HATCH FINANCIAL SERVICES RESPONSE TO THE DRAFT REGULATORY GUIDE AND CONSULTATION PAPER 327: Implementing the Royal Commission recommendations: Mortgage Brokers and the best interests' duty

General Comments

I am strongly of the view that the majority of brokers currently deliver a service that broadly speaking prioritises the Best Interests of clients. Further, these brokers have always acted accordingly. Accordingly, the impact of the recent legislation and these Guidance Notes will not so much be around the outcomes arrived at (which lender or loan is applied for) but rather the intermediate steps where the broker will need to demonstrate (document) to the client, the lender, and the regulator that they have acted accordingly.

If executed well, a broker in documenting how they are acting in a client's best interests will raise the level of the service they provide, and in the process better educating and informing their customers of the reasons for recommendations and considerations when making decisions.

BUT as a broker I have a few concerns about the impact of the Guidance Notes, including:

1. Brokers, fearful of falling foul of the Best Interest duty will focus first and foremost on ensuring that they are legally covered against any claim that they acted contrary to the duty. In doing so they provide lengthy written advice couched in a way so as to provide legal coverage from retrospective review more than anything else. In the process the advice becomes lengthy and likely to result in consumers taking in less information rather than more. The outcome could be totally counterproductive. It will see a repeat of what has happened in the financial planning space…Statements of Advice that at long and which consumers rarely read fully. But it would be hard to blame brokers from heading down this path given we sit between banks with deep pockets, and the will to avoid responsibility for their own failings, and consumers who are viewed as being incapable of being accountable for their own decisions, whose interests are represented by Consumer groups who view brokers as evil.

2. The simplification of the advice process by placing cost as the primary determinant of Best Interests and in the process failing to understand the array of factors that come into play. I acknowledge that defining how to assess whether a broker has acted in a consumers' best interests is a difficult task. But focusing on cost produces black and white result and there are a range of non-quantitative factors that play a big role in decisions on lenders/loans.

   For the majority of consumers, so long as the loan they are taking is about the mark cost-wise they are more focused on other considerations. So I believe these factors are at least as important as cost. So relegating these factors behind the cost of the loan distorts the reality of lending from both the consumer and broker perspective.

   I am not saying cost is not an important consideration, only that it is not black and white and that the best interest duty as set out in the Guidelines does not allow for a correct balancing of factors. Factors that are not adequately reflected in the Regulatory Guidance include:

a) Materiality – How much difference in cost between products raises the need to justify the recommendation of the more costly loan over the cheaper loan? If a product is $1 more expensive does that mean that prima facie the broker has not acted in the consumers' best interest without a strong justification? Or is that amount $100? $1,000? $10,000? And over what time frame?

b) Time – whilst the Guidance is clear that the relevant time for assessing best interest is the time at which the recommendation is being made, what is not clear is whether you view products over their full life (generally 25 or 30 years) or a shorter time frame. The importance of this cannot be overlooked given most loans are refinanced every 3-7 years. The assessment can look very different depending over what duration you assess best interest.

c) Consumers are not rational beings - No 2 consumers have the same needs or wants and many of the decisions they make are driven by emotion over logic. Some would argue that such decisions are flawed as they are illogical. In some way this may be right but in equal part it is the right of the consumer to make decisions for themselves, whether they conform to what others would consider logical or not.

> Example: A client is buying a home and needs a loan for $800,000. A broker shows them several loans of the type they want. The interest rates differ and with Bank A the loan is $1,500 pa cheaper than with Bank B. The client has banked with Bank B for 15 years so wants to take the loan with that bank as they don't want the "hassle" of moving - despite the saving they are giving up.

d) The challenge to get finance – Before cost is a consideration, there is a more important question; Can the consumer get a loan? This is increasingly the dominant question as more and more scenarios either sit outside standard credit policy or what lenders are prepared to consider. In that context, the priority is to be able to find a solution. If a broker can do that through skill and relationship with a particular lender that is a good outcome for the consumer. Considerable time and effort may go into getting a lender to support a deal, but it would seem a broker cannot rely on that to feel safe that they have fulfilled their Best Interest duty. It would seem brokers would need to go approach all lenders that offer a similar product at a cheaper cost to find out if they would approve the loan. As much as anything this ignores a reality that I often experience where lenders (especially the Big 4 banks) respond to a scenario that the consumer needs to submit an application to find out if the bank will lend.

e) Relationship with a lender – It is the relationships that brokers develop with lenders that often allow them to achieve a large number of positive outcomes for their clients, including workshopping deals to increase the likelihood of approval, meet time frames for approval or settlement. It is a relevant factor that ought to be part of the mix. This helps brokers work in clients' best interests.

f) Reliability of lenders in decision making and service – Customers and brokers really value reliability in decision making. If a client and broker are going to prepare and submit a loan application, they need to have confidence that it will be approved and that this will happen in a timely, efficient manner. Getting a decline helps no-one, getting asked for documents and information that have already been provided makes clients and brokers angry, an approval 2 day after the auction has been held for the property the client wanted to buy is no good, post settlement service that fails a client only destroys consumers' confidence in the lender and hurts the relationship with the broker too. The ANZ CEO recently acknowledged this was a key factor in its loss of lending business as it was not delivering a reliable service (whereas brokers were). The brokers ability to find lenders that deliver this ought to be a relevant consideration. How would you have a broker document a consideration that is real but not necessarily quantifiable.

In summary, I believe that the Best Interest Guidelines do not sufficiently take into account the non-quantitative factors that go into selecting a lender/product and in some places expressly state that such factors are not relevant, which is contrary to the best interests of consumers.

Following are comments in relation to specific questions in the Consultation Paper:

B1Q1

In structuring guidance around the process, a likely outcome is that brokers will seek to create documentation that as best as possible covers themselves against future review or claims. The result of that process will be a document or documentation that is overly long and will likely result in marginal improvement in the education or understanding of clients as faced with pages of information to digest consumers will likely digest little. It will be "Financial Planning SOA version 2.0".

B2Q2

The concept of materiality is not mentioned at all. The draft guidance is clear that the first priority in meeting the "best interests" threshold is cost but no guidance is provided beyond that as to the materiality of a cost differential. Is it as simple a loan that is $1 cheaper is prima facie in a client's best interest in the absence of any other factor? Or is that amount $100? $1,000? $10,000? Tied into this consideration is that of time.

Whilst cost is important from my experience only in a small number of cases are customers focused on cost to the exclusion of all else. For the large part, conusmers' will readily use a lender that is not the cheapest but falls within an acceptable range of the lowest cost option.

Another consideration is, do we judge cost benefits over 3 years or 30 years. Client circumstance and objectives are relevant here but statistics show that most loans are refinanced every 3-8 years (no matter the cleints' original objectives) so even though a client is likely to take 25+ years to pay off a loan is that really the term we ought to consider in assessing best interest

B4Q1

I do not clearly understand what is meant by the term "holistically". Elsewhere I read that brokers ought to advise about credit cards if they are recommending products that provide these. I note for your reference a few points:

- I have never had a lender provide any training on its credit card products even though taking up a credit card has in many cased been mandatory
- Most, but not all, lenders now offer credit cards as option extras in packages, I am unclear as to the extent of advice that ASIC suggests brokers ought to supply. As a rule, I do not advise clients about credit cards, I offer credit cards on a “no advice” basis except to the extent that the client might have a propensity to run up credit card debt in which case I counsel against taking up additional credit card limits.

B5Q1 & Q2

I do not agree that cost should be prioritised when considering best interests.

The threshold (primary) questions are: Can we & should we be getting finance for the customer? Which lenders will likely extend credit to the customer?

Secondary question: Of those lenders that might lend, which are likely to do this comfortably (that is, they will understand the scenario and see the merits of the application with minimum need to push or fight the lender into doing the deal.) And looking at these lenders/products what is the client sacrificing/losing compared to the market as a whole by going this route compared to if we battle a less willing lender.

Third question: Looking at clients’ needs & wants which lenders/products suit?

Cost comes into play through the second and third phase but is only one of the factors to consider (see B5Q3).

When cost does come into play the Guidance Notes are silent as to matters of materiality. How much of a difference in cost is material enough to be relevant? Is it an absolute threshold?

Focusing on cost is easy (by and large) as the answer is always a number and therefore black and white BUT the rise of the broker is due to the fact that lending is not black and white, nor are customers, and brokers realise this and respond accordingly.

See also comments on RG000.52, RG000.53

B5Q3

Factors relevant to consumers best interest that Guidance Notes ought to discuss:

What the customer wants – Giving the customer what they want is the starting and end point of customer service. The Guidance Notes are an attempt to define this, but customers aren’t alike. The Guidance Notes as written do not seem to provide enough flexibility to allow for this.

Lender – The draft guidance focuses on what product is in the clients’ best interest but in getting a home loan, a consumer selects not just a product by a provider. One aspect of this I have addressed at B5Q1 (which lenders will extend credit to a client). There are several other aspects to this:

1. Increasingly consumers are clearly stating their desire to use lenders that meet non-financial goals they have, such as **not harming the planet.** Sometimes clients will be prepared to pay a higher rate if the lender selected is seen as ethical, responsible, green etc

2. The flip side of consumers being attracted to using certain lenders is that consumers don't want to deal with certain lenders either due to personal experience, perceptions of the brand or their own risk profile (eg a consumer who only wants to bank with a Big 4 lender "as they are safer")
3. Customer attitude/need: Does the customer need/want branch access? Do they want a quick and easy loan process more than the cheapest loan
4. Reliability in decision making – The ANZ CEO recently acknowledged that consumers were using brokers as brokers provided a variety of lenders and therefore could provide options that delivered greater certainty of outcome in relation to loan applications AND customers valued this. This is a relevant consideration for brokers and clients in selecting lenders and as such ought to be part of the Best Interest assessment.
5. Timeliness – this is touched on in the Guidance Notes but time constraints are a real consideration. Some lenders can decision an application in 24 hours and other in 24 days. The latter might be cheaper or offering cash incentives to customers but if a client needs to go to an auction in a week only one lender can help the customer (unless the broker has some very strong relationships with the second lender)

Broker service -The ability of consumers to use the services of a broker is a consideration in determining if a product is in the consumers best interests. There are a number of lenders who will not deal with brokers. Every week I meet consumers prepared to pay a premium in terms of loan cost to avail themselves of the services of a broker rather than self-directing.

<u>**Relationships** with lenders. I note that elsewhere it is stated that…… This view overlooks the key role that relationships play in brokers helping consumers get loans that are otherwise not being approved elsewhere. A surprising number of deals we submit to lenders sits outside of the 4 walls of lenders credit policies. The approach of some lenders (most notably the Big 4 lenders) to how they will assess such a deal is along the lines of "you will have to submit the deal and see". Following such a course of action is in the lenders interest – not the consumer.</u>

Lenders that will workshop scenarios, taking the key issue to their credit team for consideration and even issue a clear sign off on the key question/matter are vital to brokers delivering great outcomes for consumers. This approach saves consumers time, protects their credit records, provides greater certainty and removes stress for the consumer. The ability of a broker to develop the key relationships across a number of banks that allow them to deliver this type of service and outcome for consumers.

The lenders offering this type of service to our business at present are also offering competitive rates (often cheaper than rates offered by the largest lenders) but even if this was not the case, a slightly higher rate is justifiable for the ability to get finance with greater ease, speed and service.

Para 42 & 56

Here it states that if a broker cannot act in the consumers best interests then they must not provide assistance and that the broker must satisfy themselves that recommending from within their panel is in the consumers' best interests. If you couple these together and also the focus in the Regulatory Guidance on lowest cost, then it seems that if the broker cannot provide the lowest cost option then they cannot write a loan for a client. That would be an absurd outcome given; some lenders will not accredit brokers, and also that brokers cannot know the credit policies of lenders they do not have access to (and therefore cannot assess if a loan with that lender is possible for the consumer)

B6Q2

The form we use varies widely, from verbal discussion, to written advice over 2-3 pages and with other modes that sit in between these 2. Our advice at its most complex still follows a very simple form. After reviewing the draft guidance I envisage that future advice would likely need to start at no less than 3 pages and would consistently be between 7-15 pages so that I can be confident that were the file ever reviewed it would be clear that I have acted in the client's best interests. I do not believe that the outcome for consumer would be materially better. Most certainly the process will be slower due to the need to spend more time documenting the process and the advice provided.

B6Q3

Our business is built around the education we provide clients, but it is the need to document every bit of explanation and education to establish that we have acted in a clients' best interest that is alarming

B6Q4

I would only present a product where I was confident that the lender would lend to my client. Certainty of outcome is vital to my reputation and to meeting my clients' expectations of a smooth, efficient service that gets a positive result.

So where a client's scenario is outside standard credit policy and our experience tells us that the overwhelming majority of lenders would not consider the scenario or would take too long to consider the scenario and still might not be willing to lend I will focus on the one solution and explain why

The same is true where speed is of the essence. If you miss settlement because lenders are slow it costs the consumer and damages the brokers reputation.

B6Q5

If a broker has explained why they recommend a product but a consumer wishes to proceed with another, then short of the client being impaired, or the broker needing to breach responsible lending rules to provide the product desired by the consumer, giving the consumer what they wants is reasonable and appropriate.

B8Q1

Most brokers have some awareness of lenders beyond their panel but there are hundreds of lenders and thousands of products and rates so what are you suggesting when you say brokers ought to consider products provided by parties beyond their panel?

Holding my own ACL I have the ability seek accreditations with lenders beyond my panel. I have 2 lenders I am accredited with beyond my aggregator panel Credit Reps cannot do this. Yet lenders seem keen to force ACL holders to become Credit Reps of their aggregator and some lenders will not accredit brokers to work with them.

So it is not overly realistic to expect brokers to consider lenders/products beyond their panel overall.

B8Q2

Our Aggregators' software shows product information for all lenders accredited on its panel – regardless of whether I am accredited with them.

B10Q1

My best understanding of a customers' needs as matched up with the lenders I am accredited with or can become accredited with (I have a direct accreditation with Bank Australia even though my aggregator has no relationship with the lender as I hold my own ACL and I identified that this lender occupied a niche that clients wanted to access.)

Cost is a consideration but so long as the options I offer are within an acceptable range (up to around 0.25%) other factors are more important, such as speed of turnaround, likelihood of approval, confidence in the decision making process, customer service for client and broker, specific product features.

B10Q2

We present between 1-5 options. That might be a comparison of 2 or more packages or a comparison of a package with a basic loan or other loan type. The number of options depends on the client; how clear they are as to what they want, do they want to be in control of the information and make the decision, or, does too much information confuse them and they simply want a strong recommendation as to how to proceed

B11Q1

Customers seek guidance on every aspect of the transaction once they trust their broker. This can include seeking advice on; how to go about buying a property (buying property at auctions, offers before or after auction etc) dealing with a real estate agent, building inspections, conveyancing, financial planning type questions, wills/estate questions.

Para 71 (a)

This is no longer a consideration as commissions are paid on the drawn down loan amount (net of offset etc)

Para 71 (b)

I have no idea which lenders pays me the most or 2 reasons:

1. The commissions paid across the majority of lenders fall in such a narrow band that the differences are largely immaterial.

2. Without knowing how long a loan will be in place for and how quickly it will be paid off it is not possible to know which lender will pay more as generally lenders who pay more upfront, offer less trail and vice versa. What I do know is that the more I do the right thing by a client the more referrals I get and that is worth far more to me.

B9Q1

Yes

B9Q2

Again, the question of timeliness. When does an initial assessment become “out of date”? A material change in circumstances or scenario would be an obvious example of when a re-assessment is needed. The draft guidance mentions a change in rates (para 59) but the materiality of this change is not discussed and there is not guidance generally on this matter

NOTES DIRECTLY ON THE REGULATORY GUIDANCE:

RG000.48 & RG000.49 & RG 000.103 - If cost ought to be prioritised, then if a broker is not accredited with a lender offering a cheaper product does this mean a client ought to decline to help the client? What if the lender does not allow brokers to act on behalf of customers with it? See my comments in relation to Para 56 of the Guidance Notes.

RG000.50 – Lowest cost is not an absolute. My experience is that whilst some clients are only driven by cost and are looking for the absolute lowest cost loan, the majority of customers are not so driven. They seek a low-cost loan but so long as the loan recommended is within an acceptable range of the "cheapest" loan they focus on other considerations, product features, service, speed etc.

RG000.52 - Again, the focus on cost at the expense of factors that are key to clients' decision-making process is overly simplistic. See my comments on Consultation Paper 327 in total but specifically in relation to B5Q1, Q2 & Q3.

If the focus is on cost, ought a broker submit a pricing request to every lender with a suitable product to determine the absolute cheapest? At what point can a broker say, in my experience or based on my knowledge lender X, Y and Z will not offer competitive pricing or will not offer pricing sufficiently better than lenders A, B or C to warrant the need to spend the time chasing pricing with those lenders. If the consumer does not believe or accept this, they can always elect to not use the broker.

RG 000.53 - This provision is ultimately talking about cost and in doing so overlooks a whole host of other relevant factors

RG 000.65 - A broker's relationship with a lender is often what will allow the broker to work through whether a lender will do a deal or overcome an issue on a file that may otherwise result in the application being rejected. This is of significant value and yet it is hard to value. It is often the difference between being able to get a loan and achieve a goal an not being able to do so.

RG 000.68 - Time-sensitivity and lender turnaround times - How would this be sufficiently substantiated? Do you suggest brokers email lenders for this information and retain it on record to substantiate the matter? Lenders often advise that turnaround times are 2 days and then when you submit the deal you find out it is 6 days. How do we track and record this as part of the process?

RG 000.107 & 108, Examples 8 & 9 - If client asks broker to negotiate a lower rate with the existing lender but there are products out there that the broker offers with lower costs that would save the client money, how is it in the customers best interests if the broker does not consider these options and discuss this with the client – no matter what the outcome.