

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

REVIEW OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY ANNUAL REPORT 2017

1: Liar loans: APRA response to UBS reports on mortgage mis-selling risks

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Mr KEOGH: ...UBS put out two reports: one at the beginning of January this year, about overstated income raising mortgage mis-selling risks, and then a few weeks ago in March, about easily falsified payslips further raising mortgage mis-selling risks...In particular UBS identified that the major banks' disclosure of mortgage borrowers' gross household income is not consistent with the total population's income as disclosed in the census, the ABS Household Income and Wealth survey and ATO data.

...

Mr KEOGH: Are you able to provide in writing on notice at some stage later to the committee, for want of a more technical term, a take-down on that report to say, 'This is where we disagree and why we disagree?' The evidence from the royal commission and your data sets seem to be at odds. There's the published data that seems to be out of whack and now we've had a whole heap of evidence that, as you very accurately described it, banks cutting corners but not cutting corners in this area, which is your job to stop.

Mr Byres: You've asked us something, so we'll see what we can provide you.

Answer:

The UBS report on mortgage mis-selling risks that has been referred to analyses major bank public disclosures on borrower income distributions. APRA notes that the report draws its conclusions by combining these disclosures and several other public data sources. A number of the data sources are compiled on different bases, including:

- in some cases, borrower income distributions are defined by number of loans, and in other cases they are defined by the value of loans. Where loan value is used, distributions are likely to be skewed to higher incomes;
- census data is based on number of households, while the bank disclosures are based on loan facilities (by number or value). There can be a mismatch in comparisons between the two, given that some households may have multiple loan facilities; and
- for some banks, the disclosures represent the income distribution of the entire mortgage portfolio, while in other cases they represent data for a particular period of lending.

To reach the specific quantitative conclusions in the UBS analysis, these differences are assumed to be immaterial. APRA is not in a position to quantify the specific impacts of these differences, but is of the view they may have a bearing on the ability to draw definitive conclusions.

APRA has outlined industry guidance specifically on income assessment and verification in *Prudential Practice Guide APG 223 - Residential Mortgage Lending* (APG 223). This states that "a prudent ADI would be expected to make reasonable inquiries and take reasonable steps to verify a borrower's available income. Verification of a borrower's stated income would normally be achieved through a combination of factors." Prudent ADIs would also be expected to discount or disregard temporarily

high or uncertain income in the serviceability assessment, applying discounts on most types of non-salary income (typically of at least 20 per cent).

APRA has also devoted attention in recent years to improving controls over the accuracy of data provided to authorised deposit-taking institutions (ADIs) by loan applicants. In particular, APRA conducted a targeted review of residential mortgage lending practices at large ADIs, which covered controls around the assessment of borrower income and expenses. As noted publicly, APRA identified a number of areas to be addressed, and continues to review and assess ADI lending practices.¹

The targeted review included within its scope an assessment of controls on income verification. The auditors that conducted the review were instructed to examine ADI controls designed “to ensure that income declared by a mortgage borrower and required by the ADI’s serviceability assessment is accurately stated.” The review concluded that ADI controls were generally designed effectively, but there was scope for strengthening the operating effectiveness at some ADIs (including, for example, the management of serviceability policy overrides). ADIs are in the process of addressing the findings from the review.

¹ *Key issues for the year ahead: Bank Capital and the approaching BEAR*, Speech by APRA Chairman, 9 September 2017