CANSTAR PTY LIMITED

Submission to Productivity Commission - 20 March 2018

The Productivity Commission has sought feedback on various matters addressed in its Draft Report into Competition in the Australian Financial System.

Canstar is pleased to offer feedback in respect of:

- General Advice (Information Requests 12.1, 12.2 and Draft Recommendation 12.1)
- Comparison Rate (Comparison Rates elements)

General Advice

Canstar respectfully disagrees with the characterisation of General Advice in the Draft Report [1] as "general promotional efforts related to products" and "like marketing". This may be true of some general advice, but a great deal of it is valuable to consumers by promoting competition between providers and helping consumers to make informed decisions.

Canstar's view is that redefining the activities that are currently regulated under general advice and providing a more customised regime for some activities will inhibit the provision of advice valuable to consumers.

- General advice, as it is now known, is an intermediate step between information and personal advice, and is valued by consumers
    - It can include generic concepts that go beyond pure fact basis and therefore does constitute advice – eg. "the ten considerations in choosing a home loan", "diversity should be an important element in your investment strategy", "keeping the cost of superannuation down is an important consideration".
    - It is a significant value-add over "plain fact reporting", turning data into insight for consumers whose lack of financial literacy means that they need help.
    - It comes at lower cost than personal advice (often free), expanding access to most consumers who would find personal advice prohibitive.
    - Ratings can assist consumers with their choice of product, by expanding the brand consideration set and establishing a shopping short list for the consumer. They are a useful decision step before the consumer overlays their own personal needs. In a field like home loans, with over 100 providers rated by Canstar, consumers need help with the complexity.

- With such a broad range of activities currently captured under "general advice", the task of confining them to a few simple models doesn't look workable.
    - General advice can include product data, product ratings, buying tips, understanding investment options, and so many more models of advice that fall short of personal advice.

[1] Overview Draft Report p29

    - To confine general advice to a small number of understood and common models is likely to inhibit innovation of newer models for provision of financial services, where they incorporate an advice element.
    - It will expose providers of multiple solutions to multiple regulatory demands, sometimes differing and even conflicting.
    - There will still be a rump of unclassified advice models fitting into none of the more common pigeon holes, leaving a continued need for a "general" regime.

Following from this, Canstar supports retaining the term "general advice", as alternatives don't promise a reduction of complexity and confusion.

- There is little to suggest that the term "general advice" would draw consumers into an inference that the advice they receive is factoring in their personal circumstances.
    - "General advice" is a legal concept, and is defined in terms of what can't be done, not what is done. It is an exclusionary term rather than inclusionary, and designed to restrict the nature of activity undertaken.
    - Because it is such a vague term, it is not a marketing slogan and is not frequently used in promotions by providers.
    - It has little meaning or visibility to consumers and low risk of misleading.
- Renaming and tightly defining the advice raises a range of complexities
    - Renaming for customised models requires moving to define services inclusively, rather than exclusively.
    - It requires understanding all models of general advice and attaching a classification that consumers will understand.
    - It will still leave the unclassified who presumably will continue to carry a general tag.
    - It could also potentially also act as a barrier to innovation, as that service not envisaged today could be left in the "banned until approved" category.

Canstar supports continuation of the current licensing regime, to preserve standards in the industry and build consumer confidence.

- The licencing regime is a necessary definition of the duties and restrictions, qualifications and conduct of licensees.
    - Digital delivery has lowered barriers to entry, making it all the more important that providers adhere to standards of behaviour and hold the degree of expertise to deliver quality consumer outcomes.
    - If not a licence, some other mechanism will have to found to achieve this function.
- The licence is also a signal to the consumer that the provider is so qualified to provide the service.
    - Finance is a field where consumers hold limited understanding, and the providers' skills and behaviours have to supplement the consumers' knowledge deficit. The licence gives consumers some comfort that this is what they are getting.
    - Removal of the licensing and regulatory obligations would leave the consumer vulnerable.

Canstar's view is that the unique licensing regime that attaches to credit, as distinct from other financial services, should be respected.

- The credit skill-set is distinct and it is reasonable that the distinction continues to be respected.
    - Current licensing requirements recognise the differing skills and demands required for credit.
    - In addition to suitability for purpose, affordability becomes a consideration in respect of credit contracts.
    - Credit is the area of finance that causes the greatest level of consumer financial stress. A relaxation of skill and experience requirements could only exacerbate the potential for financial stress.
- The industry is well resourced with lenders and brokers, and to open it to lesser qualified parties could expose consumers to greater risk
    - Brokers account for half of the home loans written, suggesting that an expansion in the number of advisers will not lift competition in the sector.
    - Financial advisers have an avenue to participate in the credit sector by qualifying for a licence, an avenue that will not see a diminution of the skill base.

Comparison Rates

Comparison rates can be a useful tool for consumers to compare the cost of a loan using a single value. However, the utility of comparison rates has deteriorated. This has been driven primarily by the assumptions used in formulating the comparison rate no longer being representative of changes in the lending market and the use of advantageous interpretations by lenders on what fees should and should not be considered.

Canstar supports restoring the relevance of the comparison rate to today's borrowers, by bringing the calculation formula up to date with changes in the industry and to remedy the other elements addressed below.

Loan Amount and Loan Term
The underlying borrowing assumptions no longer reflect the market changes which have occurred since the comparison rate inception.

For mortgages a comparison rate is required to be calculated on a loan amount of $150,000 over a loan term of 25 years. This value is $239,000 below average owner occupied average loan size of $389,000 (ABS) and loan terms seldom go full term due to either loan refinancing or new property purchase.

The influences of using the current loan amount and loan term are noted below:
- Loan Amount: It inflates the percentage impact of fees against the true average loan size.
- Loan Term: Projecting over a 25-year period diminishes the impact of upfront fees which can range from $0 to $1,270 on an owner occupied variable home loan.

The values used for other lending products e.g. personal loans are still representative of lending size and terms.

Fixed Rate Product Limitation
The usefulness of comparison rates on fixed rate loans is limited.

This limitation is derived from the revert interest rate post the fixed rate period. For example, on a 1 year fixed loan, 24 years of the calculation will be applying the revert interest rate. Proportionally only 4% of the comparison rate is configured to the fixed interest rate.

Complex Home Loan Structures
When the comparison rate was formulated the home loan market was simpler than it is in 2018. This in direct reference to the complex pricing structures now present in the market. This includes differing interest rates on loan amounts, loan to value ratios and payment options (i.e. principal and interest and interest only).

The sum of these changes requires developers of comparison rates to make assumptions on how to conduct their calculation. Where there is the potential for difference in interpretation the final representation and comparability of outcomes can be questioned.

Exclusion of fees which are not ascertainable
The legislation provides certain provisions to exclude fees from the calculation if they are unable to be ascertained. Examples of the type of fees which we have observed being excluded include valuation, settlement and legal fees which can be priced based on the complexity of the deal therefore cannot be ascertained.

To obtain the loan it would be expected the fees outlined above would be charged and therefore it would be reasonable to expect that these fees have been considered in the comparison rate calculation.

Their exclusion decreases the level of comparability between comparison rates and puts the consumer at a disadvantage when using the provided rate.

Canstar has adopted the approach of including all fees within our Star Rating methodology for lending products. Where fees are unable to be ascertained the lender is required to provide an indicative fee.

Advertised Interest Rates
We have followed the conversation on potentially adjusting the interest rate used in comparison rate calculations. Canstar would promote caution in using averages or median interest rates for comparison rate calculations. The advertised interest rate used now provides a reference point which is available to all borrowers. Adjusting this to an interest rate which is based on a median (i.e. the middle interest rate) will make the comparison rate more opaque.

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