connective

20 May 2019

Ms. Fleur Grey
Senior Specialist
Credit, Retail Banking and Payments
Financial Services
Australian Securities and Investments Commission

By Email: responsible.lending@asic.gov.au

Re: SUBMISSION ON CP 309 – CREDIT LICENSING: RESPONSIBLE LENDING CONDUCT

1. Connective welcomes the opportunity to comment on ASIC's proposals outlined in CP309 to update RG 209.

About Connective

2. Connective is Australia's leading home loan aggregator with approximately 3,500 individual mortgage brokers holding Connective membership. This represents approximately 20% of all home loan mortgage brokers in Australia and 1 in 8 home loans being written by a Connective mortgage broker. Membership with Connective provides mortgage brokers with access to approximately 60 lenders Connective has on its panel.

3. Connective sits in a unique position where we see the daily efforts mortgage brokers take towards providing a valuable service to their customers and achieving good consumer outcomes for these customers, whilst remaining compliant with applicable laws and regulations, including RG209. With approximately 56.8% of all home loans being arranged through a mortgage broker (based on December 2018 quarter data), it is critical that any update to RG 209 balances good consumer outcomes and continue to promote competition operates to provide clear guidance to mortgage brokers in performing their function whilst not adding unnecessary or excessive costs to the process. Ultimately, a balance must be struck between delivering good consumer outcomes through strong responsible lending guidelines whilst ensuring competition is not adversely affected. Without competition, key elements such as price and service may suffer.

4. Please note that our responses to CP309 are from the perspective of our members, finance brokers who operate in the home loan and asset finance space.

Summary

5. From Connective's perspective, any update to RG209 needs to take into account the following factors:

    a. For certain products and consumer profiles, RG 209 should prescribe specific inquiries and verifications as a base requirement or safe harbour. However, it is critical that these base requirements recognise the different roles a licensee can play in the credit process (i.e. a finance broker that merely provides credit assistance should have different requirements to a bank that is providing the credit and has access to more tools in order to complete its assessment).

b. It does not provide a good consumer outcome if all products are treated the same regardless of whether the consumer is at lower risk of substantial hardship based on features of either the consumer and/or the product.

c. Better guidance around scalability and what satisfies “reasonable inquiries” and “reasonable verification” needs to be provided.

d. The greater the likelihood a product can lead to substantial hardship for a consumer, the more guidance ASIC should provide (to the extent possible).

e. Although we do not advocate the broad use of benchmarks, they can be very useful in certain defined circumstances (such as sanity checking declared living expenses for certain consumers and/or product types).

f. Better guidance as to what is an appropriate level of due diligence. When is it appropriate to use benchmarks? How deeply must a licensee delve into bank statements provided to them by the consumer? It cannot be reasonable to expect the licensee to conduct a full audit of those statements.

g. It is not a one-way street. With responsible lending also comes responsible borrowing. Consumers should also be held to account for their financial decisions – it cannot just be the responsibility of the licensee. Obviously, the consumer profile will govern where that allocation of responsibility lies. Licensees cannot be in breach where consumers act in a misleading or fraudulent fashion and licensees are not aware of this deception despite taking reasonable steps.

h. Recognise licensees are different and can range from one-person small businesses operating as a finance broker, to a large multi-billion dollar bank. Also, that licensees perform different functions, and that different requirements apply depending on that function(such as a preliminary assessment versus a final assessment).

i. RG209 must address the fact that consumers may make lifestyle and spending changes following the assumption of new credit to ensure the ability to service that credit. Licensees should be able to reasonably adjust living expenses to take this into account when making an assessment.

B1 - Verification of consumer’s financial situation

B1Q1 Would it be useful for licensees if ASIC were to identify the inquiries and verification steps that we consider should be taken? Why or why not?

6. Yes. Where possible, ASIC should identify the level of due diligence required but in doing so,

recognise that such requirements are scalable depending on the function of the relevant licensee. We strongly support the establishment of 'base requirements' for different product classes subject to those requirements being scalable. Elements such as consumer profile and whether there is a real prospective of substantial hardship should be factors in determining what those base requirements are.

7. Although ASIC has usually leaned towards providing principle-based regulations, this approach may result in a lack of clarity for the industry as to what is required in order to comply. This uncertainty has noticeably increased over the past 12 months with lenders applying different standards and requirements, which in turn creates a difficult environment for our finance brokers and their consumers. It is critical that the industry has balanced rules that provide for clear principles and standards, but also where possible, clarity and certainty for participants.

8. In establishing these 'base requirements', ASIC must provide guidance for all Australian Credit Licence holders, recognising these range from finance brokers (possibly one person businesses) to lenders with extensive resources (such as a major bank). A distinction must also be made between the conducting of a preliminary assessment versus a final assessment and that different functions in the process of obtaining credit carry different responsibilities.

B1Q2 If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.

9. RG209 prescribes that licenses apply appropriate standards for completing reasonable inquiries about a consumer's financial situation and reasonable steps to verify the consumer's financial situation.

10. Determining and verifying a consumer's income and key expenses (such as rent, regular loan repayments) are reasonably straight forward these days and can form part of the 'base requirements' referenced above. However, the common theme from what we hear from finance brokers is around the difficulty and cost around verifying other expenses, especially discretionary expenses. This process is often imprecise, costly and time consuming and not necessarily relevant as such expenses, especially those of a discretionary nature, can be reduced or eliminated once the new credit is taken on.

11. Accordingly, we recommend ASIC provide further clarity in the area of verification of living expenses and discretionary vs. non-discretionary expenses and the use of benchmarks (where appropriate) as essential.

12. We would also suggest that for products where the risk of substantial hardship is remote, it is appropriate to have regard to a reasonable estimate of living expenses. A scenario we would want to avoid is one where a consumer is denied credit that they can afford without hardship simply because their discretionary spending has been over inflated.

13. In addition, we would suggest guidance around when living expenses disclosed in the relevant credit application can reflect what the consumer and broker reasonably believe that consumer's living expenses will be following assumption of that credit (i.e. to reflect lifestyle changes to ensure the consumer's ability to service the loan).

B1Q3 Are there any kinds of credit products, consumers or circumstances for which you consider it may be reasonable to undertake fewer inquiries and verification steps? Please identify the kinds of products, consumers and circumstances and particular features you think are relevant.

14. Absolutely. Consumer profile and product type are an essential factor in assessing scalability and the extent of inquiries and verification.

B1Q4 In your view, what aspects of the consumer's financial situation would a licensee need to inquire about in all circumstances? If you think some aspects of the consumer's financial situation do not need to be inquired about, please explain why.

15. As stated above, income and key expenses (such as rent, fixed loan repayments) are reasonably straight forward to verify. Similarly, for certain product types and consumer profiles, detailed verification of discretionary living expenses may not be necessary.

B1Q5 In your view, what aspects of the consumer's financial situation would a licensee need to verify in all circumstances? If you think some aspects of the consumer's financial situation do not need to be verified, please explain why.

16. See answer above to B1Q4.

B1Q6 What would be the effect on consumers of ASIC identifying particular inquiries and verification steps? For example, what would be the effect on access to and cost of credit for consumers?

17. As a whole, we believe this would have a positive effect on consumers due to improved efficiency, standardisation and a more realistic perspective on risk.

18. Recently, the overwhelming feedback we are receiving from our finance brokers is that the time to complete an application has increased substantially and even after that process has been completed, there is greater likelihood that the application will be declined or the required quantum of credit is not approved (even though the quality of consumer seeking that credit has not changed). The main driver is uncertainty and the fact that each lender has different requirements (not always transparent) and apply different standards. Ultimately, this is at the detriment of the consumer with the reduced availability of credit. Certainty for industry participants can only be positive for their consumers.

19. We disagree with the observation in paragraph 12 of CP309 that there is a risk of an unintended consequence that less scrupulous licensees might limit their due diligence solely to items listed by ASIC. We think this risk is not material and is not likely to change industry behaviour given the significant penalties and other consequences arising from being found not to have taken reasonable steps.

B1Q7 What would be the effect on business costs of ASIC identifying particular inquiries and verification steps? Please provide details of the effect on compliance costs for the licensee, and any factors that are likely to affect the level of cost or cost savings.

20. From Connective's perspective, the cost of complying with responsible lending requirements is a cost of doing business which should not be passed on to consumers. Any improvement to efficiency, such as standardisation of particular inquiries and verification stapes can free up the licensee's time to focus on complying with other key elements of RG209 and other applicable

laws and regulations. As stated above, any change to RG209 needs to also preserve competition – ensuring the commercial viability of finance brokers is a critical element in ensuring this.

B1Q8 In your view, what would be the effect (either positive or negative) on competition

21. From a broker's perspective, greater consistency across lenders will have a positive effect on competition because brokers will more easily be able to work with a wider panel of lenders with greater certainty. The proposal is unlikely to impact adversely on lenders because under the regime, we envisage they will still have the option to adopt other processes where appropriate.

C1 – Verification of consumer's financial situation

C1Q1 Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available forms of verification?

22. Information about and evidence of income are readily available from a range of sources. Non-discretionary expenses can also be reasonably verified by obtaining documentary evidence such as rates notice, rental agreement, utility invoices, insurance to confirm a client monthly declared 'non-discretionary' living expenses.

23. The verification of a consumer's discretionary expenses is the area of most contention for a broker and the area where ASIC should provide specific guidance (even if such guidance is to allow for reasonable estimates be used in defined circumstances).

24. In particular, ASIC needs to address whether bank account statements need to be reviewed in all cases. From our perspective, the review of bank statements can be an intrusive and expensive manual task. This should only be appropriate for certain products and where the risk of substantial hardship is real. We do not believe that the review of all bank account statements be made compulsory in order to form a reasonable assessment.

25. In addition, the expectation on a licensee regarding the extent of their review of a bank statement needs to be reasonable. Licensees cannot be expected to be 'on notice' solely because they have received bank statements from their consumer. Such expectations also need to be scalable based on the relevant licensee and the function they are performing (i.e. credit assistance vs. credit provider).

26. Although conceptually, we agree with ASIC's commentary in paragraphs 20-23 regarding 'New kinds of verifying information', we do have concerns that ASIC may be treating all licensees as one group with the same access to information and resources. In paragraph 23, ASIC states "*we consider most licensees will generally be able to use such services to obtain more comprehensive information about the consumer's overall financial situation*". This statement is incorrect as banks have more advanced and available resources, databases, systems to conduct reference checks, fraud checks and access to OFAC, DFAAT and PEP, whereas finance brokers have far more limited resources for completing their verification process. As noted above, ASIC must ensure that the theme of scalability remains within RG 209 and acknowledges these differences between licensees.

C1Q2 Do you consider that the examples included in Appendix 1 are appropriate? Why or why not?

27. Yes, we believe the sources for verifying information included in Appendix 1 of CP309 are appropriate subject to taking into account scalability for different types of licensees.

C1Q3 Are there particular issues with using data aggregation services that you consider should be raised in our guidance? Please provide details of those issues, and information that you consider should be included in our guidance. For example, would it be useful to include specific guidance on matters the licensee could, or should, raise with the consumer before obtaining the consumer's consent to use this kind of service?

28. The main concern is around how safe and reputable these services are and whether the consumer will consent to providing access to third parties. Although the sentiment of consumers towards these services is slowly moving towards acceptance, there is still a large percentage that will not be willing to allow access. Otherwise, we see these services as valuable and where available at reasonable cost, utilised as part of a licensee's verification function.

C2.- Obtaining and having regard to all information in all readily available information

C2Q1 Do you consider that the proposed clarification of guidance on reasonable verification steps would be useful? Are there any other aspects of our guidance on verification that you consider would be useful?

Note; these proposals are:

- *If information is received (e.g. bank statements), the licensee is on notice of all information in those documents; and*
- *Licensees who decide not to obtain forms of readily available verifying information must be able to explain why it was not reasonable to obtain and review that information.*

29. The first proposal will considerably extend a licensee's workload and expose the licensee to unreasonable risk. Where obtaining a bank statement is required, it is unfair and unnecessary for licensees to be deemed on notice of everything in that statement. It also moves the standard from "reasonable inquiries and verification" to a full financial audit of the consumer's current affairs.

30. We also disagree with how the second proposal is worded. Again, this proposal is moving the standard unreasonably when it requires a licensee to justify why it was *not* reasonable to obtain the relevant information. From our perspective, we would be more comfortable with a requirement that the licensee explain why their approach was reasonable as opposed to obtaining the other readily available information.

C2Q2 Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?

31. See our response to C2Q1. It should focus on why the approach taken was reasonable for that particular situation. We have grave concerns with an "if not, why not" approach as that unreasonably shifts the burden of proof to the licensee.

C2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on *access to and cost of credit for consumers)?*

32. Over the past 12 months, we have observed an environment where lenders are requiring more enhanced due diligence from our brokers (and that differs from lender to lender for the same consumer/same product). The feedback we are receiving from our finance brokers and their consumers is that these enhanced due diligence practices recently applied by the industry are unnecessarily intrusive and have led to credit being harder to access (and when available, less credit is being provided). If anything, consumers and our finance brokers are supportive of current practices being relaxed, not increased.

33. We do not want to create an environment where consumers are unable to obtain credit they can afford without hardship. From our data, application and settlement flows in both the home loan and consumer finance space have slowed dramatically recently, with our brokers taking the view that the main cause of this slow down is the excessive tightening of credit conditions and the reduced availability of credit.

C2Q4 What additional business costs would be involved in this approach?

34. These requirements would increase business costs as a result of increased cost of obtaining and reviewing any more than 'standard' information. Many finance brokers are already struggling to maintain a commercially viable business. Any additional costs could lead to further closure of these finance broking businesses, which in turn will lead to an overall lessening of competition.

C2Q5 In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.

35. As mentioned above in our response to C2Q4, these requirements would add additional costs to a finance broker's business which may cause some to leave the industry as their business is no longer commercially viable. Finance brokers do not have the resources to complete with lenders (especially major banks) and any rules and requirements ASIC introduce must be sensitive to the negative impact on competition they may have. With 56.8% of home loans being arranged by finance brokers in the December 2018 quarter, this increased cost and possible departures from the industry can only negatively impact competition, which in turn hurts every consumer, not just those that utilise finance brokers.

C3. - Use of benchmarks

C3Q1 Do you consider that the proposed clarification of guidance about use of benchmarks would be useful? Why or why not?

36. Yes. For low and medium risk consumers/products, use of benchmarks should meet the standard of reasonable verification to sanity check declared discretionary living expenses.

37. Brokers have limited resources and reduced or no access to relevant information lenders (especially banks) have for completing the verification steps of a consumer's current expenses. Considering a broker is only performing a preliminary assessment, with the credit provider to complete a final assessment, the use of benchmarks for sanity checking discretionary living

expenses should be permitted for certain products/consumers.

C3Q2 Please provide information on what buffer amounts you currently apply or would otherwise consider to be reasonable.

38. Connective and its finance broker members do not use and/or apply buffer amounts as we are not a credit provider/lender. The ability for a consumer to service under a new credit contract will be subject to the credit criteria/assessment prescribed by the proposed lender.

39. From a serviceability perspective, we note that lenders apply at least a 200bps buffer on the applicable interest rate. Considering a consumer is likely to reduce their expenses upon assumption of new credit in order to avoid hardship, we believe no further buffer above the one applied on interest rate is necessary.

40. Considering your question from the opposite angle, we believe that any benchmark figure used should be a realistic figure based on a consumer's income range, number and age of dependants, geographic location and not just merely a 'minimum' monthly expenditure for the household. The benchmark figure should also consider any cultural impacts in a multicultural society, meaning the methodology underlying the benchmark calculation must consider the spending habits of those individual households.

C3Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

41. Any additional or more stringent assessment or check hurts the availability and speed of delivery of credit, which in turn, may adversely impact the consumer. In addition, the cost of doing business for licensees is likely to increase without any tangible increase in revenue. As mentioned above, our finance brokers are already experiencing a substantial increase in their cost of compliance over the past 12 months. Accordingly, we recommend that ASIC only recommend an audited review of discretionary expenses by licensees only in circumstances where absolutely necessary or appropriate for the relevant product and/or consumer.

42. From our perspective, the adverse impact on competition and the availability of credit to consumers will far outweigh any issues that may arise from an increased use of benchmarks in specific scenarios identified by ASIC (i.e. for checking declared living expenses in place of a full verification process). It has already been widely reported that the shift to a more detailed inquiry and verification into living expenses has caused consumer frustration, reduced the availability of credit, and introduced expensive and slow manual systems. This is an undesirable outcome for consumers and the industry generally.

43. Finally, there needs to be a strong appreciation that consumers' expenditures often change materially when they take on financial obligations, particularly home loans. Almost all borrowers understand their home loan repayment obligations and make such adjustments as are necessary to perform their home loans without hardship. From the list of expenses listed in paragraph 46 of CP309, we note that many of these expenses may change or entirely disappear if a new financial obligation, especially something as substantial as a home loan, is taken on.

C3Q4 What additional business costs would be involved in this approach?

44. No additional business costs would be involved in an increased use of benchmarks.

C4 – Consumer's requirements and objectives

C4Q1 Do you consider that the proposed clarification of guidance about understanding the consumer's requirements and objectives would be useful? Why or why not?

45. We agree with ASIC's proposals. We agree with ASIC's observations in paragraph 68 of CP309 that it would be good practice to give consumers a summary statement of the licensee's understanding of the consumer's requirements and objectives for confirmation of that understanding.

46. The mortgage broking industry is already working towards this goal. Connective would recommend a copy of the preliminary assessment (or something similar, such as the broker interview guide which has been developed by the Big 4 major banks in conjunction with other industry participations including Connective) be provided to the consumer as evidence of the licensee's understanding of their requirements and objectives. What is valuable in this approach is requiring the consumer to countersign that document evidencing they agree with the licensee's summary of their requirements and objectives.

C4Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

47. Connective sees this as promoting good lending practices by encouraging strong lines of communication and ensuring consumers and licensees are aligned when seeking credit.

48. This focus on responsible lending often forgets to appreciate that consumers should also engage in responsible borrowing. By presenting a document outlining what the licensee believes to be that consumer's requirements and objectives to that consumer, allows the consumer to either agree to that understanding or correct it before credit is sought.

49. We do not see any direct risks and/or costs with this approach.

C4Q3 What additional business costs would be involved in this approach?

50. Nil

D1 – Areas where responsible lending obligations do not apply.

D1Q1 Are there any forms of lending where the responsible lending obligations are being used by licensees in situations where the law does not require the responsible lending obligations in the National Credit Act to apply? Please describe the situations where this takes place.

51. Not to the best of our knowledge.

D1Q2 Are there any forms of small business lending where licensees are unsure about whether the responsible lending obligations in the National Credit Act apply? Please describe the situations which give rise to this uncertainty.

52. Not to the best of our knowledge.

D2 – Fraud risks and impact on responsible lending obligations

D2Q1 Would specific guidance about loan fraud and the impact on responsible lending obligations of the licensee be useful? Would guidance encourage broader improvements in processes for identifying fraud and reduce the risk of consumers entering unsuitable credit contracts as a result of fraud? Why or why not?

53. Guidance is always useful and appreciated as the financial services industry must have zero tolerance for information falsification. Licensees should always be reminded of the seriousness of this behavior, and the potentially serious consequences that may flow from this behavior.

D2Q2 Please provide details of any risk factors that you consider it would be useful to identify, and additional verifying steps you consider to be reasonable in those circumstances.

54. No comment. Ultimately, the obligation is for licensees to take reasonable steps to verify information provided about a consumer's financial situation utilising the tools and resources available to it.

D2Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

55. No comment.

D2Q4 What additional business costs would be involved in this approach?

56. We do not have any data on this at present. It goes without saying that licensees should have an appropriate fraud risk framework in place.

D3 – Use of repayment history information

D3Q1 Would guidance about use of negative repayment history information and hardship indicators reduce the risk that credit providers consider it necessary to refuse applications for further credit products that may in fact be affordable for the consumer? Why or why not?

57. No comment as we are not a credit provider.

D3Q2 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

58. No comment.

D3Q3 What additional business costs would be involved in this approach?

59. We do not hold information on this.

D4 – Records of inquiries and verification

D4Q1 Do you consider that guidance on industry best practice for recording the inquiries and verification steps that have been undertaken would be useful for licensees? Why or why not?

60. We believe most licensees keep good file records however guidance is always useful and appreciated. Connective requires its finance brokers who operate as credit representatives under its Australian Credit Licence maintain all of its files in our systems, and this it regularly audited for compliance to applicable laws and regulations.

D4Q2 Please provide any comments on the particular recording practices identified as 'best practice' by ASIC, and whether you consider those practices are generally appropriate for licensees.

61. We consider they are generally appropriate.

D4Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

62. No comment.

D4Q4 What additional business costs would be involved in this approach?

63. Nil

D5-Content of written assessment

D5Q1 Would it be useful for ASIC to provide an example of a written assessment to illustrate the level of information that we think should be included? Why or why not?

64. Guidance is always useful and appreciated.

65. We understand this question is directed at the form of written assessment provided to consumers. Under law, this document (being the 'Preliminary Assessment') is required to be prepared and completed by the relevant finance broker as evidence of the loan being not unsuitable and a statement of the time for which the assessment is valid (usually 90 or 120 days). We are supportive of this document, or one that contains similar content, being provided to the consumer.

D5Q2 Please provide any comments on the example set out in Appendix 2.

66. Connective's current version of the 'Preliminary Assessment' document which it mandates its credit representatives complete on all of their loan files already includes these items. Accordingly, we have no comments.

D5Q3 What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?

67. Not applicable

D5Q4 What additional business costs would be involved in this approach?

68. Nil as this process is already happening.

Connective greatly appreciates ASIC's efforts in broadly consulting with the industry prior to making any updates to RG 209. It is absolutely critical that the industry understands the regulator's expectations in this space. We hope that whatever update ASIC produces will also drive standardization in the approach of credit providers which in turn will lead to improved consumer outcomes (appropriate credit made available to the right consumers in an efficient manner) and continued promotion of competition.

Connective is happy to make itself available if ASIC have any queries or wish to consult with us further.

Yours faithfully

Daniel Oh
Group Legal Counsel
Connective