



ASIC

Australian Securities & Investments Commission

Regulation and innovation in mortgage lending

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CHECK AGAINST DELIVERY

Introduction

Thank you for inviting me to speak to you today. Home lending plays a very important role in the Australian economy, as well as in the lives of millions of Australians.

Today I will speak about three main topics:

- First, I will update you on ASIC's work as Australia's consumer credit regulator, including our focus in the home lending market on key protections such as the responsible lending obligations.
- Second, I will touch on some outcomes from the Financial System Inquiry that are relevant to the home lending industry, including the Government's announcement about a review of mortgage broker remuneration.
- Third, I will talk about innovation, including in credit markets, and some important steps that lenders and brokers can take to realise the benefits and mitigate the risks of digital disruption.

ASIC's work as consumer credit regulator

As you are aware, ASIC is one of a number of regulators with oversight of credit providers and the mortgage industry more generally. We are focused on consumer protection issues in the context of personal credit products, ranging from small amount credit contracts through to home loans. The extent to which the *National Consumer Credit Protection Act 2009* (National Credit Act) affects lenders depends on who those businesses lend money to and the sector of the market they operate in.

Although we have a broad interest in consumer credit, home lending is an important area of regulatory focus for ASIC. Home loans are a key product through which many Australians purchase one of the most significant assets they will own.

As a result, lending practices in this sector are of critical importance to the financial wellbeing of Australian consumers. Where we see poor lending practices in relation to home lending, we will take action. Addressing poor practices – particularly around important obligations like responsible lending – helps ASIC promote investor and financial consumer trust and confidence.

In the current environment of low interest rates and strong demand for housing, it is important that credit licensees make robust assessments of the capacity of consumers to make the required repayments, with appropriate buffers in place to account for higher interest rates or changed economic circumstances in the future. Where those loans include an interest-only period, it is also important that the length of that period is suitable for the consumer in both the short and long term.

ASIC's review of interest-only home loans

In August last year we released [Report 445](#) *Review of interest-only home loans* (REP 455) with our findings from our review of how lenders were complying with their responsible lending obligations when providing 'interest-only' home loans. As you are aware, responsible lending is about ensuring consumers are not simply put into any loan, but only enter loans which they can afford given their financial situation and broader requirements and objectives.

Our review of interest-only home loans found examples of practices that place lenders at risk of breaching their responsible lending obligations. These practices included:

- affordability calculations that assumed the borrower had longer to repay the principal on the loan than they actually did
- files without evidence that the lender had considered whether the interest-only home loan met the borrower's requirements, and
- reliance on expense benchmarks rather than consideration of the borrower's actual living expenses.

In order to comply with their responsible lending obligations, credit licensees should clearly document their inquiries into a consumer's requirements and objectives, including how any interest-only term aligns with these requirements and objectives. Good documentation is not only important to meet regulatory obligations; it helps manage operational risk and is good business practice. We have published extensive guidance on the responsible lending obligations in [Regulatory Guide 209](#) *Credit licensing: Responsible lending conduct* (RG 209). ASIC encourages all credit licensees to consider this guidance.

Following on from our review, we identified 10 actions that credit licensees should take to reduce their risk of non-compliance with the responsible lending obligations. All lenders that were part of our review have confirmed that they intend to change, or have already started changing, their practices in this area. For example:

- all lenders committed to assessing interest-only home loans using the ‘residual term’ method of calculating repayments
- all lenders committed to using an income-adjusted benchmark when considering a consumer’s expenses, and
- most lenders who offered longer interest-only periods have committed to reducing the maximum interest-only period offered to owner-occupiers to five years.

Some people have interpreted our report as indicating that interest-only loans are not appropriate for owner-occupiers. This is not the case, which is made clear in the report. ASIC’s view is that interest-only loans can be a reasonable and effective option for some owner-occupiers.

We have commenced further work in the interest-only area. Having considered the approach of lenders, we are going to conduct a review of large finance brokers, with a particular focus on brokers’ consideration of consumers’ requirements and objectives when providing interest-only loans.

Our review will look at the quality of these inquiries and how brokers ensure that a particular interest-only home loan is not unsuitable for the consumer. We understand that, in some instances, lenders may seek to rely on the inquiries a broker has made into a consumer’s requirements and objectives. Of course, lenders are subject to their own obligations and must have reasonable a basis for any reliance on inquiries by others.

In addition to these reviews in the interest-only loan market, we are also doing some follow-up work with a number of lenders in respect to their responsible lending practices around consumers’ expenses. We are keen to ensure that where particular lenders have acknowledged a need to improve their practices; these improvements are implemented and address our underlying concerns.

ASIC enforcement outcomes in home lending

ASIC has placed a significant focus on investigating and taking action on loan fraud – where falsified documents are provided in support of loan applications.

Since becoming consumer credit regulator in 2010, ASIC has banned or revoked the licences of more than 60 individuals and companies in relation to document and loan fraud. This includes 27 permanent bans and 14 licence cancellations or suspensions. These actions cover both brokers and the employees of authorised deposit-taking institutions.

Document fraud in support of loan applications has a detrimental effect on the whole market. It impacts on the business and reputations of lenders and brokers. It also affects consumers, particularly if they should not have entered into these loans in the first place. ASIC will continue to take strong action against loan fraud to help ensure trust and confidence in the lending industry. Let me give you some examples of our actions in the last few months.

Myra Home Loan Pty Ltd

One example of a recent enforcement outcome in this area is two convictions relating to former finance broking company Myra Home Loan Pty Ltd (Myra). In December 2015 the Victorian County Court convicted Mr Aizaz Hassan and Mr Mohamed Radhi Maki Ebrahim Ahmed of conspiring to defraud financial institutions. Both men pleaded guilty to one count each of common law conspiracy to defraud, resulting from an ASIC investigation.

The charge concerned Mr Hassan and Mr Ahmed's roles at Myra and their involvement in the creation and use of false documents in support of home loan applications.

The Myra business involved the creation of false documents, including payslips, bank statements, citizenship documents and statutory declarations. Those documents were submitted in support of home loan applications to the Commonwealth Bank, Westpac, St George Bank, Bankwest, Adelaide Bank, ANZ Bank, Bank of Queensland, Choice Home Loans, Citibank, National Australia Bank, Pepper Homeloans and Suncorp Bank.

Approximately 600 loan applications were prepared and submitted through the Myra operation to these financial institutions during the period of the conspiracy, with the total value of approved home loans (approximately 520 loans) being approximately \$170 million.

Mr Aizaz and Mr Hassan were sentenced to five-year community corrections orders, with special conditions including 400 hours of community service. Her Honour, Judge Lawson, noted that but for the guilty pleas and other factors Mr Hassan and Mr Ahmed would have been sentenced to five years' imprisonment each, with a minimum of three years to serve. Her Honour said Mr Hassan and Mr Ahmed were 'important cogs' in a 'sophisticated and sustained' operation, which was described as a 'very serious offence'.

There is further work that ASIC is undertaking in respect of this matter. For example, Mr Najam Shah has also been arrested in relation to the Myra operation – proceedings against Mr Shah are ongoing.

Bassem Fares

In December 2015 ASIC permanently banned Bassem Fares, a former lending officer at Firstfolio Services Pty Ltd, from engaging in any credit activities. Mr Fares admitted to creating false income verification documents and false letters of employment in support of six mortgage loan applications seeking loans totalling over \$3 million during the period from December 2013 to March 2014.

Among the false documents were:

- six PAYG payment summaries which contained false information as to employment or income earned
- 11 payslips that had not been issued by the purported employer containing false ABNs or incorrect compulsory superannuation amounts, and
- three reference letters from purported employers.

ASIC found that Mr Fares was not a fit and proper person to engage in credit activities.

ASIC believes that strong compliance practices and enforcement outcomes help improve market outcomes and protect consumers. And our work on responsible lending and loan fraud is not just of benefit to consumers – it also helps lenders and brokers. Businesses that do the right thing by their clients, and the industry, need to be confident that the actions of other operators don't place them at a competitive disadvantage or undermine the public's trust in the home lending industry.

Financial system inquiry

As I'm sure you're all aware, there are a number of recommendations from the Financial System Inquiry that are very relevant to credit providers and brokers in the home lending sector.

Some of these recommendations – such as those relating to bank capital ratios and mortgage risk weights – are primarily matters for other regulators such as the Australian Prudential Regulation Authority. There are also other matters Government intends to monitor developments in to determine whether changes are warranted. Examples include the uptake of comprehensive credit reporting and limited recourse borrowing arrangements involving superannuation funds.

Today I will provide you with some information on recommendations and Government considerations that are relevant to both ASIC and the mortgage industry, such as:

- the scope of ASIC's powers and funding
- an upcoming review into broker remuneration, and
- recommendations and measures to promote innovation.

Scope of ASIC's powers

The Financial System Inquiry recommended that ASIC be given a product intervention power, which would allow us to proactively intervene where there is a significant risk of consumer detriment but not necessarily a demonstrated or suspected breach of the law. The Financial System Inquiry contemplated that this power could allow us to require or impose:

- amendments to marketing and disclosure materials
- warnings to consumers, and labelling or terminology changes
- distribution restrictions, and
- product modification, or in the most extreme cases, product banning.

Government has accepted this recommendation, but indicated that it will be subject to consultation with stakeholders to ensure that the power provides ASIC with appropriate tools without stifling industry innovation. We look forward to assisting Government with the consultation process.

ASIC's funding

The Financial System Inquiry recommended that Government recover the cost of ASIC's regulatory activities directly from industry participants through fees and levies. These levies would be calibrated to reflect the cost of regulating different industry sectors. Government would continue to set ASIC's overall funding needs, but would do so through a three-yearly funding review to ensure increased stability.

Government consulted on an industry funding model for ASIC during the second half of last year. We understand that this funding model, and the submissions received, are still being considered by Government and Treasury.

Broker remuneration review

As part of the Government's response to the FSI, the Minister for Small Business and Assistant Treasurer has asked ASIC to review mortgage broker remuneration structures and their effect on the quality of consumer outcomes.

The Government and regulators have previously considered remuneration in other contexts, such as financial advice and insurance. We recognise that there are significant differences between the commission structures of financial planners and those of mortgage brokers. Nonetheless, it is important in any sector to understand remuneration practices and structures, because these are key drivers of behaviour and culture.

Our primary objective is to produce a clear picture of mortgage broker remuneration structures and trends in Australia. We are currently finalising the scope of our review, and we will be consulting widely on this issue in the near future. We will hold industry roundtables in the coming weeks with relevant stakeholders. Where people are not able to attend, we will provide an opportunity for written submissions.

Although the scope of the review is yet to be finalised, we expect that some of the issues we will be considering include:

- the current incentive structures and commissions offered by the large banks versus smaller lenders
- the number of different loan products that brokers have on their panel
- the proportion of loans written by brokers to their owner (relative to those written to other lenders on their panel)
- whether loan amounts are in line with remuneration structures, and
- how accessible lender panels are for smaller credit providers.

One thing that has become clear is that any review of remuneration will require us to look at the whole distribution chain. As a result, we expect that this review will be relevant to many stakeholders in the home lending sector, including credit providers, aggregators and brokers.

We will be reporting to Government by the end of 2016.

Recommendations and measures to promote innovation

In addition to the streams of work I have already mentioned, the FSI also included recommendations about changes that could help facilitate innovation in our financial system. Among other things, the Financial System Inquiry's final report suggested:

- establishing a public–private sector collaborative committee to facilitate innovation and enable timely and coordinated responses from Government
- embedding technological neutrality in new laws and amending existing obligations where they are inconsistent with this principle, and
- developing a national strategy for trusted digital identities.

The Government has accepted these and other recommendations, and work is already underway.

It goes without saying that innovation is an area of current interest for Government and industry. We have all witnessed the fast pace of change in how we do business – both as consumers and as businesses. Technological innovation is influencing every industry, including the financial services and credit markets.

Innovation and digital disruption can improve the consumer experience. Businesses have seen the potential for new ways of creating and sharing value with technologically savvy investors and consumers. For example, we see significant potential in:

- peer-to-peer lending or digital marketplace lending
- robo-advice
- crowd-sourced equity funding, and
- changes to underlying payments infrastructures.

In the future, we will likely see further developments, including in areas we haven't even thought of yet.

Digital disruption, by its nature, is not change by evolution – it represents competition emerging more rapidly in markets. But, of course, financial innovation brings both opportunities and risks. What is fundamentally important in all of this is thinking critically about the implications of digital disruption.

A common theme that we have observed across new technology-related offerings is increased convenience and timeliness for consumers. Technology has facilitated customers' around-the-clock remote connection with their financial institutions, meaning consumers are perhaps more demanding now than ever before – expecting speedy transactions and response times, and their interactions with their financial institution to work seamlessly.

With access to technology, consumers also have an increased ability to act collectively and communicate broadly. When expectations are not met, consumers can now make that publicly known to the wider world through social media and other online forums. Now more than ever, word can spread fast about negative consumer experiences, even where the financial institution may not have broken any laws. This also applies to the experience

that consumers have with regulators, and it will only increase as the next generation grows up in the age of smartphones and social networking.

So, in addition to ensuring compliance with the relevant laws, industry also needs to focus on customer satisfaction. From our perspective, this is about providing useful and appropriate products and services that give consumers the tools to pursue their financial objectives. However, when things go wrong, it is also about responding and reacting with a keen interest in how your customers are affected. We believe that operating in this way will foster the trust and confidence of your customers.

ASIC and innovation

Although I've spoken quite generally about some of the benefits and risks of digitally-driven competition, I'd like to close by speaking more specifically about some of the things we have done to promote and facilitate new and innovative business models, including in the consumer credit market.

As you may be aware, ASIC has established an Innovation Hub. The intent of this hub is to help new business – particularly small, financial technology businesses – navigate the laws we are responsible for. We believe that by giving new businesses early exposure to senior ASIC staff, we can help them identify key regulatory issues that they should think about as they settle on their business models and prepare to apply for licences from us.

Our Innovation Hub has five elements:

- The first is engagement with other fintech initiatives, including physical hubs and co-working spaces. We make ASIC staff available from time-to-time to present information and answer questions.
- The second element is informal guidance from ASIC to help new businesses consider the important regulatory issues. We expect this guidance will minimise the time and cost of applying for a licence or relief from the law.
- Third, we have established new 'Innovation Hub' webpages for innovative businesses to access information and services targeted at them. This information will be updated on an ongoing basis.
- The fourth aspect of our Innovation Hub is a senior internal taskforce to coordinate our work on new business models. The taskforce draws together learnings and skills from across ASIC.
- The final element is the Digital Finance Advisory Committee (DFAC), an external group we established to advise us on our innovation-related work. DFAC members are drawn from a cross-section of the fintech community, as well as academia and consumer backgrounds.

As part of our Innovation Hub, we have accepted over 40 requests for assistance from new and innovative businesses. Roughly one quarter of these have been businesses looking to enter the credit market – either as lenders, or as service providers whose

business models are built around assisting consumers to find and apply for loans that meet their financial situation, requirements and objectives.

We have also attempted to foster innovation by taking a flexible approach in administering the financial services and credit regimes. In some areas we have powers to provide exemptions from, or to modify, certain obligations. One situation where we might use these powers is where the law applies in unintended or unforeseen ways. We will consider using these 'relief' powers where there is a net regulatory benefit, or where the regulatory detriment is minimal and is clearly outweighed by the resulting commercial benefit.

Our relief powers can be particularly important for new products and services, which may not fit well within established frameworks. Having said that, we are conscious of Parliament's intent when setting the regulatory regime and, as a general rule, we won't use our powers to overturn the intended effect of the law.

A recent example of where ASIC has exercised flexibility is our relief to facilitate electronic disclosure. Electronic disclosures may allow firms to present information in ways that consumers find more engaging and informative than traditional or printed disclosure documents. The electronic delivery of information may also allow for faster, cheaper disclosures that are more convenient for everyone involved. Under the *Corporations Act 2001*, businesses are able to make disclosures available digitally, and notify the client the disclosure is available, without the need for client agreement to receive the disclosures in that manner. Clients continue to have the ability to opt-out of receiving disclosures in this way.

However, sometimes the law does not give us power to address these issues ourselves. A recent example of this is the barriers to electronic disclosures under the National Credit Act and the National Credit Code. We don't have necessary powers to enable default electronic disclosure in the credit sector, but we have provided advice to Treasury so that they can consider whether changes to the law or regulations are required. We generally support electronic disclosure and we note that rules that continue to require paper documents as the default disclosure document may not be consistent with the Financial System Inquiry's recommendations about technological neutrality.

Conclusion

I hope that my speech today has given you some insights into the work ASIC has been doing in the home lending sector, as well as wider Government and ASIC initiatives about innovation.

I'd like to conclude by emphasising the importance of industry and regulators working together to harvest the opportunities from financial innovation.

We expect that all parts of industry – including those developing new and innovative offerings – will have the customer interest front of mind. We all have a common interest in seeing the opportunities of new technology work to the benefit of consumers. At the same time we need to mitigate the risks, so that we all enjoy the benefits of investor and consumer trust and confidence in our markets, and sustainable growth.