible lending obligations. As it announced last week, it intends to hold public hearings on these submissions.

The AFR write up of these submissions is here. According to the article, the major banks argued that the updated guidance could affect the supply of credit by requiring banks to take too many steps to verify customers' information.

The submissions do not seem as strongly worded as the article implies. The banks generally argued that there is still some ambiguity as to what is expected, particularly on income and expense verification.

For example, the guidance states that bank statements should be used for verification. But the banks argued this could mean either using statements to identify discrepancies with stated expenses, or using statements to account for every aspect of customers' expenses. If ASIC were to require the latter, then this would be costly and it would take a lot of time to approve loan applications.

The banks also argued that verification requirements should be proportional to the potential negative effect on a customer. For example, if a loan is a small share of a customer's income, the requirements should be less.

Sue's write up of ASIC's proposal in February is below. Our take at the time was that there were no surprises in the proposal.

My phone number is if you would like to discuss.

Thanks
Eden

From: BLACK, Susan
Sent: Thursday, 14 February 2019 6:23 PM
To: KOHLER, Marion ; CONNOLLY, Ellis
Cc: DM - IMS Analysts
Subject: ASIC Guidance on responsible lending obligations [SEC=UNCLASSIFIED]

Marion – you might want to raise at the 8:50:

ASIC has launched its consultation over responsible lending conduct, with an updated guidance note set to be released by September this year (this process had been put on hold pending the Royal Commission). My take on it is that there aren't any surprises in their proposals and that it will be a positive to provide more certainty around obligations for lending to households and small business.

https://asic.gov.au/about-asic/news-centre/find-a-media-release/2019-releases/19-028mr-asic-consults-on-updating-its-responsible-lending-guidance/

Consultation paper: https://download.asic.gov.au/media/5008524/cp309-published-14-february-2019.pdf

ASIC propose to update or clarify guidance on:

- the kinds of information that can be used to verify income and expenses and what are reasonable steps

  - provide a list of forms of verification that are readily available
  - outline that what are 'reasonable steps' will change over time, as different sources of verifying information become available (eg open banking and data aggregation services)
  - not sufficient to obtain verifying information but not have regard to it, or to use a source of information to verify only one aspect of the consumer's financial situation if it contains other (potentially inconsistent) information about other aspects
  - including an 'if not, why not?' approach—that is, if a lender decides not to use verifying information that are readily available, they should be able to explain why it was not reasonable to do so.

- The role of benchmarks to verify expenses (ASIC think that practices have improved in recent years to reflect their earlier guidance that use of a benchmark figure is not a substitute for making inquiries about the particular consumer's expenses, and that there has been an improvement in the use of income-adjusted expense benchmarks).

- Benchmarks can be a useful tool to test the plausibility of consumer-provided information, but do not give a positive confirmation
- If a benchmark is used to test expense information, the following kinds of steps should be taken:

    (i) ensure the benchmark figure is realistic (adjusted for different income ranges, dependants and geographic location, and isn't only reflective of 'low budget' spending);

    (ii) if the benchmark figure is reflective of 'low budget' spending (such as HEM), apply a reasonable buffer that reflects the likelihood that many consumers would have a higher level of expenses; and

    (iii) periodically review the expense figures being relied upon—if there is a high share of consumer that have expenses near the benchmark figure, rather than a distribution, it might indicate the lenders' inquiries are not being effective to elicit accurate information about the consumer's expenses.

- what lenders should take into account when assessing whether a credit product meets a consumer's objectives.

    - Update the current guidance on reasonable inquiries about the consumer's requirements and objectives (to reflect the findings and guidance in *Review of interest-only home loans: Mortgage brokers' inquiries into consumers' requirements and objectives)*

ASIC also proposes to include additional guidance on issues that are not currently addressed in any detail, including:

- areas where the responsible lending obligations do not apply such as <u>small business lending</u>

- how negative repayment history information may be used, and the effect this may have on the kinds of inquiries that should be made with the consumer;

RECENT RESPONSES TO HOUSING AND MORTGAGE MARKET RISKS

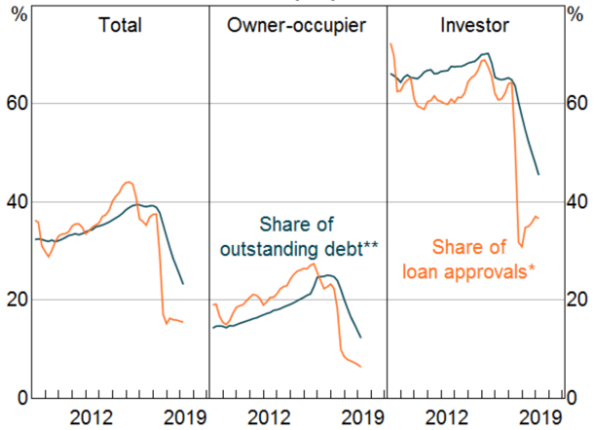
Date	Event	Response/findings
July 2019	APRA – Changes to interest rate floors and buffers used in serviceability assessments • Minimum interest rate floor of 7% removed in response to the prevailing low level of interest rates and the introduction of differential pricing for mortgage products. • Expected level of interest rate buffer raised from at least 2% to at least 2.5% above the prevailing interest rate at the time of origination. • ADIs to determine their own floor rate relative to the interest rate cycle, portfolio mix and risk appetite.	• Changes were finalised following a two-month consultation with industry. • So far, most lenders have announced floors of between 5.5-5.75%. • Size of resulting increase in maximum loan size will vary by borrower and loan type (largest increase for owner-occupier P&I loans, smallest or no increase for investor IO loans).

February 2019	ASIC – Consultation to update Responsible Lending Guidelines. Designed to improve clarity around:
	• Verifying customers' financial situations
	• The use of benchmarks for income and expenses
	• Taking reasonable steps to determine a customer's purpose of obtaining credit
		• Initial concerns/feedback from banks:
		  • Longer loan processing times due to additional verifications disrupting credit supply.
		  • "Over regulation" prompting customers to shift to unregulated credit providers.
		• ASIC has stressed that the goal is to provide more clarity, rather than introduce more stringent guidelines. Faces continued difficulties in providing clarity without setting formal obligations, such as minimum standards.

December 2018	APRA – Removal of interest-only (IO) benchmark of 30% of new lending: • Linked to earlier removal of investor benchmark; both removed provided ADI meets conditions. • These conditions include internal risk limits on IO lending, such as high LVR lending and to owner-occupiers.	• IO lending was around 15% of new lending in the March 2019 quarter down from 38% in March 2017 when the benchmark was introduced. • Negative IO credit growth for 7 consecutive quarters, and no significant rebound since the removal of the benchmark.
April 2018	APRA - Removal of 10% investor benchmark, provided: • Investor credit growth has been below 10% (y/e) for the previous six months. • Assurances provided on the strength of lending policies and practices – notably, internal limits on the share of lending at very high DTIs and reduced reliance on expense benchmarks.	• Banks have increased the number of expense categories on loan application forms and are working to reduce reliance on benchmarks. • Investor credit growth has continued to slow.

Interest-only Housing Loans

Seasonally adjusted



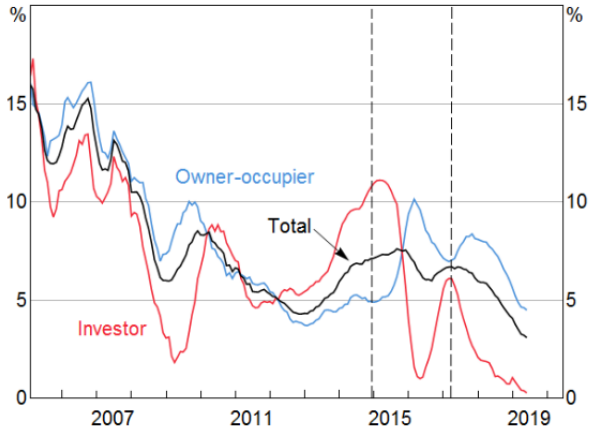
* Interest-only housing loan approvals as a share of total housing loan approvals

** Outstanding balance of interest-only housing loans as a share of total outstanding housing loans

Sources: APRA; RBA

Housing Credit Growth

Six-month-ended annualised



Sources: APRA; RBA

Financial Stability Department
2 August 2019