Mortgage Choice

MORTGAGE CHOICE LIMITED

SUBMISSION TO AUSTRALAN SECURITIES & INVESTMENTS COMMISSION

CONSULTATION PAPER 309 - UPDATE TO RG 209: CREDIT LICENSING:

RESPONSIBLE LENDING CONDUCT

Executive Summary

Mortgage Choice Limited (ACN 009 161 979) is a provider of credit assistance services, operating as a franchisor of mortgage broking businesses under Australian Credit Licence 382869. As at 31 March 2019, the franchise network comprised 397 franchises, located in all States and Territories, with 559 brokers registered as Credit Representatives under Mortgage Choice's credit licence. The company was founded in 1992 and listed on the Australian Stock Exchange in 2004. It is a member of the Mortgage and Finance Association of Australia (MFAA) and the Combined Industry Forum (CIF). Its lender panel comprised 33 credit providers at 31 March 2019, across residential, asset, personal and commercial finance.

Mortgage Choice considers that enhancements to the policies detailed in RG 209 are highly desirable to improve the efficiency of the consumer credit sector, provide certainty to credit licence holders, improve consumer (borrower) protection outcomes and deliver a reduced risk environment to the entire consumer credit industry.

While acknowledging that principles-based guidance does provide a degree of flexibility and a capacity for licensees to adopt practices relevant to their specific businesses, the degree of variation throughout the industry in terms of meeting responsible lending obligations has resulted in a significant level of uncertainty, confusion and frustration. We submit that many of these outcomes can be remedied by adoption of more prescriptive guidance, with application of specific and unequivocal minimum standards that must be met by all licensees, irrespective of their business activities.

Mortgage Choice submits that it is appropriate for ASIC to provide greater guidance in relation to the following aspects:

- Minimum inquiry and verification steps to be completed by licensees in respect of credit application assessments.
- Fundamental aspects that require consideration in all instances of credit application.
- Minimum standards of verification evidence.
- Classification of living expenses and how these are assessed.
- Consideration and assessment of borrower objectives and requirements.
- Format and contents of assessment detail document.

Note that this paper does not respond to every question included in CP309. Where no specific response is provided, Mortgage Choice has no particular comment to make.

SPECIFIC RESPONSES

PART B - REASONABLE INQUIRIES AND VERIFICATION STEPS

B1 Q1 - **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?**

We consider it would be highly beneficial if ASIC was to identify the inquiries and verification steps that it considers are necessary to be taken.

After nearly nine years of industry operation under the terms of the *National Consumer Credit Protection Act 2009* (NCCP), there remains considerable uncertainty within the credit industry in respect of what steps need to be taken in order to adequately determine and verify an applicant's financial position. This has resulted in a wide variation in standards applied by licence holders and a resulting lack of clarity in respect of what is appropriate practice. Faced with that lack of guidance, credit assistance providers, in particular, cannot be wholly confident that their practices are adequate, given the disparity between some credit providers' standards and practices.

We submit that there should be clearly defined minimum standards of fundamental inquiry and verification that apply universally across all credit and credit assistance providers. Essentially, all licensees should be adopting the same minimum standards, as the legislation is equally applicable to all. This approach does not prevent any licensee adopting higher standards if it so desires.

B1 Q2 - **If there are particular examples of industry practice that you consider should be reflected in any guidance, please provide details of those practices.**

An example of industry practice that requires guidance is the verification of a credit applicant's current liabilities and financial commitments e.g. existing mortgage loans, personal loans, credit cards etc. Across the current Mortgage Choice Lender Panel, a number of lenders (including some of the "Big Four") do not require the applicant to provide evidence of these facilities, essentially accepting the applicant at their word. While the argument may well be that accessing the applicant's credit history file can provide that verification, that approach is not conclusive, remembering too that access to credit history files is not always open to brokers.

We would suggest that application of a clear expectation that licensees must verify all current credit facilities by way of written evidence issued by the credit provider (where the facility is not held with the licensee to which a new credit application is being submitted) is an example of where minimum standard guidance needs to be provided by ASIC.

B1 Q3 - **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.**

We would suggest that the fundamental elements of responsible lending should apply universally across all types of consumer credit.

Nevertheless, we are willing to accept the view that some forms of credit products, as a general rule, carry an inherently lower level of risk in relation to an outcome of substantial financial hardship e.g. credit cards with credit limits below what would be considered significant. In such circumstances, it may be justified to adopt a reduced level of inquiry and verification, compared to that applying to mortgage loan products.

B1 Q4 - **In your view, what aspects of the consumer's financial situation should 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.**

We suggest that a licensee needs to inquire about the following aspects of a credit applicant's financial situation in all circumstances:

- Current income from all sources;
- Future income relevant to the purpose of the credit application e.g. rental income;
- Current liabilities and financial commitments;
- Current dependents (if any);
- Living expenses post settlement of the credit sought;
- Foreseeable changes to the financial situation.

B1 Q5 - **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.**

We suggest that the following aspects of an applicant's financial situation should require verification by a licensee:

- Current and future income required to demonstrate servicing capacity for the proposed new credit;
- Current liabilities and financial commitments (e.g. rent);
- Living expenses (current and likely future);
- Where relevant, evidence pertinent to the foreseeable changes e.g. availability of parental leave and the income to be received during that period.

We suggest that there need be no specific requirement to verify the number of stated current dependents as provision of such evidence would be onerous on many applicants and likely unduly delay the application approval process.

B1 Q6 - **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?**

It may be that, if mandatory inquiry and verification steps were adopted by ASIC, the process of obtaining credit would be more complex for consumers than currently exists, particularly for non-mortgage credit e.g. personal loans, credit cards. This may result in increased inconvenience for the consumer, if a more rigourous assessment process results in a longer application assessment time.

B1 Q7 - **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.**

Implementation of additional inquiry and verification steps, if a licensee is not already applying those steps in its existing processes, may impose additional business costs for the licensee. Most likely the major costs would be those required to reconfigure software to include additional data points and store increased levels of verification records. Additional staff costs may also result if the additional steps impose a work load that cannot be adequately processed by existing teams within expected turnaround times.

B1 Q8 - **In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.**

We submit that the adoption of more specific guidelines would have a positive effect on competition, in that it would negate any advantage currently enjoyed by licensees that have not adopted appropriate responsible lending standards. There should be no competitive advantage inherent in compliance, so any initiative that creates a level playing field and brings all licensees into line can only be a worthwhile outcome for the industry.

We note the comments on page 9 section 11 in respect of minimum requirements. We agree with the benefits noted within that section and suggest they are both highly desirable and necessary for the industry. While the imposition of minimum standards may result in the removal of some flexibility, as noted in section 12 following, we suggest that, in consideration of how fundamental responsible lending standards should apply to the finance industry, the effect on flexibility is of relatively little consequence. The primary factor for determination should be how do the regulator and industry ensure that licensees are applying responsible lending appropriately when considering credit applications? Yes, this may result in certain businesses incurring increased compliance costs, however it is arguable that such businesses should have been following the minimum steps from the outset of NCCP anyway.

The further comment in section 12 that minimum standards may result in *less scrupulous licensees* ignoring other relevant issues and following only the specific inquiries is possibly valid, although we make the observation that the vast majority of licensees, in most instances, adopt practices that reflect their assessment of what minimum steps it needs to apply to meet responsible lending expectations i.e. no one consistently seeks to do more than it considers it has to. The acknowledged challenge for ASIC in determining minimum standards for the industry is to set minimum standards that would, if these were the sole inquiries followed, provide an adequate level of protection for all consumers in all instances. It would always be open for a licensee to adopt higher standards than the prescribed minimum if it so desired.

PART C - UPDATING OR CLARIFICATION OF CURRENT GUIDANCE

Mortgage Choice strongly supports the proposal noted under C1 (page 11) in relation to provision of greater guidance in respect of the kinds of information that could be used for consumer financial situation verification.

Verification of consumer's financial situation

C1 Q1 - **Please provide details of any particular types of information that you consider should be reflected in the guidance as being appropriate and readily available form of verification.**

Attached is the *Customer Financial Position Verification Standards and Recommended Best Practice* document adopted by MFAA. We suggest that this document should form the basis for any guidance provided by ASIC. Ideally, it would be adopted as a uniform industry minimum standard.

It is common, but not universal, practice for credit assistance providers to access credit applicant credit history reports. Once the applicant has provided consent for such inquiry to be made, it is the practice of many credit assistance providers to obtain a copy of the applicant's credit history file. While a useful and often essential step in the process of completing a preliminary assessment, it does impose a cost on the credit assistance provider and this impact would need to be considered if ASIC is contemplating making it a mandatory inquiry. It is arguable that the advent of comprehensive credit reporting and open banking, and the level of data that these will provide, effectively results in an unavoidable need for credit assistance providers to obtain an applicant's credit history file. That being said, the varying potential logistical challenges which different forms of data access may pose, and who meets the costs of these, are factors that would require further consideration.

We agree that any guidance provided by ASIC is appropriately framed on the understanding that contemporary views of what constitutes *reasonable steps* will necessarily change over time as new verification options become available and widely accepted.

C2 Q1 - **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?**

We suggest that the industry would welcome provision of more detailed guidance in respect of what constitutes reasonable verification steps, as this remains an area of considerable uncertainly and debate across the industry. Certainly, confirmation that it is expected of licensees to investigate and verify customer information that is questionable or unclear, based on the evidence available is, we suggest, appropriate. In those circumstances where customer information is inconsistent between sources e.g. pay advices indicate a certain level of income but bank account statements indicate a different amount, it should be made clear that, in such circumstances, the licensee is obliged to carry out further verification steps in order to confirm the true position.

C2 Q2 - **Would an 'if not, why not' approach encourage improvements to current verification practices? Why or why not?**

We suggest that a licensee that does not obtain an appropriate form of verifying information or evidence, as per the designated minimum standard, in any given instance, should be required to explain why it did not comply with the standard. Introduction of such a requirement would likely result in an improvement to current verification standards, as licensees would be required to justify any variant behaviour i.e. there would need to be a legitimate reason for any deviation from the minimum standard. Such reason would be subjective and be open to external scrutiny, which may result in additional uncertainty.

C2 Q3 - **What are the benefits, risks and costs for consumers in this approach (including any effect on access to and cost of credit for consumers)?**

The need for licensees to undertake possibly more detailed levels of verification may result in a more protracted credit application process, with an associated need to provide greater levels of evidentiary documentation requiring the consumer to provide more material as part of their application. A greater level of customer data scrutiny may result in an increase in the rate of application refusals, however this is in the best interest of consumers if they do not legitimately qualify for credit.

C2 Q4 - **What additional business costs would be involved in this approach?**

A need to undertake increased levels of verification may result in greater costs for some licensees, as staffing resources required to meet those standards may need to be increased. There would be minimal additional cost to Mortgage Choice as we currently apply a rigorous verification standard. Additional costs may be incurred if disclosed data needs to be challenged and rectified due to identified discrepancies and perceived errors.

C2 Q5 - **In your view, what would be the effect (either positive or negative) on competition between licensees? Please provide details.**

As noted previously, there should be no competitive advantage inherent in adopting compliance policies. If all entities are working to the same standards, any potential advantages a licensee may enjoy due to adopting a comparatively lower verification standard than what is regarded as appropriate should not be allowed to continue.

We endorse the principles noted in section 27 (page 14).

Use of benchmarks

We agree with the comments included in sections 52 (page 20) and 54 (pp 20-21). We would go further in suggesting that the discussion and debate about the use of benchmarks would become, for the most part, largely academic if it was made clear that the verification standards applied equally to an applicant's *actual* living expenses i.e. licensees need to make reasonable inquires about the applicant's living expenses and take reasonable steps to verify those stated expenses. That means seeking appropriate evidence to confirm the figures provided.

If the applicant's actual, verified expenses are used for assessment purposes, it is arguable that HEM (or any other benchmark) has minimal relevance. Whatever benchmark is used, there will be people who sit above or below it. An applicant's actual, verified income and financial commitments are used in determining their servicing capacity, so why should not their actual, verified expenses be similarly included? That aside, we concede that HEM or similar benchmarks may have practical beneficial use as a reference point for assessing the validity of verified expense figures.

We suggest that if ASIC was to provide guidance to the effect that licensees are expected to ascertain and verify applicants' actual living expenses, this would remove much of the uncertainty and debate within this area. The commentary in section 55 (page 21) that there exists a higher risk of consumers entering into unsuitable credit contracts where licensees rely on comparison to benchmark figures, rather than using positive verification would indicate endorsement of our view that such a risk would be significantly reduced by introduction of a mandatory obligation to actively verify consumers' actual expenses. Further, the concerns apparently reflected in section 59 (page 21) that *Licensees should take steps to limit the risk that the expense figure used understates the consumer's actual expenses* would be actively addressed by a verification requirement for licensees.

We take this opportunity to provide some additional views in respect of living expenses categorisation, an area where we suggest that provision of guidance from ASIC would be valuable in achieving a reduction in the level of uncertainty and variable practice that exists within the industry. We propose that a realignment of thinking in relation to living expenses is now appropriate, with the element of consumer personal responsibility factored into considerations.

We propose that expenses be assigned to two fundamental descriptive headings: Essential and Non-Essential Lifestyle (or whatever titles are thought appropriate).

Essential - those costs that are effectively unavoidable for basic existence and (if applicable) owning real estate e.g. groceries, clothing and personal care, medical and health, childcare (assuming children), education (assuming children/dependants), telecommunications, transport, insurance, property costs (including utilities).

Non-Essential Lifestyle - avoidable costs that are fundamentally recreation and entertainment expenditure e.g. dining out, alcoholic beverages, tobacco, gaming, vacations, theatre, cinema, sports, pets, media streaming, other entertainment, travel etc.

The difference between the expenses in the two categories comes down to an assessment of the expenditure item. If it could be reduced or eliminated with no threat to the core day-to-day standard of living for the consumer, we would suggest that it be included in the latter category. If the assessment is that the consumer's current non-essential expenses are such that they would not be able to service the proposed credit without substantial hardship unless the expenses were reduced or removed, it would be appropriate for the consumer to acknowledge their need to reduce their expenditure by an appropriate amount prior to the finance being approved. This approach places the onus upon the consumer to modify their lifestyle appropriately; any failure on their part to do so which leads to subsequent difficulties in servicing the finance could not then be assigned to any licensee as a deficient application of responsible lending requirements.

Overall, we advocate for a greater level of personal responsibility being assumed by consumers for borrowing decisions, provided they have received sufficiently detailed information prior to committing to new finance.

Consumer's requirements and objectives

C4 Q1 - **Do you consider that the proposed clarification of guidance about understanding the consumer's requirements and objectives would be useful? Why or why not?**

We consider that provision of guidance about understanding the consumer's requirements and objectives would be useful. To date, there exists a lack of clarity in relation to the extent which borrowing objectives need to be ascertained and confirmed, especially since many borrowers hold no objectives further than an expressed desire to borrow sufficient funds to complete their stated purpose e.g. I wish to buy that specific property and need to get a loan to help me do so. We suggest that some indication in respect of the depth of objectives analysis deemed appropriate would have beneficial outcomes.

<u>Specific considerations</u>

- Borrower's fundamental borrowing objective/s i.e. why do they wish to obtain finance and what do they aim to achieve with the funds?
- Borrower's objective/s in relation to the on-going operation and servicing of the loan account/s or facility. Note that responses provided by borrowers in respect of these aspects may be of limited value, depending upon the sophistication and aspirations of the borrower and their capacity to consider longer term outcomes.
- What lender and loan product features will provide the outcome/s to meet the borrower's objective/s and thereby become borrowing requirements?

- Does the proposed credit product/s carry the relevant features to align with the requirements?

The rationale commentary included in sections 62-68 is reasonable and largely appropriate.

PART D - ADDITIONAL GUIDANCE ON SPECIFIC ISSUES

Fraud Risks and impact on responsible lending obligations

D2 Q1 - **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?**

Any guidance that ASIC can provide in this area would be of value as it is an important aspect of required vigilance of which brokers need to be acutely aware. Less experienced brokers may not be as attuned to the risks of fraud perpetration as more experienced licensees are, so availability of assistance in detailing what factors warrant additional attention and scrutiny would be useful to many licensees.

D2 Q2 - **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.**

We are unclear of the relevance of detailed consideration of fraud risk factors in relation to responsible lending standards and practices.

D2 Q4 - **What additional business costs would be involved in this approach?**

Additional verification steps or procedures may add to the overall cost of credit assessment for all applications and result in delays in obtaining credit approval for consumers.

Records of inquiries and verification

D4 Q1 - **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?**

The importance of establishing and maintaining diligent and appropriate record keeping practices cannot be understated and certainly our Credit Representatives have historically been encouraged and trained to adopt thorough record keeping processes. Despite this, consistency and uniformity are difficult to achieve when dealing with multiple individuals and separate businesses. Any guidance that ASIC can provide in respect of what it regards to be best (and thereby recommended) practice would be of considerable value in ensuring that our recommended steps are aligned with what is deemed to be appropriate behaviour.

Content of a written assessment

D5 Q1 - **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?**

We consider that provision by ASIC of what it considers to be an appropriately detailed assessment detail document would be desirable. This would ensure that licensees are providing sufficiently comprehensive information to consumers and, in doing so, are adopting and recording the outcomes of sufficiently robust verification processes.

D5 Q2 - **Please provide any comments on the example set out in Appendix 2.**

We would consider that the content of the proposed example set out in Appendix 2 is appropriate.

Mortgage Choice Limited
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