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**Private and confidential**

Senior Project Manager (Credit)  
Policy & Strategy Division  
NSW Office of Fair Trading  
PO Box 972  
Parramatta NSW 2124  
**Email:** [policy@oft.commerce.nsw.gov.au](mailto:policy@oft.commerce.nsw.gov.au)

Dear Sir / Madam

**SUBMISSION ON THE EXPOSURE DRAFT OF THE FINANCE BROKING BILL 2007**

The Australian Securitisation Forum Inc. (“**ASF**”) appreciates the opportunity to comment on the exposure draft of the Finance Broking Bill 2007 (“**Exposure Draft**”).

We welcome the implementation of this regulatory scheme which aims to neutralise the inconsistencies in the current state-based framework, as well as address increasing consumer concerns relating to the growth in the broking market.

ASF however submits that the proposed scheme shall have serious ramifications for secondary credit providers who acquire loans from an originator of that loan.

**1. Background to ASF and securitisation**

ASF was formed in 1989 to promote the development of securitisation in Australia. As a peak industry body representing the securitisation market, the ASF performs a pivotal role in the education of government, regulators, the public, investors and others who have an interest or potential interest both in Australia and overseas, regarding the benefits of securitisation in Australia and aspects of the securitisation industry.

In short, a Residential Mortgage Backed Securitisation (“**RMBS**”) involves an originator of housing loans selling a portfolio of these loans to, or originating these loans on behalf of, an insolvency remote special purpose vehicle (“**SPV**”). The SPV funds the purchase of these loans by issuing debt securities (notes or bonds) to investors. The interest and principal payments made on the underlying assets are used to make the interest and principal payments on the debt securities. Various liquidity and credit enhancements are put in place to help ensure the SPV can repay investors what is promised on the debt securities.

Therefore, the key characteristics of securitisation are:

- The existence of a predictable cash flow;
- The establishment of an SPV to hold the assets for the benefit of investors; and
- Credit, liquidity and cash flow enhancements to support the payment of interest and principal to investors.

A similar structure can be used for commercial mortgages, known as Commercial Mortgage Backed Securitisation (“CMBS”).

## **2. Securitisation related issues identified in the Exposure Draft**

### **2.1 Liability of ‘credit provider’**

Clause 29 of the Exposure Draft provides that a credit provider is liable for any compensable conduct by an unregulated person as if the conduct were the credit provider’s conduct.

A credit provider is defined as “the person by whom credit is or is to be provided”.

Generally, ASF submits that a credit provider should not be held liable for the conduct of a person who is entirely outside the credit provider’s control.

In many cases, the credit provider will be an Authorised-Deposit Taking Institution (“ADI”) or a bank. ADIs are currently regulated by the Australian Prudential Regulation Authority, the Uniform Consumer Credit Code (as are non-ADIs) and Code of Banking Practice. These measures have, to date, ensured that banks, in their dealings with customers (including dealings via OMBs), act with the utmost integrity. Of particular relevance to the proposed regime is that clause 25.1 of the Code of Banking Practice provides that before a bank offers or gives a customer a credit facility, it will “exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay it”. Similarly, clause 15 of the Credit Union Code of Practice and clause 14 of the Building Society Code of Practice provide that a credit union or building society must make an assessment of a consumer’s capacity to repay a loan. A further protection for consumers is offered by the Uniform Consumer Credit Code which provides mechanisms where a customer can ‘reopen’ an ‘unjust contract’ and have its terms amended (as occurred in the case of *Permanent Mortgages v Cook*). Also of relevance is the upfront disclosure requirements contained in both the Uniform Consumer Credit Code and the Code of Banking Practice.

It is unreasonable to hold a credit provider liable for the conduct of a third party where, that credit provider, has complied with all of its obligations under the existing regulatory regime.

*Recommendation 1:* that credit providers are not liable for compensable conduct by an unregulated person.

If the regulation is intended to prevent credit providers from dealing with unlicensed brokers, a separate clause and offence could be created which clearly outlines the credit provider’s obligations to take reasonable steps to ensure the finance broker is licensed prior to processing a credit application.

## 2.2 Stay of enforcement action

Clause 54 of the Exposure Draft provides that a consumer can apply to the Supreme Court for an order prohibiting the credit provider from taking any action in relation to the loan or requiring the credit provider to cease any action that may have been commenced until a dispute between the broker and consumer is settled.

In the securitisation context, as SPVs rely on the receipt of payments from loan agreements in order to support the payment of interest and principal to investors, ASF submits that it would be unreasonable for secondary credit providers to carry the risk of delay and bear the costs of not receiving payments when the dispute is essentially between the consumer and the finance broker. In addition, delayed payments and enforcement flows to the investors in the notes issued by the SPV and then has further market flow-on effects.

Clause 54(4) of the Exposure Draft requires the Supreme Court to consider:

- (a) whether a successful outcome of the dispute between the finance broker and consumer would prevent the need for enforcement; and
- (b) whether the consumer would be able to make payments to the credit provider to ensure that neither the credit provider's or consumer's interests would be irretrievably affected if a stay of enforcement was granted.

This clause however does not prevent a stay from being ordered even if the Supreme Court considers that the credit provider's interests would be adversely affected. The reason a mortgage is being enforced against a consumer is that it has failed to make payments on its housing loan. In most cases, a credit provider will give a consumer an opportunity to cure defaulted payments. It would be highly unlikely for a credit provider to enforce against a consumer if that consumer could demonstrate its ability to continue to pay the housing loan. Furthermore, the credit provider in offering credit to the consumer, should have complied with the regulations set out in the Banking Code of Conduct (or Credit Union or Building Society equivalents) and Uniform Consumer Credit Code. By doing this, the relevant credit provider would have made an independent assessment of the consumer's ability to repay. We therefore submit that allowing a stay of enforcement action would unfairly prejudice the credit provider's interests, again, as the credit provider should not bear the cost of finance broker conduct.

*Recommendation 2* - that the provisions relating to a stay of enforcement action be removed.

If Recommendation 3 is not accepted we recommend in the alternative that the time frame during which a consumer may take action against a finance broker is reduced from 3 years to 6 months. This period of time is sufficient to allow any improper conduct of the finance broker to come to light. Such a reduction would limit the risk passed on to investors in RMBS and CMBS in a securitisation structure.

*Recommendation 3* - if Recommendation 2 is not accepted, that the period of time during which a consumer may apply to the Court for an order under Part 4 be reduced to 6 months.

### **3. Other issues identified in Exposure Draft**

#### **3.1 Licensing regime**

Currently, the regime suggests state-based licensing requirements.

We suggest that allowing for differences between jurisdiction is an unnecessary burden on finance brokers and also credit providers. More often than not, the credit providers act across jurisdictions and finance broker firms are nationally based. We therefore advocate a national licensing regime with uniform requirements.

#### **3.2 Assessing the consumer's capacity to repay**

Under clause 31(b) of the Exposure Draft, the finance broker is under a strict liability to ascertain both the consumer's credit requirements as well as the consumer's capacity to repay the loan. More specifically, clause 33 sets out a number of requirements that the broker must establish including the consumer's income and expenditure, credit history and future prospects. These requirements also extend to the finance broker contacting third parties and analysing third party documentation in order to ascertain the consumer's exact financial position.

A finance broker has only limited means of determining whether the borrower can repay the loan, for example, by performing credit checks on behalf of a particular proposed lender. It is unrealistic to expect the finance broker to go further than relying on the information and documentation provided by the consumer when there will be privacy restraints on the ability of a finance broker to obtain all the information it needs to assess credit history, credit capacity and so forth.

In addition, for a finance broker to adequately assess the capacity to repay a credit product in an effective manner similar to that applied by a credit provider, it would require proprietary information of each credit provider being the information used by each credit provider to assess its borrowers capacity to repay. Such a requirement is inappropriate and impractical as this information is confidential to the credit provider and commercially sensitive.

The requirements for assessing the consumer's capacity to repay the loan as set out in the Exposure Draft are overly prescriptive. If a finance broker makes reasonable inquiries and is acting to the best of its knowledge or belief it should not be held liable for its conduct.

Consumers already receive protection from the regulations and obligations imposed on the credit provider, as discussed above at 2.1.

<p><i>Recommendation 4</i> - the finance broker should be able to rely in good faith on information and documentation provided by the consumer, without being obligated to make inquiries of third parties.</p>
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#### **3.3 Strict liability of the finance broker in making credit proposals**

Under clause 35(3)(b), the finance broker is under a strict liability to not fail to put forward a credit proposal that is available to the broker if:

- the credit offered by the proposal meets the consumer's credit requirements, and
- the broker has ascertained that the consumer has the capacity to repay that credit.

This requirement is unrealistic in practice as it compels the broker to put forward every single credit proposal to the borrower that is available on the market and do a comparison.

Furthermore, such an obligation is likely to give a competitive advantage to finance brokers who operate on an 'exclusive-arrangements' basis as they are not required to comply with the clause. Such an advantage would lead to reduced competition as brokers offer a smaller range of products to consumers. This reduction in competition would be an unintended consequence of this regime, as it is intended to protect consumers and ensure that consumer's have access to the best finance product for their needs.

*Recommendation 5 - that clause 35(3) of the Draft Proposal should be deleted.*

Similarly, in relation to making credit proposals for a reverse mortgage contract in clause 37, the finance broker is under a strict liability to include a range of estimates as to future debt under the credit contract and future value of the mortgaged land.

It is submitted that this would be impractical for the finance broker to put this all together as many of these estimates would require specialised knowledge in this area of assessment.

*Recommendation 6 - that clause 37 should be deleted.*

If this recommendation is not accepted, in the alternative, it is imperative that the legislation makes provision for appropriate assumptions, qualifications and tolerances to be adopted by the finance broker in calculating these estimates. We refer you to s158 and regulation 36 of the Uniform Consumer Credit Code which does this, albeit in a different context. It will be an impossible task for a finance broker, without clear guidance, to comply with this requirement and the broker will risk, inadvertently, being liable for misleading and deceptive conduct.

*Recommendation 7 - if Recommendation 6 is not accepted, that clause 37 should be amended to include appropriate assumptions, qualifications and tolerances which may be made in performing the calculations required of that clause.*

Thank you for considering these submissions.

Should you require any further information in relation to the issues raised in this submission, please do not hesitate to contact Stuart Fuller on +61 2 9296 2155.

Yours faithfully

[Sgd] S Fuller

Stuart Fuller  
Chair, Regulatory Committee  
Australian Securitisation Forum Inc.