Loan Market™

4 October 2019

Manager
Financial Services Reform Taskforce
The Treasury
Langton Crescent
Parkes ACT 2600

By email: ConsumerCredit@treasury.gov.au

To whom it may concern,

We thank Treasury for the opportunity to provide a submission in response to the exposure draft of the National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 and associated draft regulations.

We welcome and support the Government's response to the Hayne Royal Commission recommendations. The purpose of this submission is to ensure that the proposed legislation and its implementation creates a framework to achieve the Government's ambition.

Loan Market Group is the largest 100% family-owned and operated (not bank-owned) mortgage brokerage, representing over 600 brokers across Australia. Loan Market mortgage brokers help over 23,000 customer secure loans every year.

Loan Market has worked closely with the Mortgage and Finance Association of Australia (MFAA) and the Combined Industry Forum (CIF) through various working groups and we broadly support their submission to Treasury.

We have concentrated our submission on specific areas for feedback to Treasury that we feel strongly about. It is our hope that Treasury will review our submission and we invite you to contact us directly for further clarification and or feedback.

The proposed changes we explore in our submission align with the overarching objective of improving customer outcomes.

We wish to continue to work constructively with all stakeholders - consumer groups, industry groups, lenders and regulators to ensure that the Government’s vision is translated into

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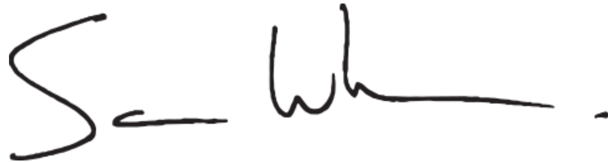
practical and valuable legislation that gives consumers increased confidence and continues to drive competition in this important sector for all Australians, regardless of how and from whom they choose to secure mortgage finance.

Kind Regards



Sam White
Executive Chairman
Loan Market Group

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Part 1 - Best Interests Duty

Regulation 158K - Mortgage brokers must act in the best interests of consumers when giving credit assistance in relation to credit contracts.

Overview

Loan Market Group welcomes the requirement for mortgage brokers to act in their client's best interests. We recognise that the government has adopted the Hayne recommendations that call for a 'principles' based approach rather than a 'prescription' based approach to the application of a Best Interests Duty.

Accepting this is the approach the Government has chosen, with approximately 17,000 mortgage brokers operating in Australia it will be important to communicate clearly and concisely how a mortgage broker can confidently meet this test and ensure that customers get the benefit of this legislation.

1.1 The need for clear and concise regulatory guidance

In practice, it is likely that the Best Interests Duty will be assessed in hindsight i.e. reviewed for audit purposes several months after the advice was provided or in the case of litigation arising from a client complaint, several years after the advice was provided.

Regulatory guidance on what mortgage brokers need to do from a process point of view including documentation, file notes, the depth of investigations into the client's financial capacity, the process around recommendation and disclosure etc. will provide a number of benefits:

- It will set a clear expectation for mortgage brokers in terms of what process they need to adopt as a minimum to be confident they have met the requirements, this includes the standard of file evidence required including file notes, information pertaining to recommendations, the recommendation process and disclosures, amongst other things This clarity will ensure more consumers benefit from this legislation immediately.

- It will enable the Australian Credit Licensee (ACL) to have a clearer view of what standards they can hold the mortgage broker accountable to and will assist in the development of technology, audit processes, training, monitoring and supervision to support them.

- The Australian Securities and Investments Commission (ASIC) will have a guideline to which they can assess mortgage brokers and ACL holders when reviewing

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performance and/or assessing client complaints.

- The Australian Financial Complaints Authority (AFCA) will be assessing files of a similar standard and it will make reviewing client complaints where there is a standard set of guidelines as to how a file should be presented.

- Of course this guidance can be updated and amended relatively easily as ASIC determines the effectiveness of the industry response and the impact this is having on improving customer outcomes.

We believe that it is paramount for the regulatory guidelines to address how ASIC will determine if brokers and licensees have met this duty. ASIC stated in its Report 628 that *"the home loan journey is complex, multifaceted and non-linear."* Imposing a Best Interests Duty on mortgage brokers who need to help clients navigate that journey without further detail creates, in our view, a duty which is subjective and ambiguous.

We are concerned that if this duty is not clarified through regulatory guidance it may produce the following adverse consequences:

1. **Decline in consumer access to credit**
   If there is ambiguity in the interpretation of the duty some may interpret it incorrectly. Those that interpret it more strictly than intended may reduce their exposure to complex clients with difficult scenarios. Those that interpret it too loosely will fail to meet the primary objective of improved customer outcomes. Clear regulatory guidance reduces the chance for parties to misinterpret the requirements.

2. **Reduce competition**
   Potentially cause some mortgage aggregators and mortgage brokers to reduce the size of their lending panel to a smaller number of lenders and so reduce competition within the mortgage market.

3. **Cause a fragmented market**
   Incentivise aggregators to move as many of their Credit Representatives as possible to operate under that brokerages own ACL, so reducing potential liability and uncertainty to the aggregator. This could lead to a fragmented market with potentially several thousand small ACLs moving to self-licensing making it harder for ASIC to review and monitor.

4. **Rising costs**
   Cause professional indemnity insurance premiums and compliance costs to rise more than they need to, creating more costs and complexity than is necessary.

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5. **Delay the benefit of the legislation**
   Require expensive and time consuming litigation to develop case law interpreting this legislation which means that for some time - until this litigation is complete - customers may not get the benefit of this legislation.

6. **Impact to small business operations**
   The people on whom this obligation falls are 17,000 small business owners who genuinely believe they operate in the client's best interest. Aggregators and lenders will need to deliver new systems in their technology platforms, new training programs and new audit and oversight processes to ensure that these small business owners are complying with the new duty. This is a significant task made all the more complicated if there is uncertainty as to what a broker needs to do to discharge this duty.

To be clear we will do whatever is required to comply with the law, we merely seek clarity on what the law requires and how it will be interpreted. Without guidelines our mortgage brokers are anxious about how their conduct today will be assessed in the future and on what basis this assessment will take place. This is particularly stressful given the magnitude of the penalties for non-compliance.

1.2 'Process' versus 'Outcomes' in meeting the client's best interests

A clearly defined process will assist all stakeholders in understanding what activities a mortgage broker should undertake in order to have a high level of confidence that they will meet their Best Interests Duty.

We recommend a working group of regulators, industry associations and experienced mortgage broking SMEs to work on a defined process with the goal to provide detailed regulatory guidance across each step in the mortgage broker to client process to set clear parameters around what conduct would satisfy the Best Interests Duty.

Work has already commenced in industry forums on a standard process *(refer process chain below)* where at each step in the process the activities of a mortgage broker has been detailed. This would be useful in assisting ASIC in drafting regulatory guidance attaching to this duty. The industry is ready and willing to provide this work to ASIC.

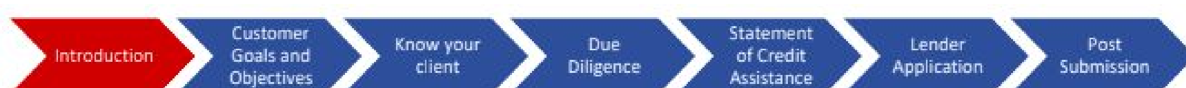

Image: Mortgage broker customer process chain

It is also important to note that an assessment on outcomes is flawed in specific circumstances and the mortgage broker should not be held accountable for outcomes where

a significant and unpredictable event has occurred post the credit assistance i.e. a sharp rise in interest rates, a property downturn, a change in personal circumstances after the advice was provided (i.e. loss of job). A mortgage broker should be assessed on the recommendation at the time the credit assistance was provided which is why process becomes important.

This method of assessment applies to Trustees, Directors and Financial Planners (via a 'safe harbour') and mortgage brokers should be afforded the same professional standards.

1.3 Concern that interest rate will be seen as the sole determinant of Best Interests Duty

In particular we are concerned by reports that the Best Interests Duty would be assessed primarily against the interest rate of the product or products recommended. Whilst of course all borrowers want to get the lowest rate possible, the client's individual circumstances may mean other things are more important to a client at that time. If a client has a number of lenders that meet all their requirements then of course rate will be a key factor in their decision. We believe there are many instances where a mortgage broker can be operating in the client's best interests where the client does not get the lowest rate.

Factors affecting the advice mortgage brokers offer
There are many and varied reasons why the lowest interest rate is not always the best outcome for the customer, including;

- For some clients the structure of the lending and security arrangements is more important than the rate. They may want the loan in one name or more names that match up with the ownership of the security, in a company structure or a trust, it may be that they wish to avoid cross-collateralised securities.

- Often a client's main priority is to stay outside of Lenders Mortgage Insurance (LMI), others want to include or not include guarantors.

- Each lenders individual credit policy may mean that some clients only qualify with a single lender, whilst others may qualify for many.
    - Principally this occurs because all lenders treat different types of income differently.
    - Besides a standard PAYG wage, the lenders have different shadings on income types which dramatically affect how much someone can borrow. This includes different shadings (i.e. some lenders will take some income types at 100%, 75%, 50% or 0%) for part time income, casual income, commissions income, bonuses, gig economy income, trading income, share income, dividends, family tax benefits, childcare allowances and government allowances as well as whether the client is in the probation period of a job or

for how long they have been employed.

- The different treatment of income becomes significantly more complex if the applicant is the owner of a small business, where historical profitability and cash flow can be treated very differently.

- Where the applicant is a landlord, some lenders take 80% of rent, others only 60%.

- There are a significant number of policy areas where lenders have adopted different stances and which affect whether a client will be accepted by a lender.
  - These policies include the lenders 'genuine savings' policy (can range from 10% to 0%), particularly in the case of first home buyers,
  - in others it will be things like the age of the applicants (finding credit for people over 60 is increasingly difficult)
  - or their credit history (some treat defaults on, say, utilities bills more severely than others).

- Lenders have very different policies on how they assess a client's living expenses. It used to be based on HEM. Now each lender has their own calculators which treat expense categories differently and mean that some lenders will approve clients whilst others will decline them.

- Lenders set their own assessment rate - the rate they use to assess each application. This was standardised but now floats and is the actual rate plus a margin in anticipation of future rate rises. This margin can vary by lender and as a consequence it means some clients will qualify at a certain amount of borrowing with one lender and not with another.

- The security type can also be an important determining factor. Some lenders do not take small inner city highrise properties as security, some lenders avoid regional areas.

- Lenders have different valuation methodologies which means that two different lenders can come up with significant differences in the value of the same property. This can have a direct impact on the amount the client is charged in LMI or on the maximum loan that lender will consider.

- Some lenders welcome construction loans, others do not offer this product.

- Some lenders will lend to 98%, including LMI, of the value of the security, others will have a maximum lend of 95%, including LMI.

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- There are also features of the loan that a client may be interested in.
    - Redraw, offset, the ability to suspend payments or have flexibility in payment options are important to some and not to others.
    - Some clients want a lender with branches, some want a private banker, and some want different online services, which can vary significantly.

- The other common factor that influences a client's choice is time.
    - Some lenders may have turnaround times of 10-15 days between submission and approval. Others may be able to do so in two days.
    - The turnaround times for each vary based on their own internal resourcing and the attractiveness of their offer and fluctuate over time.
    - If a client needs an answer in three days then there may be some lenders with competitive offers that we cannot recommend.
    - The urgency of each client's individual situation would determine that - in general with a purchase - time is of the essence, whereas with a refinance it is less so.

- Related to that is the confidence the broker has in the lender's ability to deliver to their policy. There are some lenders that are very clear on what they want and where the assessors follow the credit policy closely. There are some that don't. Again this fluctuates over time, particularly when credit policy is changing, and can have an impact on the confidence the broker can give a client that their application will be successful and hence impact the client recommendation.

- How a lender passess on interest rate changes can also impact a client's choice. For example, a broker may have two products that fit a client's needs and for which the client qualifies. The broker may recommend the product with a slightly higher rate but where there is evidence that they look after their clients better by passing on rate reductions.

- Some clients make decisions based on a lenders reputation, their corporate and social responsibility programs or their environmental credentials.

- Then there is the interest rate, the fees that a lender may change in addition to the rate and sometimes a lender may offer a cash back to a client.

We have included in ***appendix A*** some case studies where clients have prioritised other factors ahead of the interest rate or where a customer's circumstances has restricted the choice in lenders they had and the effect this had on the advice given to those clients.

All of these factors indicate the complexity with judging whether, at the time the advice given, the broker is acting in the client's best interest.

Considering all of the points above we believe the only way to determine whether a broker is acting in a client's best interest is to develop guidance that requires brokers to follow a process to arrive at these outcomes. It is also the only way an aggregator can supervise the conduct of their brokers. As ASIC rep 628 suggests, brokers will need to ensure that they fully understand what the clients want to achieve now and in the future, understand their financial position and any likely changes, engage their clients in the process of recommending products, be fully transparent regarding their remuneration from all lenders - those recommended and those not, where possible recommend a number of lenders - and keep detailed notes and ensure that the client is fully informed.

We would welcome the opportunity to engage with ASIC and other stakeholders on the development of the regulatory guidance to provide much needed certainty as to the activity that constitutes compliance with a Best Interests Duty.

Part 2 - Conflicted Remuneration

Drawdown amount for credit contract relating to purchase of residential property - Regulation 28VB

Of significant concern is the suggestion in Regulation 28VB that the calculation of commission will be limited to the "the amount of credit that is used for **that purpose**". In discussions with Treasury it has been **uncovered** that the intention is to restrict payments of commission to only the residential property amount in most cases.

This small and opaque reference requires transparency given the **Federal Treasurer's public statement on 12 March, 2019 that commissions would be reviewed in 2022** whereas the draft bill could be construed differently:

- Result in a reduction of upfront commissions on **new loans from 1 July 2020** when certain (not clearly prescribed) amounts would be excluded from the calculation of commissions by lenders when due;

- Result in a reduction of upfront commission **on increased loans from 1 July 2020** when certain (not clearly prescribed) amounts would be excluded from the calculation of commissions by lenders when due;

- Result in a reduction of trailing commissions on **existing loan balances from 1 July 2020** when certain (not clearly prescribed) amounts would be excluded from the calculation of commissions;

- Result in a reduction/removal of trailing commissions on **existing loan balances pre 1 July 2020** where the lender cannot ascertain (due to poor record keeping) which amounts related to "that purpose" potentially putting lenders in breach on every loan.

We are concerned that this introduces a new public policy test as to the purpose for which a client can use funds secured by a mortgage. Clients utilise their mortgage to obtain funding for a variety of needs including:

- Investment purposes
- Contribute towards own business
- Purchase of shares
- Deposit for an investment property
- Debt consolidation of personal loans and/or credit cards
- Home renovation
- Landscaping and exterior home improvements
- Lifestyle events such as weddings, honeymoons and holidays

In the vast majority of these cases a mortgage broker would in fact be acting in their client's best interest given firstly that it directly meets a need or objective of the client and secondly, it is a better structure for the client than higher interest rate alternatives.

If Regulation 28VB was interpreted as excluding a mortgage broker from being remunerated for loans for these purposes then it would have an adverse effect on customers. If this were to be the interpretation then, if the mortgage broker were to act for the client they would be doing so without the prospect of being remunerated by the lender. In that event a mortgage broker may decline to act for the client or have to charge the client a fee.

This concern is further heightened by the fact that the proposed time is calculated from the date of contract rather than settlement. In practice some properties do not settle for 90-days after the contract and, in these circumstances, under the proposed legislation we conclude that the mortgage broker would not receive any remuneration.

We are also unclear on how this will affect refinances and top up applications where the purpose is for renovation. This is not wholly or predominantly for the purpose of purchasing residential property but they are related. Is this portion of the loan to be excluded? What about where some of the loan is used for structural renovations are some of the funds are used to purchase depreciable items associated with the renovation e.g. cabinetry, kitchens etc.

If it is the intention to exclude these other purposes then, in practice, the lender will reduce their expenses and clients will get no benefit. Mortgage brokers will either need to perform that service for no remuneration or else charge a fee to the client for such a service, which we submit will not be in the clients best interests. We note that this would be occuring at the very time that brokers will need to be increasing their compliance and oversight costs to comply with the best interests duty.

2.1 Net of Offset calculations - Regulation 28VB

"... the drawdown amount for the credit contract is so much of the amount of credit as is used for that purpose within 90 days after the day on which the credit contract is entered into by the consumer."

Loan Market supports the CIF recommendations (made in response to ASIC report 516) that upfront commissions be calculated net of offset so as to not financially incentivise a mortgage broker for recommending a higher loan than the client needs.

The unintended consequence is that each lender has a different approach to how and when this amount is calculated which has once again created complexity and added a further conflict for the mortgage broker to manage.

The net of offset calculations commenced 1 January 2019 and our estimates show that this has reduced income to mortgage brokers by a further 8-9%.

We welcome the government's initiative to standardise the date upon which net of offset calculations are made **however** we are concerned about the 90 days from the date of contract that has been proposed due to the fact that in practice this is not enough time for the majority of clients to utilise these funds. The end result is that the mortgage broker has performed their client's Best Interests Duty to a new and higher standard only to find that because of this timing anomaly they would not be remunerated and instead the lender would retain this margin.

In all these cases the clients will want the surety of a lender's approval to know precisely what their financial capacity is before they start researching, bidding at auction or transacting and in many cases this will be more than 90 days from the date of original contract.

We strongly recommend a review of the timing for the calculation of **drawdown** to a timeframe that more accurately reflects what happens in practice and put forward our recommendation of "**12 months after the day of the initial drawdown**."

2.2 Clawback requirements - Regulation 28VE

We acknowledge that the existing clawback provisions are an important control mechanism on the mortgage broker remuneration model and operates to incentivise the mortgage broker to ensure the client can pay back the loan (i.e. not fall into arrears) and that the loan meets the client's requirements and objectives (and therefore the client does not refinance with another lender).

In the event the client either falls into arrears or the client discharges the loan within the clawback period lenders "claw back" the commission paid to Loan Market and then we subsequently claw back payments made to the mortgage broker. Across our group 6.6% of our income is clawed back annually.

Clawbacks happen for a number of reasons - the client may go into default, the client may decide to switch lenders (if for example interest rate cuts are not passed on), the loan may be a no end debt relocation loan, the clients could decide to sell the property either because they planned to or because their circumstances change.

We had hoped that the proposed legislation may choose to prescribe the clawback period in a more detailed way and in so doing reduce a lender choice conflict for mortgage brokers. With variation in formulas and calculations for clawbacks across each lender this creates another area for mortgage brokers to manage conflict.

Many mortgage brokers offer a review option for their clients, which some clients elect to take up. Sometimes the outcome is that the mortgage broker approaches the current lender

with a repricing request for the lender to reduce the rate and sometimes, although less frequently the client will want to re look at their options. The operation of a Best Interests Duty with a clawback period means that when a mortgage broker reviews the client's situation anywhere in a two year period there will be a conflict to manage in that the mortgage broker will need to manage a new application and potentially receive no remuneration.

In order to mitigate this conflict, we suggest consideration be given to either:

(i) limiting the clawback period to 100% within 12 months of settlement (aligned with net of offset timeframes)

(ii) In the event that Treasury wants to retain a 2 year clawback period that the clawback be amortized on a monthly basis over the 2 year period.

We believe that this provides the necessary balance for a mortgage broker to ensure the recommendation is in the client's best interest.

Firstly, it retains clawback as a control mechanism to the commission structure; secondly, a standardised clawback model removes any lender choice conflict for the broker; and thirdly a clawback that either lasts for 12 months or declines proportionately over 2 years allows the broker to confidently put the client's interests above their own.

2.3 Clarity on application to Licensee/Aggregator Fee Models
Regulation 158NB Licensee must not accept conflicted remuneration

We request clarity that the Licensee/Aggregator fee models are not deemed Conflicted Remuneration where a component of how this fee is calculated on a percentage (%) basis. We charge a mortgage broker with lower turnover a higher percentage fee than a business with a higher turnover This enables us to charge a scaled fee based on the size of mortgage broker business, and the services they expect us to deliver.

Our aggregator or franchise fee is charged to a mortgage broker on an aggregate basis in terms of the total revenue or total mortgage settlements (calculated on a net of offset balance) across the total number of clients in a year and is not influenced by any individual credit provider, so therefore has no influence on "the credit assistance provided to consumers."

Such charging structures are common in mortgage broking and are also common in Financial Planning and as such should not be seen as Conflicted Remuneration because it does not influence the mortgage broker's recommendation on either product selection or loan size.

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Our recommendation is that the legislation specifically exempts the charging by an aggregator of a percentage (%) to mortgage brokers by the Licensee from Conflicted Remuneration.

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Part 3 - Negative impact of extra layers of regulation

3.1. Impact of proposed legislation on State Payroll tax liability

As an Australian Credit Licensee (ACL) we are very concerned that with the increased obligations to monitor and supervise brokers and despite the fact that mortgage brokers very clearly being self-employed, that some state governments may use this requirement as a basis to assert that a common law employment or relevant contract exists between a licensee and a mortgage broker.

If this connection were to be made a mortgage broker operating a small business without employees (the majority of them) would, in effect, have their incomes cut by the amount of the state payroll tax. This would cause further significant costs and undue hardship on mortgage brokers who have already seen their income reduce this year by 8-9% due to net of offset calculations and increased costs due to expanded compliance requirements. This is before the new investment will be required to meet the Best Interests Duty.

We assume it is not Treasury's intention to disturb the nature of the commercial and legal relationship between licensee and mortgage brokers and accordingly we would welcome a statement to that effect in the legislation or related documentation that the proposed legislation is not intended to:

1. Assert an employee/employer relationship exits between licensees and mortgage brokers; or
2. Assert that mortgage brokers are conducting the business of the licensee.

3.2 Overlap between responsible lending and Best Interests Duty

The proposed Best Interests Duty is in addition to existing legislation including Regulation 209 on Responsible Lending (currently under review). In Commissioner Hayne's recommendations he mentioned on several occasions the need to "simplify" the law. We believe that reducing complexity is important to ensure a large and diverse network of mortgage brokers understand what is required of them and can refer to fewer areas of legislation as possible.

We suggest that Regulation 209 Responsible Lending should apply to lenders where ultimately they are the decision makers when it comes to approving a client for a loan on their balance sheet. The current requirement for Responsible Lending is "not unsuitable" which is immediately at odds with the proposed requirements that are "client's best interests".

New legislation for a Best Interests Duty can standalone as the mortgage broker test of the appropriateness of their credit assistance, similar to the way the Financial Planning

regulations apply to financial advice under the Corporations Act. Requirements that currently apply to mortgage brokers under Responsible Lending can be incorporated into guidance for Best Interests Duty as discussed above.

3.3 Clarity around 'ancillary' or 'packaged' products to the mortgage

In practice a mortgage broker will discuss products that are ancillary to or packaged with a mortgage such as credit cards. An unintended consequence would be to apply the Best Interests Duty to products on a standalone basis i.e. that the credit card also has to meet with the Best Interests Duty and the mortgage broker needs to do a similar exercise to review all credit cards in the market to meet the duty.

This would increase complexity and negatively impact the client experience for little positive benefit. Having said that a credit card that is expensive, poorly structured would certainly have an impact on the mortgage broker's recommendation of a particular mortgage product.

It is important that this is clarified to avoid confusion and additional work which will have a detrimental impact on the client experience.

3.4 'Graduating' penalties for non-compliance

We regard the inclusion of pecuniary penalties for clear breaches of the Best Interests Duty as an important signal to participants that blatantly do the wrong thing i.e. falsifying information, misleading and deceptive conduct, disregard of any of the requirements set out in the regulatory guidance notes etc.

We would like some clarity on how these penalties are "graduated" depending on the magnitude of the breach. At one extreme the penalty for fraud should receive the maximum judgement however at the other extreme poor file notes or a question around the extent of investigation into a client's circumstances would surely not warrant such a large penalty.

It should be noted that mortgage brokers are sole traders or small business owners and do not have the financial capacity like larger financial institutions to absorb such hefty penalties or employ a team of lawyers to defend court cases. Most likely one judgement would bankrupt them which is on one hand a deterrent for serious breaches like fraud but on the other hand is unfair where a small breach, error or oversight has occurred. The impact of a lack of clarity in this space would also add further upward pressure to professional indemnity insurance premiums adding further cost where there is still no strong evidence of gross misconduct or client detriment.

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Part 4 - Implementation timetable

4.1 Transition arrangements and facilitative compliance

Like most significant legislative reforms where there are thousands of individuals impacted across a diverse sector, implementation timelines are critically important to the success of the legislation.

We recognise that the Government is keen to introduce regulations to implement all of the Hayne recommendations as quickly as possible. Given that we support a 'facilitative' implementation approach given:

- the people who will need to comply with this legislation are 17,000 small business owners representing a large, diverse and decentralised network
- The nature of the obligation is not specifically spelt out and remains ambiguous
- As noted by ASIC (ASIC report 628 at 13), "home loan journey is complex, multifaceted and nonlinear"
- The penalties on these small business owners (whose average income is $87,000) is double that applicable to lenders, some of whom are the largest companies in Australia, for breaches of responsible lending guidelines
- There is less than nine months between initial responses closing and legislation commencing.

Similar legislative change such as Financial Services Reform Act (FSRA) and Future of Financial Advice (FOFA) have provided for an implementation period of 12-months. This allows for any required technology changes and most importantly for the training and skilling of participants. One area often overlooked is the cultural change management of such a significant reform.

As much of the conflicted remuneration changes have already been implemented and subject to the requirements that lenders may have to change their system, we believe many of these changes can be introduced by 1 July 2020. However on the best interest duty we would ask that consideration be given to a 12-month 'facilitative' period for mortgage brokers, aggregators and ACL holders. For this period existing requirements for Responsible Lending could run in parallel before transitioning in full to requirements under the Best Interests Duty.

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Appendix.

Customer scenario case studies

Below is a series of standard home loan customer case studies. Each case study describes the background of the Applicant, the options available and the outcome. These case studies are representative of the work mortgage brokers do on a daily basis. They show how important it is to understand the customers objectives and requirements, the importance of following a process, understanding the different criteria of lenders and the outcomes the clients achieved..

These are real case studies, based on real events. Meetings with the clients occurred during the last year. The names of the applicants and the lenders have been removed. We are happy to expand on these case studies or provide more to Treasury or ASIC as required.

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Case study 1
Broker educates Applicants to save on LMI.

Background:
First Home Buyers Applicant A (28-years old) and Applicant B (32-years old) are both teachers with consistent incomes. They were referred to the broker by a friend. The Applicants had been in a romantic relationship for less than two years.

Applicants;
- have $6,000 saved
- $50,000 gift from Applicant A's relative
- they also have some minor poor account management issues in a savings account including a late fee and dishonour fee.

They had seen another loan provider and were frustrated that the most they could borrow was at 90% of the property value.

The applicants told the broker they wanted to buy a property in the $600,000 - $650,000 price range.

Discussions:
To meet the original needs of the Applicants the broker researched loan products that were consistent with borrowing 95% of the property price, with no genuine savings. These products included interest rates ranging from 4.6% - 5.5%. The Applicants would pay $19,000 in mortgage insurance.

The broker had the Applicants rethink their budget and instead look at properties in the $500,000 - $650,000 price range. They were tasked with defining the list of property features and suburbs they believed were non-negotiable.

In the second meeting, the Applicants could not agree with a budget, property features or suburbs.

As a result, the broker discussed the following;
- the buying process
- loan features
- dealing with agents
- account conduct

The broker explained that only one bank would use three months rental payments to consider their potential application, at an interest rate of 3.45% but the lender would likely look poorly on the low-level of saving and account conduct issues.

Solution:
After three meetings with the Applicants, it was confirmed that they would target a purchase price of $550,000 maximum. They also committed to saving an extra $7,000, reducing mortgage insurance by half to $9,000, and also increase their lender panels options significantly. These Applicants may be in a position to proceed to an application next year.

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Case study 2
House and land valuation comes in short necessitating a change of lender.

Background:
Applicant A and Applicant B wanted to purchase land and build their first home up to the value of $345,000. Due to very tight servicing in November 2018, the Applicants wanted to find a bank who would lend them the amount they needed and allow a loan of 95% including capitalised lender mortgage insurance (LMI).

After settling the land in January 2019 the Applicants presented with the building contract in February. The loan was with a Big Four Bank, with an interest rate of 3.89%. The bank valued the completed product at $320,000, which was $25,000 short of what the Applicants required to complete.

Options:
The broker discussed the valuation shortfall with the Applicants and determined access to additional savings or a gift from a relative was not possible.

The broker recommended approaching other banks to get another valuation.

If the Applicants opted to stay with their current Big Four Bank it would mean;

- they would have to save the valuation of the shortfall before commencing the build
- while paying rent
- and paying their new mortgage on the land.

Solution:
The broker found that a different smaller lender had the most accurate valuation of $345,000 and was offering a comparable loan product to enable the Applicants to complete their build. The interest rate was 4% but the Applicants would not have to contribute any additional funds.

The broker submitted a new application to the smaller lender to refinance the land loan and add on the construction loan so the Applicants could successfully complete their build.

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Case study 3

Broker helps business owner refinance loan to assist with cash flow.

Background:

The Applicant had an existing business loan through a bank that aggressively changed repayments from $3,300 per month to $13,200 per month, affecting the business' cash flow. The business loan was secured through the Applicant's residential property. The Applicant required a refinancing of his business debt to a bank that would have a less aggressive amortisation profile and better appetite for his industry. As the business loan was supported by residential securities, existing home loans also needed to be refinanced.

Options:

These were the options presented to the Applicant:

- The aim of the refinance was to extend the repayment term of the business debt to better suit the Applicant's business cash flow.
- As the need for refinancing was dictated by the business loan, a discussion was held around which banks have supportive appetite and policy for the Applicant's industry.
- Also discussed was that including the home loan refinance to provide the security to the business loan would achieve a better outcome for a longer repayment period and better pricing.
- A tender process was conducted with three banks that have known the appetite for Applicants' industry.

Solution:

Only one bank was supportive of the application. The broker refinanced the business loan and home loan to this bank. The residential security also provided support to the business loan which gave the Applicant a longer repayment schedule, a higher chance of approval and a better rate on the business debt.

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Case study 4
Broker guides self-employed visa Applicants to home loan.

Background:
De Facto couple living together wanted pre-approval, however, Applicant B's visa was not acceptable to the Big Four Banks. The broker needed to set up a quick approval for a purchase, as the cooling-off period ending within five days.

Applicant A is a degree qualified recruitment consultant working in Australia with a permanent residency visa as a skilled worker. Applicant A quit her PAYG job three years ago and became a self-employed director of Company A, which was trading profitably and no debts. The broker did not use any income for Applicant A, however, will provide her 2018 personal tax return to show her last year PAYG income.

Applicant B is a qualified tradesman, working in Australia initially under a skilled worker Visa which expired in mid-2019. Applicant B is now working under a bridging Visa whilst his Visa 186 permanent residency is being processed. Applicant B did expect to already have the Visa 186, however, delays in visa processing have meant that he is on a Bridging Visa with full working rights.
Applicant B is the sole director and shareholder of two businesses being Company B (since January 2013) which is a large commercial waterproofing business and Company C (since June 2015) which is a supply business.

Both businesses were set up to run separately, however, it is fair to treat them as one for assessment as Company B purchases the stock and Company C supplies the manpower/contractors to install the stock on commercial projects.

Applicant B is a director of Company D which is not trading, does not have any debts or liabilities.

Applicant B has a small $246 paid default (paid within three days) from mid-June 2018. Applicant B's credit score is low due to that small paid default and the business commercial credit enquiries incurred as part of his business growth.

Options:
These were the options presented to the Applicants;

- The broker researched Applicant options with the main priority to determine if Applicant B's Visa status was acceptable. The broker called all of the Big Four Banks who said it was not acceptable and Applicant B could not be a borrower.
- The only lender who would accept the Visa status was small lender, and prior to lodging a full application, the broker provided the current and expired visas which credit confirmed was acceptable.

- The broker then highlighted and confirmed the small paid default was acceptable with a letter explaining. The small lender confirmed Applicant A could be the sole owner of the property with both Applicant A and Applicant B on the title.
- The broker then had servicing concerns as none of Applicant A's income was acceptable to use, meaning it was all down to Applicant B's income and had to make sure the small lender would accept the add-back of company profits to boost Applicants serviceability.

Solution:
The broker secured a principle and interest 30-year term loan with an online small lender. This was an appropriate rate and the product aligned to the Applicants needs, with 100% offset ability which will assist the Applicants to save on interest post-settlement.

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Case study 5
Broker helps self-employed Applicants with complex purchase of new home.

Background:
Applicant A and B are purchasing a new home while refinancing their current home and turn it into their investment property. They have a 15% deposit.

Applicant A and B are both self-employed. Applicant A's company has a large turnover and she owns 50% of that business (Applicant A owns 46.875% and the remaining 3.15% is owned by her family trust of which Applicant A and B are director trustees). Applicant A's salary is $140,000 and her share of her company profit is $1,261,961. Applicant B's income is $84,000 per year.

The broker needed to use Applicant A's share of company profit for servicing, however, Applicant A did not own 50% of the company nor does she own all of her shares in her personal name which is a big issue for some banks.

The complexity of the deal included five trading companies, with different directors and shareholding, two-family trusts and one Self Managed Super Fund return and multiple companies not trading.

Supporting documents (totalling more than 500 pages) were challenging as banks require a copy of every bank account the Applicants have both personal and company along with all debts including company car leases.

Applicant A was also halfway through inheriting a property which was not yet in her name (this property would sit in a new trust) and the bank for the estate would not provide current loan statements for that property.

Applicant A also co-owned an investment property with her business partner, meaning the lender will use the entire debt and only 50% of the income for servicing.

Applicant A has $500,000 set aside in managed funds, under the supervision of a financial planner to pay for her dependents $60,000 per year school fees and the interpretation of that as living expense is crucial for servicing.

Options:

- The broker considered the totality of the issues meant that serviceability needed to be strong to achieve approval, and therefore narrowed the lenders down to consider who would accept a one-year tax return as opposed to two years, in that it represented a more accurate view of Applicants current circumstances.

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- The broker then investigated which banks would accept the ownership structure and the allocation of profits which we needed for servicing. For example, Big Four Bank 1 policy says 50% ownership in a personal name for any profit to be used for servicing, whereas Applicant A owned 48.25%

Solution:
The broker ran both scenarios simultaneously with Big Four Bank 1 and Big Four Bank 2 and it was not until the very point of making the loan submission, the Applicant considered the Big Four Bank 2 proposal a better fit with their policies and was the strongest application to pursue.

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Case study 6
Deal structure and interest rate both important to Applicant.

Background:
The Applicant is a 30-year-old professional with two investment properties financed by a Big Four Bank, with a 4.8% interest rate. The Applicant was only able to pay interest only (IO) repayments for cash flow reasons. The Applicant is in a de facto relationship, however, both properties are solely under the Applicant's name as they were purchased prior to the relationship.

The Applicant and partner keep separate finances and have no combined liabilities. As part of a wealth creation strategy, the Applicant wanted to change one investment loan to Principal and Interest (P&I) to start paying down the loan. When refinancing, the Applicant's partner did not want to be on the loan as they did not own the properties. The Applicant has $200,000 in an offset account and wanted to purchase an owner-occupied property in the near future.

Options:
These were the options present to the Applicants;

- When looking to refinance, the current Big Four Bank and smaller lenders wanted to put two adults in servicing even though the Applicant was not paying for his partner's expenses. The pricing with the current Big Four Bank on a variable loan was 4.4%. This created a borrowing capacity issue for the Applicant.
- The Applicant would only be able to save money at their current lender with a fixed loans with cheaper rates. This was non-negotiable for the Applicant as they wanted to make extra repayments and utilise the offset account.

Solution:
The broker ran a scenario with smaller lenders regarding the de facto relationship. The broker was able to agree with smaller lender A to provide the loan with one adult servicing. The Applicant's partner provided payslips to verify income, as requested by the smaller lender A. The loan was transferred to smaller lender A P&I as the rates for P&I were 3.4% and 3.66% for (IO). Once transferred, the Applicant was able to save approximately $10,000 per annum on their current rates, and approximately $6,000 per annum on re-priced rates. The offset account was kept intact to purchase the owner-occupied property. The Applicant was able to start working towards their retirement and pay down debts, while not affecting cash flow.

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Case study 7
Broker finds new options for Applicants to keep property portfolio.

Background:
Applicant A and Applicant B are an established couple, both employed within the Public Service. The Applicants hold an existing owner occupied home in the ACT, which they intended to sell, and two investment properties in the NT. The Applicants hold loans across two Big Four Banks. The Applicant's wanted to purchase a new owner occupied home. The Applicant's felt they were in a comfortable financial position with no signs of financial stress.

Discussions:
- The Applicants approached their current Big Four Bank lenders and had been told that they needed to sell multiple properties. The Applicants felt in both cases that the banks had not fully assessed their current financial position and were asking them to liquidate properties when they did not need to.
- The Applicants were reluctant to sell their investment properties in the NT due to a dip in the property market and were unlikely to reach their intended sale price.
- The Applicants sought the advice of the broker.

Solution:
The broker assisted the Applicants in obtaining finance to purchase their new home, with their current owner occupied home as the only property to be sold. The broker assisted the Applicant to negotiate with real estate agents and solicitors in both the purchase of the new property and sale of the existing property.

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Case study 8
Broker helps self employed applicant whilst minimising risk to spouse.

Background:
The client purchased a home in a coastal town in his own name and had gone unconditional when he approached the broker. Applicant A and his wife applicant B own n unencumbered property is a high net worth individual with a highly profitable business. Any bank could have done this deal by cross collateralizing both securities with both borrowers being joint and several but Applicant B was concerned about their liability she would assume..

Discussions:

- Due to Applicant A needs, this was vastly complicated. The applicants wanted to minimise the risk to Applicant B and sought to have Applicant B as a security guarantor only and not be responsible for the whole debt, which would be assumed by Applicant A.
- Applicant B obtained independent legal advice on her obligations under such an agreement.

Solution:
The broker discussed with the Applicants how to effectively structure a loan solution individual to them given they had entered into an unconditional purchase contract and paid a deposit.

Only one bank allowed for such a transaction given the size, LVR and credit ability to assess a sizable deal which was a Big Four Bank. The balance funds requested used equity in an existing home with loan/borrowings remaining in the name of Applicant A and Applicant B was a security guarantor only. This enabled the requirement for independent legal advice to further ensure that both Applicants had another layer of clarity on each of their positions.

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Case study 9
Broker sources lender with a suitable term for age policy.

Background:
Applicant A and B are a married couple in their 60's, both working full time with no dependent children. The Applicants were planning their future transition to retirement. The Applicants wanted to restructure their existing owner-occupied borrowing and two investment borrowings including, consolidation of debt and home improvements. All borrowing would be principal and interest (P&I) repayments over 20-years and exit strategy was provided to the lender. The Applicants were looking for a lender that offered competitive owner-occupied and investment variable rates that offered both redraw and 100% offset accounts.

Discussion:

- As per the Applicant's requirements, Small Lender A owner-occupied interest rates, for both investment home loans were suitable. Small Lender A required the Applicants bring their owner-occupied loan across to the lender. This included all borrowings at 3.29% variable with redraw and 100% offset account capabilities.
- Prior to proceeding with Small Lender A, the broker contacted a Small Lender A relationship manager to clarify their 'term for age' policy.
- The application could not proceed as Small Lender A policy articulated that any Applicant who is 60-years of age or more, refinancing and/or purchasing any owner-occupied property, will only be offered a maximum 10-year loan term, regardless of an exit strategy. This policy adversely affected the Applicants borrowing capacity, therefore the application could not proceed.

Solution:
The application was re-submitted with Big Four Bank A. Big Four Bank A had higher, but still competitive, interest rate compared to Small Lender A, and a more relaxed 'term for age' policy that met the Applicants requirements.

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Case study 10
Time and bank reputation; the key factors for Applicants.

Background:
The Applicants' sold their existing owner-occupied property and wanted to secure pre-approval to purpose their next home. The Applicants were looking at properties prior to contacting the broker so there was urgency with turnaround times.

The customer requirements;
- fast turnaround times
- a bank with a reputation for high customer service standards as they weren't always satisfied with their existing bank
- an offset account and the ability to make extra repayments
- a low rate and low fees
- a familiar bank
- quality banking facilities i.e. internet banking
- fast turnaround times

Options:
The brokers presented the Applicants with three options from three small lenders. All three options had similar rates and features and all three met the Applicants requirements.

Solution:
In the end, the main deciding factor for the Applicant was brand familiarity and word-of-mouth, they weren't the cheapest of the three options but the Applicant chose to proceed with smaller lender 1. The deal was approved in three days once the Applicants' had located the property they wished to
purchase.

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Case study 11
Certainty and timing of approval main factors for Applicants.

Background:
Applicants are married, with two dependants. Applicant A is self-employed, while Applicant B is PAYG, both are directors in the business.

Applicants have an existing mortgage for an owner-occupied home and want to purchase an investment property for Applicant B's parents to move into in South East Queensland.

Applicants had recently refinanced using another mortgage broker.

Applicants came to the broker wanting to refinance their owner-occupied home away from the current lender and seek pre-approval for a new purchase for an investment property.

The Applicants' expressed specific must-have feature for their loan. Their needs in order of importance to the Applicants are detailed below:

1. The deal approved - this was the single most important requirement above everything else.
2. An offset account on the owner-occupied loan, they did not require an offset account on the investment loan.
3. Good internet banking - this was very important to Applicants due to the way they conduct their banking and where they reside
4. Good customer service but they did not require a lender with a branch network
5. A competitive interest rate
6. A preference to have one lender for both loans for convenience

Discussions:
After completing a detailed needs-based discussion and reviewing the Applicants objectives the broker advised the Applicants that based on current credit policy and experience dealing with a specific small lender would be their most appropriate solution.

The broker discussed;

- this lender was not the cheapest offering.
- they were aligned to their needs and objectives,
- this lender had offered a competitive interest rate on both the owner-occupied and investment loans.

The Applicants agreed this was their way forward.

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Solution:
Within days the Applicants had found a property and signed a contract of sale with a 14-day finance clause.

At the time the lender's service level agreement time for a contract of sale was three days. The broker had the deal submitted and approved unconditionally within that period.

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Case study 12
Applicant refinances to remove parental guarantee and secures more competitive rate.

Background:
The Applicant wanted to refinance his home loan to remove parental guarantee. He also wanted an additional $40,000 to $50,000 for renovations. His original Big Four Bank said that he couldn't remove the guarantor just yet because his home value needed to increase and they would have to do a full inspection valuation.

After an initial discussion, it was established that his home had in fact increased in value and the parental guarantee could be removed. It was also established that the Applicant was paying 3.98% plus an annual fee on his loan of $395, and that he was not getting additional benefit from this product (such as an offset account) as he was paying all of his additional repayments into the loan directly, and building his redraw instead.

Options:
The broker undertook an initial lender comparison across 9 lenders and results were presented to the Applicant of 5 lenders ranked from lowest to highest rate; a small lender at 3.05% to a Big Four Bank at 3.35%.

After a discussion of the lenders and their offerings, the Applicant decided to proceed with the Big Four Bank at 3.35%.

The Applicant was advised that he could meet his requirements by staying with the original Big Four Bank, as well as securing a lower interest rate (which the broker priced at 3.39%) however, the Applicant chose to move from the original Big Four Bank based on the following:

1. The lender was chosen as they would pay the Applicant a fee of $2,000 (cashback)
2. The product chosen did not have an annual fee and this saved the Applicant $395 per annum
3. The amount of interest and fees (minus any cashback) was compared across all 9 lenders
4. The second Big Four Bank (after their cashback) proved to be less expensive over the initial 2 year period at which time the Applicant would be reviewing his finances.

Solution:
The Applicant was presented with all 9 lenders, their cost over 2 years and a detail of the commissions earned across each lender. He was clearly and quickly told that he would be able to achieve his main goal of removing the parental guarantee property regardless of

which lender he chose, and that staying with the original Big Four Bank was also possible for the broker to proceed with.

The Applicant reviewed all of the information provided to him, determined that he wanted to avoid the annual fee, choose a basic variable home loan with redraw, and chose to move to the second Big Four Bank.

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Case study 13
The importance of social and environmental credentials to borrowers.

Background:
The Applicant wanted to refinance her existing loan which, at the time, was 5.39% p.a. As she had been in that loan for three years she was interested in sourcing a more competitive rate.
The broker and Applicant discussed her lending needs and objectives. One requirement for her refinance to be viable was that the valuation on her property would eliminate the need to pay Lender Mortgage Insurance (LMI).

Options:
At the meeting, the broker presented the Applicant with three basic home loan options as her only criteria was a redraw facility. Interestingly, when going through each option the Applicant showed a genuine interest in a small lender's social and environmental credentials including the fact that the lender passed on a portion of its profits to charities.

Solution:
The Applicant emailed the broker to advise that she had selected the smaller lender mentioned above, not only for their competitive rate but also because of their social and environmental philosophy being aligned with her own. Unfortunately, due to the smaller lender's low valuation of her property which would mean LMI would be payable, the Applicant was restricted to a Big Four Bank who came in with the same low rate, but a more favourable valuation and consequently no LMI.

The social and environmental credentials were so important to the Applicant that she will relook at her loan again in a year or two with the hope of a better valuation so she can switch to the smaller lender.

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Case study 14
Broker helps elderly couple drowning in debt to keep their home.

Background:

When the Applicant's first spoke to the broker they were in real financial trouble after family circumstances that had seen them care for their elderly parents. The broker spent three months working on the right solution for the Applicants.

The Applicant's current home loan with a small lender was at a rate of 6.05% which had not been reviewed in years. The Applicants had over 20 different credit cards and facilities open. These were with a large range of lender's all on very high rates – between 18%-25%.

Applicant A was 74-years old and Applicant B was 63-years old. Both Applicants were still working as they could not keep up with their repayments on all of their credit facilities.

They would focus on their mortgage payments to ensure this was up to date as they feared they would have to sell their family home if they fell behind. At the same time they were trying to focus on paying credit card's down one at a time to reduce the number of facilities, however, this would sometimes result in the missing of payments elsewhere (essentially thinking they were doing the right thing).

Options:

Once the broker had this information, the broker worked on sourcing a lender that would take on the factors of this application including age of the Applicants, the number of debts needed to be consolidated, the amount of missed payments and conduct on the accounts, as well as ensuring there was an exit strategy in place.

In addition to finding a lender, the broker also engaged a debt assistance agency to help negotiate the Applicants position with the credit card lenders. They managed to liaise with lender's and lower the amount repayable from $96,000 to down to $65,000. This was a massive relief for the Applicants and made the prospect of paying down their debts so much more achievable.

The broker then had the time-consuming job of working with the Applicants to ensure they had three-months worth of statements for every facility being opened which resulted in over 60 statements and 180 pages of physical statements as they did not use internet banking.

The broker then had to go through all these to ensure they could take note of any spending that needed to be explained.

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Once the broker got this far into the loan application and had sourced a lender and negotiated loan limits, she then had another little hurdle to cross. The valuation had mentioned power lines being at the rear of the Applicants home and therefore the lender did not want to take on the security. The broker researched the area to prove that these power lines were no longer in use and had been decommissioned. The broker contacted local power companies to find out who controlled the lines and any information to supply to the lender.

In regard to settlement, the broker worked with the lender, the debt assist company and the Applicants to ensure all debts were paid and in fact closed off. This took some time as debt assist was in place, the broker ensured the Applicants were well communicated with until the whole process was completed.

Solution:
The Applicants now have a loan at 5.29% and are saving over $3,000 a month in interest payments, equalling $36,000 a year. They also saved $25,000 with the reduction of their debt.

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Case study 15
Broker and BDM find the right solution for Applicants to buy, build and resell.

Background:
Applicant A and B are married and have a residential investment property which they will build on, and sell the property once built. The Applicants bank with Small Lender A. When applying for a loan, Small Lender A advised that due to the nature of the lending being deemed 'short term' due to the buy, build and resell, they will not consider lending and will refer to the commercial and business banking division, resulting in higher rates, application and ongoing fees. The Applicant's approached a Big Four Bank and was referred to the commercial division. The Applicants were waiting for the bank representative to contact them. The Applicants were also referred to the broker.

Discussions:

- The broker advised the Applicants in regards to constructing a dwelling on the property.
- The broker consulted a BDM of Small Lender B to clarify the lenders policies with the Applicant's situation. The BDM confirmed the Applicant's met Small Lender B's requirements.
- This allowed the broker to advise the Applicant's of Small Lender B's construction guidelines, fees and charges.

Solution:
The broker was able to facilitate the Applicant's request without any penalties and the Applicants were able to proceed with the construction of the dwelling on their property.