



ASIC

Australian Securities & Investments Commission

Consumer credit regulatory update 2014

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*Mortgage and Finance Association of Australia (MFAA) National
Convention*

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CHECK AGAINST DELIVERY

Thank you for inviting me to speak to you today. ASIC recognises the role played by the MFAA in promoting professionalism within the finance industry, which is crucial to building public confidence in its members' services.

I welcome the opportunity to set out ASIC's priorities in the consumer credit market and provide some insight into what this means for industry participants. It has been a particularly busy period for ASIC as, in addition to our regular work, we are also involved in two inquiries – the major Financial System Inquiry and the Senate inquiry into our performance.

It is interesting to note that around half of the submissions to the Senate inquiry relate to ASIC's regulation of credit. Our submissions to the inquiry are available on our website, including a specific submission that focuses on the impact of the *National Consumer Credit Protection Act 2009* (National Credit Act). The submission outlines ASIC's role in regulating consumer credit both prior to and post the introduction of this legislation. Our submission noted that the reforms had led to substantial improvements in industry practice.

ASIC's regulatory focus in credit

ASIC's areas of regulatory focus in relation to consumer credit are:

- advertising
- responsible lending
- loan fraud
- general licence obligations relating to conflicts of interest, and
- property investment and lending through self-managed superannuation funds (SMSFs).

We believe that regulatory compliance in these areas is central to improving market outcomes and protecting consumers. However, our work in these areas is not just of benefit to consumers – it also helps compliant market participants. Businesses that do the right thing by their clients, and the industry, need to be confident that the actions of unscrupulous operators don't place them at a competitive disadvantage or undermine the broader public trust in the industry.

Advertising

ASIC has been increasing its focus on financial services advertising more broadly over the last 12–18 months. Ensuring credit advertising is not

misleading is a significant part of this broader work, as the credit sector has a particularly active profile in advertising. Advertising is often a consumer's first contact with a credit product or a credit business, and therefore plays a significant role in the consumer's perceptions and expectations.

ASIC administers the consumer protection provisions of the *Australian Securities and Investments Act 2001* (ASIC Act), which prohibits misleading, deceptive and unconscionable conduct in relation to financial services. Importantly, in today's market this includes a growing focus on advertising and marketing through online and mobile channels. Over time our focus on advertising has also taken into account the insights of behavioural economics about how consumers make decisions.

Advertising can play a valuable role in creating the informed consumers who help ensure the potential benefits from competition are realised. Conversely, misleading advertising can be quite detrimental if, as a result, consumers enter into unsuitable products that do not meet their objectives. Furthermore, we are keen to prevent the type of industry-wide dynamic that can be generated through misleading or false advertising, whereby providers engage in a 'race to the bottom' through dubious advertising practices to keep up with competitors.

ASIC therefore takes a proactive role in monitoring advertisements to identify potentially false or misleading representations. Regulatory Guide 234 *Advertising financial products and advice services (including credit): Good practice guidance* (RG 234) contains good practice guidance on advertising financial products, including a number of specific real life examples.

ASIC has a broad range of compliance tools it can utilise where it identifies concerns with advertising. Following publication of RG 234, ASIC put industry on notice that it intended to take a stronger approach where it identified misleading advertising. Allowing industry to simply correct advertising after the fact doesn't always provide a sufficient incentive to get it right in the first place. With this in mind, ASIC has stepped up its use of infringement notices and enforceable undertakings for instances of false or misleading advertising. We are also looking at taking more civil penalty actions in this area.

For example, in February we issued a credit assistance provider with two infringement notices with a total penalty of \$20,400 for advertising 'guaranteed' finance. ASIC was concerned the representations were false or misleading because an unconditional guarantee that finance can be provided is inconsistent with responsible lending laws. Consumers can lose confidence in the industry if they apply for such offers and find that finance is not available for their specific circumstances, or if they form the view that industry is engaging in irresponsible lending.

Responsible lending

Our second area of focus is responsible lending, one of the obligations central to the national consumer credit regime. 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. We therefore see industry compliance with responsible lending obligations as fundamentally linked to consumer confidence.

Responsible lending compliance review

When ASIC took responsibility for consumer credit we commenced reviews of a number of areas which we considered were likely to raise compliance challenges.

These reviews sought to understand existing practices, and to identify compliance risks and how these risks may be addressed. In addition to working through identified compliance risks with individual licensees, we also sought to ensure that the broader industry would benefit from the lessons learned by publishing reports of our reviews, including specific compliance risks and ways these might be managed.

The reports we have completed include:

- Report 262 *Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans* (REP 262), November 2011
- Report 264 *Review of micro lenders' responsible lending conduct and disclosure obligations* (REP 264), November 2011
- Report 330 *Review of licensed credit assistance providers' monitoring and supervision of credit representatives* (REP 330), March 2013, and
- Report 358 *Review of credit assistance providers' responsible lending conduct relating to debt consolidation* (REP 358), July 2013.

We will soon publish our latest report on *Review of lenders' responsible lending conduct, focusing on 'low doc' home loans*. This review focuses on the responsible lending conduct of authorised deposit-taking institution (ADI) and non-ADI lenders providing low doc home loans. This report follows on from our earlier reviews of credit assistance providers' responsible lending conduct.

We have noticed a number of changes and improvements in the market since we commenced our reviews.

For example, over the course of our reviews we have noted that licensees are collecting, recording and considering more information about consumers' financial situation, and their requirements and objectives.

We have also seen licensees implementing new systems to ensure compliance of their representatives and the reliability of information provided by other third parties.

While our upcoming report focuses on lenders providing low doc home loans, as with our other reports the findings will be relevant for credit licensees more generally.

Some of the compliance tips for licensees include:

- giving the consumer details of the information relied on in making the assessment of unsuitability at the same time as making an application for or offer of credit. We found that some licensees were already doing this, as they believed it reduces the prospect of a consumer later disputing the basis on which credit was provided
- ensuring records to support an assessment of unsuitability demonstrate an understanding of the consumer's requirements and objectives, using all the inquiries set out in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209), and noting the relative priority of these objectives (e.g. cost versus flexibility). Record keeping more generally has been a central theme of all our reports, and I cannot stress enough the importance of keeping records that support the assessment of unsuitability and demonstrate that you are meeting your responsible lending obligations
- having discrete processes to make inquiries about, and take reasonable steps to verify, consumers' variable expenses. In other words, don't just rely on a benchmark figure, be it the Henderson Poverty Index or a variation of it – take the time to understand your customer's individual circumstances. If a consumer has a hard time estimating what they spend, perhaps you need to discuss with them how much they save and where they might make any additional savings needed to afford any proposed loan repayments, and
- ensuring the use of adequate buffers to allow for changes to financial circumstances (e.g. interest rate increases, income/expenditure fluctuations) when assessing a consumer's ability to make repayments without substantial hardship.

Loan fraud

When responsible lending obligations were first implemented we took a facilitative approach to compliance. This facilitative approach has, however, not been taken where a licensee or broker deliberately breached responsible lending obligations or failed to make sufficient effort to comply. In particular, we have no tolerance for loan fraud involving false loan applications and related documents, and we have had a campaign to identify and crack down on misconduct of this sort.

ASIC has banned 42 persons (19 permanently) since the introduction of the National Credit Act. Almost half of these bannings relate to instances where persons submitted falsified documents to lenders. We have also recently been successful in obtaining several criminal convictions for loan fraud, which indicates the seriousness of this activity. There are more such matters in the pipeline, as we send the message that loan fraud is unacceptable.

We acknowledge the role that industry plays in identifying dishonest operators, with many of the bannings arising as a result of industry alerting us to inappropriate behavior. We note the role the MFAA plays through its own disciplinary process and that the value of this depends on all members reporting serious misconduct.

There has been some suggestion in the industry that, in relation to loan fraud, ASIC is targeting finance brokers. I have two comments on this point. The first is that those we remove from the market, or criminally prosecute, have been the subject of these actions for good reason. The second point is that we will take action regardless of who breaches the law. In addition to ensuring consumer confidence, we believe that this creates a fairer environment for those that are doing the right thing.

Clearly, dishonest operators are the exception when one considers there are approximately 5800 licensees (with approximately 4,400 self-identifying as a finance broker or mortgage broker) and over 30,000 authorised representatives. While some may see it as unfortunate that rogue brokers make the headlines, it sends a positive message to consumers that these operators are being identified and removed from the industry.

General licence obligations relating to conflicts of interest

Another area of focus is general licence obligations and, in particular, the management of conflicts of interest. Licensees must have adequate arrangements to ensure consumers are not disadvantaged by conflicts of interest. We have seen in the financial services space how investor confidence can be quickly undermined if they form the view that businesses are putting their own interests ahead of consumers' interests.

Motor vehicle finance and add-on insurance

As I noted before, we focused our early responsible lending work on areas which we thought posed potential compliance challenges for licensees. We have taken a similar approach in relation to our work on credit licensees' management of conflicts of interest, with our initial area of focus being on flexible commission arrangements in the motor vehicle finance sector. Our work in this space is quite advanced, having gathered information and spoken to industry stakeholders about our preliminary views, and I expect we will publish a report of our findings in the not too distant future.

I also recently noted in a speech to the Insurance Council of Australia that we are currently undertaking a scoping study of issues in relation to add-on insurances sold in the motor vehicle sector, including consumer credit insurance, gap insurance, and tyre and rim insurance.

We have already identified a number of issues, including:

- insurance purchased through a car yard where the insurance product(s) is not the consumer's focus – it is a subsidiary decision after deciding on the car to purchase and which finance to obtain, and
- premiums are usually charged as a lump sum, and may be added to the loan amount.

In addition to potential issues related to management of conflicts of interest in such situations, there may also be responsible lending issues in relation to the assessment of the consumer's requirements and objectives – for example, instances where loan terms are significantly extended in order for consumers to be able to afford various add on insurances.

Property investment and lending through self-managed superannuation funds

Self-managed superannuation funds (SMSFs) are also an area of focus for ASIC. To date, our focus on SMSFs has primarily been on the financial advice given to consumers about the establishment of an SMSF or the investments to be made by the SMSF.

However, we have recently started taking a closer look at potential risks associated with one-stop shop business models that provide advice on and assist in:

- establishing SMSFs
- sourcing and purchasing of investment properties, and
- obtaining finance for the property purchase.

Now, there may be benefits for the consumer in being able to access a number of services under one roof. However, we are keen to ensure that advice is not compromised as a result and that consumers are not misled into believing they are getting a certain level of advice, where they may only be referred to another part of the business to be sold one product.

Credit assistance providers operating outside such one-stop shop arrangements may consider that the issues raised in relation to SMSFs do not directly impact on them. However, limited recourse borrowing arrangements for SMSFs are much more complex than a normal home loan, and credit assistance providers therefore need to be aware of the additional risks associated with such transactions. Broadly speaking, risks in such transactions include:

- *breach of credit legislation* – As limited recourse borrowing arrangements are complex and difficult to unwind, there are increased risks of breaching various obligations under the National Credit Act as well as more general provisions under the ASIC Act, and
- *inadvertently providing unlicensed financial advice* – Our Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337) notes that in some instances, recommendations about SMSF investment in real estate may trigger financial service licensing requirements. ASIC has previously cancelled a credit licence and banned its director from engaging in credit or financial services due to a number of concerns, including the provision of unlicensed SMSF advice.

ASIC is aware of work the MFAA has done to develop a course on limited recourse borrowing arrangements. We understand the course is intended to educate credit assistance providers about how SMSFs and limited recourse borrowing arrangements work in order to assist them to better understand their role, and the role of other professionals (e.g. financial advisers, lawyers, accountants) in such transactions. Hopefully this assists credit assistance providers to better understand their role and obligations, including what *not* to do, in order to reduce their risk of non-compliance.

Closing

In closing, I note that ASIC is aware of the important role credit assistance providers play in the credit industry. Many consumers will want to obtain advice from someone they can trust. Many consumers use credit assistance providers to select and obtain a loan which suits their specific circumstances. This not only assists the consumer obtaining the loan, but can also benefit other consumers, through market competition, by ensuring that business is directed to those lenders who provide loans which better meet consumers' requirements and objectives.

However, the benefits available to consumers from using a mortgage broker or other credit assistance provider depend not only on the integrity of the industry, but also consumer's confidence in the industry, which is why both industry self-policing and effective enforcement of the law by ASIC is important.