

## **Opening Statement by Raj Venga, Credit Ombudsman, to the Parliamentary Inquiry into competition in the bank and non-bank sectors**

Thank you for the invitation to address the Inquiry.

Apart from making a few observations about the need for the bank sector to lift its game, the Credit Ombudsman Service Limited (COSL) is not in a position to comment on what should be done to enhance competition in the non-ADI sector. This I will leave to others who are more expert than I in these matters.

However, because COSL has 8,500 members and operates exclusively in the non-bank sector, we are in a unique position to inform the Inquiry of our own experience in the sector.

Among others, COSL has as members, on a voluntary basis, non-bank lenders and mortgage brokers.

Mortgage brokers and loan writers account for about 47% of all home loans in Australia.

Many of them are former bank managers and employees who became disillusioned with bank branch closures in the 1990s.

Of the estimated 20,000 mortgage brokers and loan writers operating in Australia, about 75% of them are either members of COSL or contractors of COSL members.

95% of COSL's membership comprises groups of only one to five operators, essentially small businesses or husband and wife teams.

### *Broker's role*

Brokers are a significant feature in the Australian financial services landscape. Their value proposition is to provide borrowers with access to different lenders, competitively-priced products and loan options; and to ensure that these options align with the borrower's particular needs.

Because mortgage brokers act for the borrower and not for the lender, they are generally subject to a fiduciary duty to act in the best interest of their clients.

This can be contrasted with the position of a bank branch employee whose employer bank who owes no such duty.

There are of course rogue brokers in the industry. These tend *not* to be members of COSL or a peak industry body such as the Mortgage & Finance Association of Australia (MFAA). They tend to operate at the fringes, not having met appropriate training, accreditation and probity requirements demanded by reputable industry bodies as a condition of membership.

The impending Commonwealth legislation will require the national licensing of mortgage brokers and this ought to see such operators exit the industry. Clearly a good thing.

## *Responsible lending*

There is little by way of comprehensive responsible lending legislation in Australia, which is why industry self-regulation has an important role in consumer protection.

And it is here that we see the higher standards the non-ADI sector has set itself.

For example, clause 25.1 of the Banking Code (which, incidentally, not all banks subscribe to) provides that, before a bank offers or gives a prospective borrower a loan (or an increase on an existing loan), they will exercise the care and skill of a diligent and prudent banker in selecting and applying **their** credit assessment methods and in forming **their** opinion about the person's ability to repay it.

The Australian Bankers' Association has rejected any suggested change to this clause in its submission to the current review of the banking code, saying that a more prescriptive approach to credit assessment would place its members at a competitive disadvantage with non-bank lenders.

Quite the contrary, more responsible standards of credit assessment are imposed on COSL's members which are subscribers to the MFAA Code of Practice.

The Abacus *draft Code of Practice* for non-bank ADIs (that is, credit unions and building societies) will, when adopted, also impose higher credit assessment standards than the banking code.

The MFAA Code of Practice provides that:

*A member must suggest or recommend to an applicant only those arrangements for finance that the Member genuinely and reasonably believes are appropriate to the needs of that applicant after undertaking an assessment of the applicant's capacity to repay the loan.*

*A Member must always make such enquiries as are reasonably necessary in all the circumstances to determine an applicant's capacity to repay the proposed loan.*

It is our view that the vast majority of non-ADI lenders conduct business and provide credit in an appropriate way.

Indeed, our records indicate that only 7% of the complaints we received in the first half of this calendar year could be classified as inappropriate lending by non-ADI lenders or by brokers. We define inappropriate lending as involving predatory lending, lending where the borrower has no capacity to repay, or "churning".

It might be noted that this 7% only relates to complaints received by us – it does not mean that they had been made out.

## *Financial hardship*

We are of course acutely aware that falling property values and higher interest rates, petrol and food costs are placing increasing stress on Australian households.

A staggering 23% of all enquiries and complaints we received in the last quarter related to financial hardship and the difficulties borrowers were experiencing in meeting their loan repayments.

In terms of financial hardship relief, the non-ADI sector has again shown the way.

The MFAA Code, which COSL applies to its lender members, and for that matter, the proposed draft Abacus Code, contain much stronger provisions than the banking code in terms of lenders assisting borrowers in financial hardship.

Clause 25.2 of the banking code merely says:

“With your agreement, we will try to help you overcome your financial difficulties with any credit facility you have with us. We could, for example, work with you to develop a repayment plan.”

On any reasonable basis, that is an exceptionally weak and vague commitment.

In stark contrast, under the MFAA Code’s hardship provision:

- If a non-ADI lender becomes aware, or is advised by the borrower, that the borrower is in financial difficulties, the lender must consider whether their loan repayments should be varied.
- The Code’s financial hardship provisions apply whether or not the loan is regulated by the Credit Code, and irrespective of the amount of the loan
- It requires the non-ADI lender to suspend any legal action to take possession the home
- It prohibits the lender from listing the default or requiring the borrower to apply for the early release of his or her superannuation, or seek funds from family and friends.

#### *EDR schemes differ*

Interestingly, even the external dispute resolution schemes operating in the bank and non-ADI sectors take entirely different views on their ability to deal with financial hardship and penalty fees.

The Financial Ombudsman Service, whose members include all banks, has chosen not to hear complaints about excessive fees charged by banks, and continues to refuse to consider borrowers’ complaints about financial hardship, except in the limited context of clause 25.2 of the banking code mentioned above.

In contrast, COSL, which operates exclusively in the non-bank sector, willingly accepts complaints about penalty fees and complaints about its lender members not properly considering financial hardship applications. It has even issued a comprehensive guideline to assist its lender members to properly deal with payment variations in circumstances where a borrower is experiencing financial hardship.

#### *Conclusion*

When one considers that some non-ADI lenders have left the industry or are otherwise in hibernation, it is apparent that market power has been further concentrated in the hands of the biggest five bank lenders.

We agree with Challenger's written submission to the Inquiry that mortgage brokers play a significant role in facilitating competitive pricing by subjecting loans to independent price scrutiny and comparative analysis with other products.

Loans originated by a bank branch are not of course subjected to this process.

The current constraints on non-ADI lenders to offer competitively priced loans has, however, meant that mortgage brokers are having to channel more loans to the banks, thus further increasing both their market share and their pricing power.

A reduction in the number of non-ADI options for brokers to provide to borrowers will reduce their effectiveness and their usefulness to consumers. They will simply become another conduit for customers to the big five banks, without value adding to the competitiveness of the market.

It seems to us that banks are so similar in their approach to interest rates and product offerings, that they may as well be the same organisation.

Recent ABS data shows that the big four banks now have about 90% cent of all home loans by value - the highest rate in 13 years.

One has to ask "Where's the competition?"

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