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Friday, 17 July 2009

Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

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Dear Sir/Madam

SUBMISSION CONCERNING NATIONAL CONSUMER CREDIT PROTECTION LAW (NCCP)

Challenger is pleased to present our submission to the Senate Standing Committee on Economics in relation to the National Consumer Credit Protection law. This submission is made by Challenger in its own right and also on behalf of PLAN Australia and Choice Aggregation Services, which are 100% owned by Challenger, along with Finance & Systems Technology (FAST) in which Challenger holds a partial ownership interest.

As Australia's largest mortgage broking aggregator and non-bank lender, Challenger strongly supports the importance of mortgage brokers and mortgage managers within the Australian mortgage market. It is consumers who choose to avail themselves of assistance from mortgage broking professionals to obtain the benefits of choice, by obtaining help to select and apply for a mortgage. We therefore seek to ensure that the new credit law provides competitive neutrality across lending distribution channels and does not adversely affect the consumers' experience, regardless of whether they choose to obtain their home loan via a mortgage broker, a mortgage manager, or a direct-to-lender channel such as a bank branch.

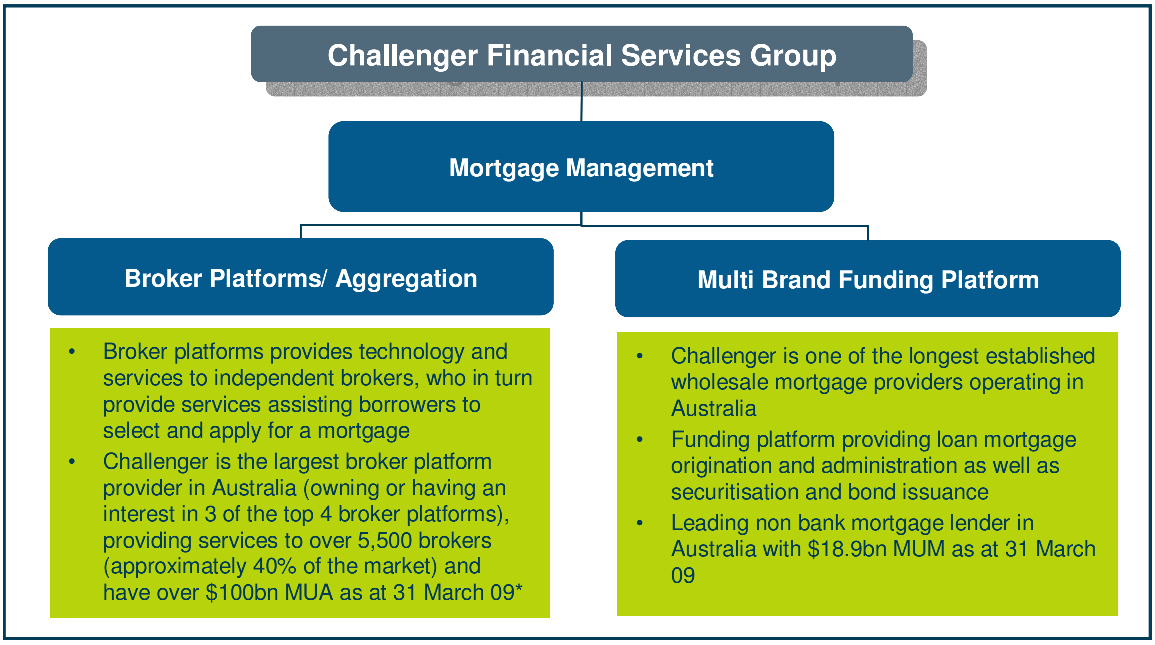
Challenger is concerned to ensure that the NCCP:

- requires disclosures to consumers only if the disclosures are uncomplicated, useful and not duplicated;
- treats non-bank lenders and bank lenders equally so that consumers do not experience a more complicated application process if they choose to use the services of a broker or mortgage manager;

- imposes licence obligations with which licensees of any size may comply readily and at a reasonable cost.

1. Challenger Mortgage Management – Background and credentials of our submission

Challenger Mortgage Management comprises two businesses, one providing Broker Platform (Aggregation) services and the other multi-branded lending for residential and commercial loans. At 31 March 2009, Challenger Mortgage Management had A$100 billion* in mortgages under administration within the Broker Platform business (that is, third party loans arranged by brokers) and a further A$18.9 billion in residential and commercial mortgages under management within the Lending business (that is, loans managed or serviced by Challenger).



- *Broker Platforms / Aggregation*

  Challenger's Broker Platform (Aggregation) business provides support services to accredited finance brokers, who in turn assist borrowers in selecting and arranging their loan. Challenger owns or has an interest in three of the four largest broker aggregation platforms in Australia, representing an estimated 40% of the total broker market. There are more than 5,500 individual brokers who operate under the umbrella of the aggregation services provided by Challenger Broker Platforms. These brokers operate their own independent businesses however, they are required to meet the accreditation requirements of their respective Challenger Broker Aggregation Platform.

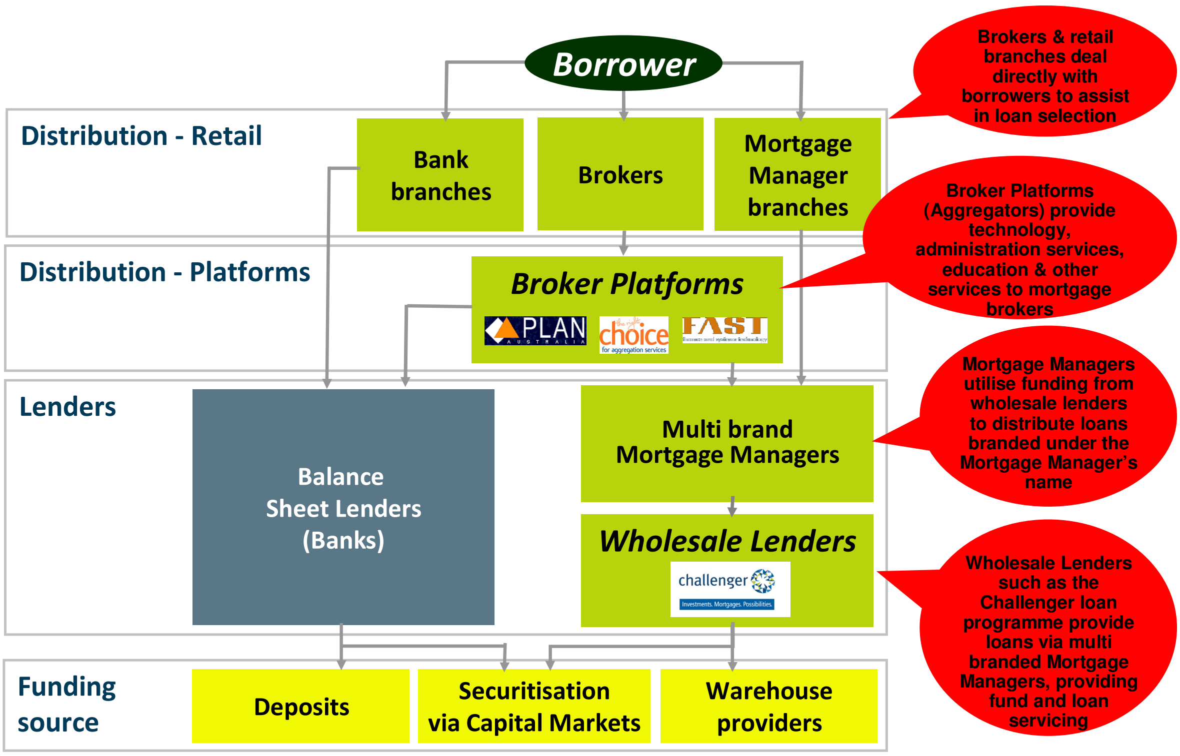
  Challenger's voice therefore is a significant one on behalf of brokers and also the borrowers who choose to obtain their loan with the benefit of value adding services provided by a broker. Within this submission, we represent views which cover approximately 40% of all brokers in the Australian mortgage industry, who in turn provide services to around 45% of borrowers who choose to obtain their home loan with the assistance of a broker. The net result is that Challenger and its affiliated brokers are involved in arranging approximately one in five new home loans in Australia.

- *Lending*

  Challenger's Mortgage Management Lending business primarily provides wholesale mortgage products to mortgage managers who distribute these products to borrowers under their own individual brand. Challenger distributes its loan products via a network of over 450 mortgage managers and is one of the largest non-bank lenders in Australia. Challenger acts as the servicer and manager of loans financed out of trusts of which an independent party (predominately Perpetual Trustees Victoria Ltd) is the trustee/lender of record.

  In relation to lending, Challenger's voice is also significant. We are the largest servicer of non-bank loans in Australia. The loans that we are responsible for servicing are distributed and managed by hundreds of mortgage managers, who collectively play an important role in fostering competition by offering non-bank loan alternatives to borrowers.

To fully understand Challenger's position within the mortgage market, along with the position of its associated brokers and mortgage managers, it is important to understand the interconnectivity of the various parties within the market, as shown below:



As can be seen from the diagram above, borrowers have multiple avenues available to them when applying for a loan. Borrowers may obtain finance by:

- Applying directly via a bank branch;
- Via a broker, who may assist in arranging a finance application from a bank or a mortgage manager;
- Applying directly to a mortgage manager;
- The mortgage manager in turn arranges finance from a wholesale lender.

This diagram illustrates the importance of having choices available to borrowers (and thereby competition within the market), which must not be prejudiced by onerous requirements being placed upon any particular distribution channel. In this submission, we will therefore differentiate between the legislative responsibilities that we believe are appropriate for intermediaries who are responsible for assisting with loan selection and distributing product (as a distribution channel), versus those responsible for assessing and providing credit (as a credit provider).

Given that the role of mortgage managers is not always well understood, it is important to outline their role within the non-bank lending sector. Mortgage managers perform functions which are in many ways similar to bank branches, in relation to branding, distribution activities and the provision of customer services. Mortgage managers are responsible for managing the consumer interface, and for providing a loan branded as the mortgage manager's. The mortgage manager outsources funding of the loan to a wholesale funder, much as a bank does to its own internal treasury department. For example, Homeloans Ltd. (in which Challenger holds a partial ownership interest) retails mortgages and provides consumer services under its own name, but arranges funding via a number of different wholesale funders including Challenger, ING and Bendigo & Adelaide Bank.

2. The role of brokers facilitating competition as an independent distribution channel

Brokers play an increasingly significant role in facilitating competition within the mortgage market by enabling borrowers to select via a side-by-side comparison from a range of different options, including different lenders and product features. Given that around 45% of all new loans are originated via mortgage brokers, these consumers enjoy the benefits of having a number of different options presented directly to them.

Any regulatory action which impairs the capacity of brokers to provide borrower choice, and for non-bank mortgage providers to write competitively priced loans, will allow the banks to continue to rebuild their margins at the expense of Australian homebuyers. The credit regulation regime must therefore be carefully targeted at assuring the quality and integrity of mortgage broking services, without substantial increases in administrative or other costs that may diminish brokers' ability to operate in the market.

If brokers, as a distribution channel, are placed at a competitive disadvantage compared to the direct-to-lender channel as a result of differing or unnecessary duplication of processes arising from legislative requirements, then there is a risk of creating a distortion that may result in borrowers favouring the direct channel. Any process and cost differences that could result in channel bias may result in a reduction of the proportion of loans distributed via brokers, and thereby a reduction in borrower choice for individual consumers. If this leads to shrinkage of the broker sector, an unintended consequence could be reduced benefits of competitive tension more broadly throughout the market.

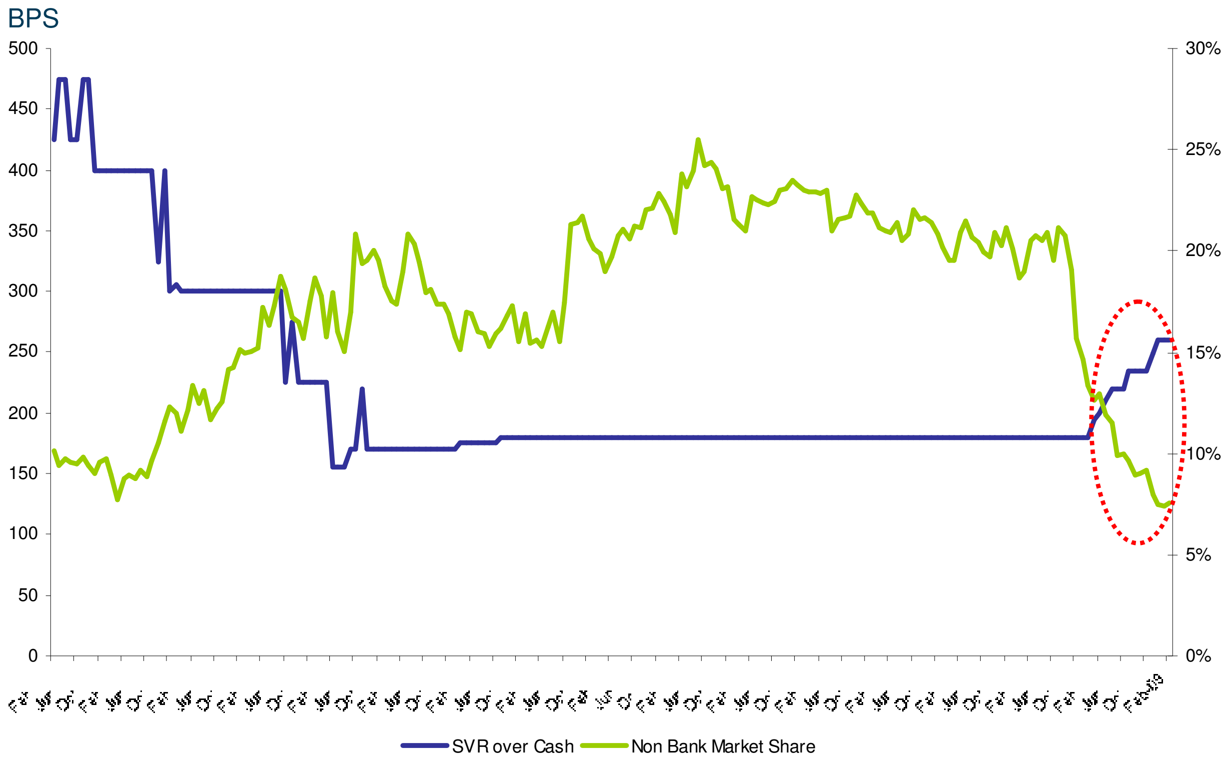
As a result, Challenger submits that the legislation should result in a consumer experience which is similar regardless of whether a finance application is submitted via the broker channel or direct-to-lender channel. We outline in following sections a number of areas where we believe that the draft legislation will result in a more complicated and expensive borrower experience via the broker channel.

3. The role of non-banks facilitating competition within lending

For more than a decade non-bank mortgage managers have provided effective competition to the banks for the direct benefit of Australian homebuyers. Prior to 1990, the margin between the mortgage rate and the bank bill rate was often negative so there was little or no room for housing lending on any scale by anyone other than banks, building societies and credit unions. In the early 1990's a combination of financial deregulation and lower inflation substantially reduced the gap between the bill rate and the deposit rate allowing a new class of lenders, the non-bank mortgage providers, to enter the market.

Because the banks had far larger mortgage books than the non-bank mortgage providers and wanted to maintain their average margins, the non-bank mortgage providers were able to borrow at the bill rate and undercut the banks' mortgage lending rates. In 1994, the competition between non-bank mortgage providers and banks intensified providing a major benefit to home buyers in the form of a significant reduction in the margin between mortgage lending rates and the official cash rate.

By offering lower mortgage rates than the banks and by the brokers offering greater choice to the borrowers, competition was increased resulting in a reduction of more than 2% in the margin on mortgage lending, as shown below. With competition in the Australian mortgage market already declining due to market consolidation and lenders exiting the market, we are seeing the margin on mortgage lending already starting to increase, making it vitally important for Australian homebuyers that we maintain competition levels so that margins do not widen materially further.



Source: ABS, RBA

4. Licensing requirements

(a) Different licence categories, including small businesses

We note that the vast majority of brokers currently operating within the market are small businesses, typically employing less than five people and often only one. Small businesses such as these would typically not have available resources or capabilities to devote towards any licence application process which requires extensive advice or involvement from third–parties such as lawyers.

Challenger submits that the legislation should include provisions for different classes of licences (brokers, aggregators, lenders, mortgage managers, intermediaries and debt collectors), each with an appropriate application process and template. In relation to brokers, we submit that any licensing requirements which are defined within the regulations should adopt a practical approach, such that a typical small business broker applicant could prepare their own licence application without external assistance.

In relation to the general conduct obligations of licensees, it is noted that these are the same regardless of the licensee's size and type of business (per the types noted above). Challenger submits that certain obligations as currently drafted in the Bill are inappropriate for small scale business.

(b) Licence exemption for parties involved in securitisation

As noted above, Challenger is the servicer of Australia's largest pool of non-bank mortgages and is also the leading non-bank originator of new residential mortgages. Our lending business model is based on securitisation, whereby loans (which are income producing assets) are equitably assigned into trust-based funding vehicles that are funded via the issuance of notes known as Residential Mortgage Backed Securities (RMBS) purchased by third-party professional investors.

We note that the intention of the legislation is to provide a comprehensive framework that offers protection to consumers in relation to the provision of credit. Consequently, the measures within the Bill are directed (appropriately) where contact points exist with consumers. However, we believe the current drafting of the Bill is such that the impact of regulation, most likely unintentionally, extends well beyond consumer interfaces and impacts a number of other participants who are involved upstream in the funding supply chain.

Specifically, under the current definition in Section 10 "assignees" are deemed to be credit providers and are therefore required to be licensed and are consequently caught by the consumer protection provisions, even they may have no interaction with consumers. A fundamental principle and operational feature of securitisation is separation between the lender of record (a trustee), parties involved in servicing loans (which *should* be NCCP regulated), parties involved in managing funding activities and the professional investors which provide wholesale funds. A number of these participants in the equitable assignment process have roles relating to the provision of wholesale funding, rather than dealing with consumers. We note that as participants within the wholesale funding markets, such entities would ordinarily be regulated by ASIC under Australian Financial Services Licences. Consequently, we submit that such participants should be exempt from the NCCP law.

We note that this area is highly complex and that the consequences of not providing a licensing exemption to entities such as Trustees, Trust Servicers and Equitable Assignees would most likely be substantial. Challenger refers to the submission to

Treasury concerning the NCCP Exposure Draft which was made by the Australian Securitisation Forum which covers in substantial depth various issues relating to securitisation. Challenger fully endorses this submission and the recommendations therein. We also note that a number of other submissions made to Treasury have also called for this change to be made to the Bill, including submissions by the Mortgage & Finance Association of Australia, the Australian Bankers' Association and a number of banks.

5. Challenger's support for minimum standards, including training, to enhance industry professionalism and consumer protection

The requirements for brokers to have appropriate professionalism and experience, carry adequate professional indemnity insurance and provide consumers with access to an external dispute resolution scheme reflects the standards we have supported for many years through our accreditation program for brokers who have Challenger on their panel of lenders, as well as for Challenger Broker Platform accredited brokers.

Through Challenger Broker Platforms, we have always been at the forefront of maintaining broker educational standards and feel that it is important to recommend minimum Certificate IV in Financial Services (Finance/Mortgage Broking) or equivalent educational requirements.

We submit that the requirements as described above should be included within the applicable Regulations.

6. The responsibilities of brokers as distribution intermediaries, versus lenders as credit providers

(a) Challenger's position

We believe that the intent of the Bill is appropriate, by defining the role and responsibilities of brokers to act (in paraphrased terms) in the best interests of consumers by assisting them to select and apply for a finance product which is suitable to their needs.

However, we submit that the responsibilities of brokers (in their capacity as credit assistants within the distribution channel), versus those responsible for assessing and providing credit (in their capacity as a credit provider or loans servicer) should be regarded as fundamentally different.

We agree that brokers should be responsible for ensuring that recommended products are appropriate to the circumstances of the borrower. In making a determination of which products may be appropriate, brokers should be required to take into account factors concerning the borrower's individual circumstances.

However, in our submission, in assessing a borrower's needs *brokers* should only be obliged:

- to make *reasonable enquiries of the consumer;*
- to collect third-party information from the borrower (for example pay slips from an employer which are held by the borrower), but only if requested by a credit provider;

- to sight original documents and to verify the authenticity of copied documents against originals, but only if requested by a credit provider;
- to collect information directly from third-party sources (such as a credit bureau or an employer), but only if requested by the credit provider;
- NOT to provide the credit provider with any information that is known to be incorrect, or ought reasonably have known to be incorrect.

Challenger believes that during the credit assistance stage brokers should not be required to *verify* any information collected from the consumer or any third-party, unless requested to do so by a credit provider, given that in our submission this should solely be the responsibility of credit providers for the reasons which follow.

The risk that credit providers might in future place reliance on another party's credit assessment, which was one of the factors in the U.S. credit crisis, means that verification should not be required by intermediaries and should be the responsibility of lenders.

We agree entirely with the intent of the draft legislation that *credit providers* should be responsible for both *obtaining and verifying* credit information and for ensuring that the finance is appropriate for the consumer's circumstances. The credit provider has an interest in verifying borrower information from two perspectives. The first interest is to ensure that the loan is suitable for the borrower, in accordance with the intent of the legislation. But equally importantly, the credit provider has an in interest in ensuring that the borrower has an appropriate capacity to repay the loan, so that the lender will earn an economic return.

It should always be borne in mind that there will inevitably be some instances where borrowers are not honest in their representations to credit providers, which reinforces the importance for the lender to *verify* the particulars provided, independently of the broker. Thus, we believe that *verification* is a critical and appropriate responsibility of the credit provider.

As the legislation is currently drafted, brokers and credit providers are *both* responsible for *verifying* credit information. We submit that this could result in borrowers who engage the services of a broker in loan selection being required to produce documentary verification evidence twice in the process (or potentially more than twice if a mortgage manager is involved), rather than once only via the direct-to-lender channel. For example, a broker might verify income by calling an employer at the preliminary assessment stage and then the credit provider would do likewise following receipt of the loan application. Any duplication of process and documentation is unnecessary when ultimately it is the *credit provider* who is responsible for the verification and credit assessment, and will perform these checks regardless of any verification conducted previously by a broker.

From a process perspective, there is often a considerable elapsed time between a borrower considering finance options (usually the first point at which a broker is involved), to making a decision, through to lodging an application. During this time, the consumer's circumstances may often change. Given that the *credit provider* will always require *verification* as part of their credit assessment following receipt of an application (which is entirely appropriate), we believe that verification should only be a requirement upon the credit provider in conjunction with (or after) the submission of an application. The requirement upon the *broker* should be to make *reasonable enquiries of the consumer* with respect to the consumer's requirements, objectives and financial situation.

(b) Challenger’s response to the Australian Bankers’ Association’s (ABA) submission

Challenger notes that the ABA’s submission to Treasury regarding the NCCP Exposure Draft recommends that banks and their credit representatives should be removed from the definition of credit assistance and removed from the requirements concerning preliminary assessment. We note that the intention of the legislation is not to regulate the provision of credit broking, but rather, to regulate the provision of credit in general.

It is a fact that many banks have a vast array of different products, with various characteristics that may or may not be suitable to the needs and circumstances of any given customer. We also note recent contentious examples of credit provision, such as the Storm Financial imbroglio, where questions have been raised as to whether consumers were provided with appropriate credit assistance from bank branches. Therefore in our view, banks should be held responsible for selecting and recommending products which are not unsuitable for the customer at the credit *assistance* stage, as well as making a determination of suitability at the credit *assessment* stage.

Challenger objects in the strongest possible terms to the ABA’s recommendation that banks should be exempt from the laws relating to credit assistance, on the basis that this would result in requirements which are considerably more onerous for intermediaries, compared to the requirements applicable to the direct channel. As a result, consumers would be inconvenienced by a more complex process when utilising the services of a broker, which would create a competitive disadvantage to the broker channel. Challenger’s position is that if the law does create a distinction between the processes of credit assistance and credit assessment, then the assistance components should apply equally to banks and intermediaries.

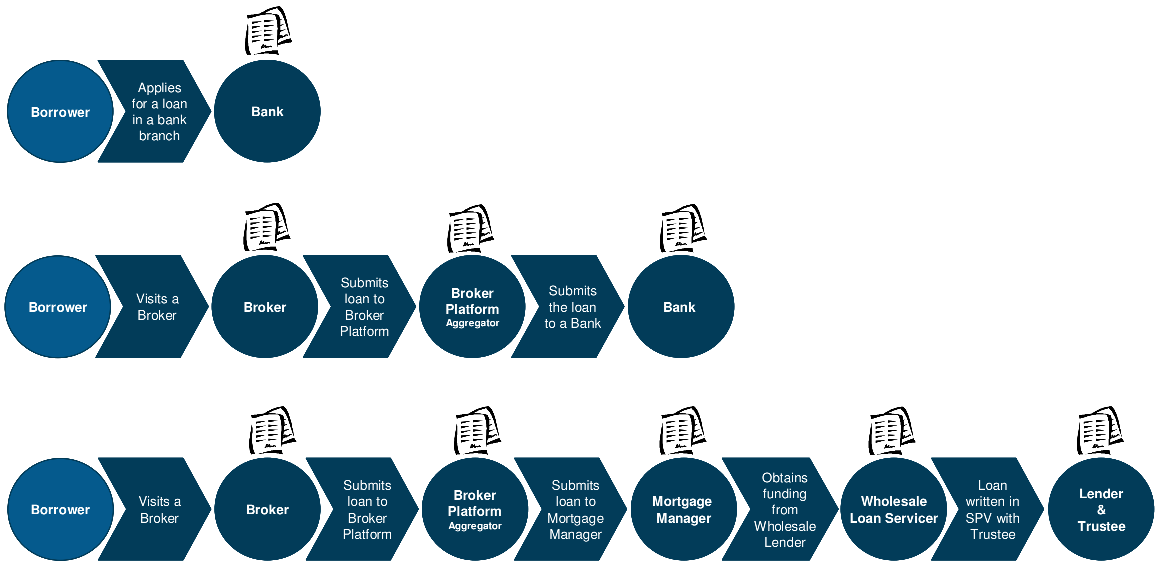
However as an alternative, Challenger notes comments in the submissions to Treasury by Westpac and the ABA which discuss that in practical terms the distinction between credit assistance and credit assessment will not always apply and may not occur in a sequential manner. Both submissions provide the example of applications lodged directly by consumers via the internet. The ABA makes a recommendation that the legislation should be framed in outcome oriented terms, rather than in process oriented terms as is currently drafted. It is suggested by the ABA that an outcome oriented approach could be achieved by way of requirements to the effect that “intermediaries and lenders should not *recommend* or *offer* any credit contract that is unsuitable for the customer”. This approach could allow the somewhat artificial legislative distinction between credit assistance and credit assessment to be removed. Challenger would support such an approach, provided that any obligations concerning “recommending” should be applied equally to intermediaries and the direct-to-lender channel.

We also disagree strongly with the ABA’s recommendation that banks should be exempt from disclosing to consumers any commissions which are payable to their employees when acting as authorised representatives. Whenever there are commission payments pertaining to the sale of credit products, there is a risk of a potential conflict of interest which applies equally via the intermediated and direct-to-lender channels. To allow consumers to be fully informed of such potential conflicts, the disclosure of commissions should apply equally to all licensees within all distribution channels, including banks.

Finally, the ABA recommends the introduction of a positive credit reporting regime. Challenger notes that the legislative enablement of such a regime lies under Privacy legislation, rather than NCCP. As a non-bank lender, Challenger supports positive reporting and notes that it would provide significant benefits for lenders in assessing the suitability of credit for consumers. However, as an aggregator representing the interests of brokers, we assert that assessing credit reports (whether negative or positive) should be the responsibility of lenders.

7. The current requirement for multiple parties within the lending process to provide credit guides to consumers may discriminate against the broker channel and the non-bank lending sector, versus the direct-to-lender channel

As shown in the diagram on page 3, a consumer has multiple avenues available to them via which they can obtain a loan. Consider the scenario below where a borrower could receive up to five credit guides to obtain a loan via a broker, versus receiving one to obtain the product from a bank branch.



Challenger submits that the provisions within the Bill concerning the provision of credit guides to consumers be amended such that where there are multiple parties involved in the process, a single guide (or guides) may be provided to the consumer which explains the respective role of each party and fulfils the disclosure requirements within the legislation. For example:

- A combined guide could cover a broker and its aggregator
- A combined guide could cover a mortgage manager, wholesale loan servicer, lender and trustee.

Each party named in any such consolidated document could be required to provide their consent and would be held to maintain the same responsibilities and obligations that would otherwise apply under the legislation, as if they produced their own individual credit guide.

It would be preferable that a broker should only be required to provide their own credit guide when they commence dealing with a consumer and the information required to be provide in the credit guides of other entities in the supply chain should only be provided in loan documentation when a recommended credit product is being arranged. Provision of this information earlier in the process is unnecessary and might well imply a foregone conclusion in relation to the loan being arranged.

8. Requirement for credit guides to name the top 6 lenders

As described above, brokers and broker platforms (aggregators) offer a benefit to consumers and the market in promoting competition and consumer choice. In doing so, they offer a range of products from a range of lenders. Over time and in response to changing market offerings and consumer preferences, the main credit providers with whom they deal will change.

The current drafting of the Bill requires licensees, including brokers and broker platforms (aggregators), to disclose their top 6 credit providers. Given that these are likely to change over time, there could consequently be a requirement to frequently reprint credit guides. Challenger submits that the legislation be amended such that the licensee should only be obliged to disclose 6 of the top 10 credit providers, over an extended period of time.

9. Quotes & disclosures concerning commission, fees and charges

The draft legislation requires that a quote must be provided prior to a licensee providing credit assistance to a consumer. Challenger submits that providing a quote at the very beginning of the enquiry process is likely to be difficult, even though the legislation allows for disclosure of maximum amounts, rather than precise figures.

Challenger submits that the legislation should refer to “estimated fees and charges” with provisions to require further written disclosure to the consumer and to obtain their consent to proceed, if it becomes likely at a later time that the estimated amounts will be exceeded.

In relation to the disclosure of commissions, Challenger submits that it is not practical to disclose any potential commission amount in dollar terms “at the same time as providing credit assistance”. This is because the commission payable is likely to vary depending upon a number of variables including the lender and the amount of credit, which may not be known until such time as a credit application is made.

Challenger therefore proposes a number of amendments including:

- Disclosure of the calculation method, rather than a dollar amount
- Requirement for disclosure in writing, rather than within a “credit proposal document”

Challenger endorses the proposal made by the Mortgage & Finance Association of Australia in their submission to Treasury in relation to the NCCP Exposure Draft, in which it is proposed that commission should be disclosed as percentages within bands, with a listing of lenders which fall into each band.

Challenger also seeks an exemption for mortgage managers being obliged to disclose fees, margins and commissions, due to factors arising from their business model, as explained below.

As described in section 1 of this submission, mortgage managers are retail distributors and service providers, with many similarities to a bank’s branch network. Mortgage managers apply their own brand to loans, using funding sourced from wholesale funders. We submit that it would be inequitable to require mortgage managers to disclose to borrowers any margin, commissions, fees or charges which they will derive from the loan. To do so would create inequity between bank lenders, who will not be required under the legislation to disclose the cost of operating their branch network, including any salaries and other costs associated with lending sales staff.

However, where a mortgage manager's loan is distributed to the consumer via a broker or any other intermediary who deals directly with consumers we believe that it is appropriate that the broker should be required to disclose any commissions, fees or charges that will be received from the mortgage manager.

10. An exemption should be added to ensure that brokers are not held responsible for assessing whether the use of borrowed funds are appropriate to the borrower's needs

Challenger submits that the Bill should recite the liability of brokers such that they are not responsible to assess whether or not the borrower's use of credit is appropriate for their needs.

For example, a consumer could apply for a line of credit loan secured by their residence with the intention of using the funds to purchase shares. Given the consumer's objectives and intentions, and assuming their capacity to make repayments was satisfactory, a line of credit loan could be deemed as a suitable credit product for a broker to recommend. However, in this instance the finance broker should be held responsible only for ensuring that the credit product is appropriate. Assuming that the broker is not also a financial advisor, they should not be held responsible for the borrower's investment choices.

As a further example, a consumer may wish to utilise borrowed funds to invest in a residential property that will be rented out. Challenger submits that the broker should not be held responsible for assessing whether or not that investment property is suitable to meet the consumer's investment objectives.

And as a final example, a consumer may wish to utilise borrowed funds to purchase a residential property in which they intend to live. The finance broker should not be held responsible for assessing whether or not the property is suitable to the consumer's needs, or indeed whether or not the property has any deficiencies.

Conclusion

Challenger supports the NCCP, but wishes to ensure that any new processes which will be introduced as a result of the new law should apply in a manner such that the impacts are equal between:

- different distribution channels (particularly broker versus direct-to-lender); and
- different types of lenders (including bank, versus non-bank, versus mortgage manager).

We also seek to ensure that the new law:

- requires disclosures to consumers only if the disclosures are uncomplicated, useful and not duplicated;
- treats non-bank lenders and bank lenders equally, so that consumers do not experience a more complicated application process if they use particular class of lenders;
- imposes licence obligations with which licensees of any size may comply readily and at a reasonable cost.

Challenger requests an opportunity to appear as a witness at the Committees' public hearing to present our submission further.

Yours faithfully

Drew Hall
Chief Executive, Mortgage Management
Challenger Financial Services Group

* Includes loans under administration within Plan Australia and Choice Aggregation Services, which are 100% owned by Challenger, along with Finance & Systems Technology (FAST) in which Challenger holds a partial ownership interest.