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LF Economics

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Senate Standing Committees on Economics

Consumer Protection in the Banking, Insurance and Financial Sector

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Introduction

LF Economics is one of the few research firms in Australia that has conducted an investigation into the Australian mortgage market to identify potential acts of illegal activity and the risks to financial stability. We believe it is prudent to advise the committee of our concerns for victims of this particular variant of financial crime.

We would like to draw the committee's attention to LF Economics' submission (#63) to the Penalties for White Collar Crime inquiry (PWCC), consisting of a detailed analysis of criminal fraud and misconduct within our banking and financial sector.

Term of Reference

A.i. Current laws and regulatory framework

It is LF Economics' understanding that Australia currently has the laws, regulatory framework and resources to tackle financial crimes against consumers, borrowers and investors, whether domestic or international.

Public institutions such as APRA, ASIC and the RBA have considerable resources to identify financial crimes perpetrated against consumers. These resources may be utilised by analysing macroeconomic datasets or examining individual consumer loans. Further, the Global Financial Crisis (GFC) provided our regulators with case studies of financial failures that have occurred in other nations. The most obvious example is the mortgage fraud crisis in the U.S., where lenders issued many borrowers with mortgages that were predatory and unaffordable.

There is no doubt current laws and regulations can be changed to reflect the ever-increasing complexity of our banking and financial system. Nevertheless, there appears to be adequate protections available to consumers afforded by the law to shield against fraud. If regulators were abiding by their mandates to protect consumers from fraud perpetrated by lenders, the risks of becoming a victim of having being sold a fraudulent financial product (i.e. a predatory and unaffordable mortgage) should be close to zero.

Unfortunately, our research into the mortgage market and banking system provides evidence to suggest many borrowers have or are at risk of becoming a victim of fraud, committed by lenders.

A.ii. Enforcement of the current laws and regulatory framework, including those arising from resourcing and administration

The reason Australians face a high risk of becoming victims of financial crime is due to the intentional disregard by our regulators to investigate and enforce the law in the case of serious instances of financial crimes committed by our politically and economically powerful lenders. Put simply, the CommInsure and BBSW scandals are the equivalents of parking tickets versus systemic, widespread fraud in our \$1.6tn mortgage market.

Example #1

Using the mortgage market as an example, we argue ASIC has deliberately refused to conduct an investigation into credible evidence gathered by Australia's leading financial consumer activist and President of the Banking & Finance Consumers Support Association (BFCSA), Denise Brailey. The BFCSA has uncovered over a thousand loan application forms (LAFs) shown to be altered by lenders to inflate the assets and incomes of borrowers to issue predatory and unaffordable mortgages.

ASIC has also received many claims by alleged victims that lenders have fraudulently tampered with their LAFs. Unfortunately, ASIC has refused to investigate even one of these claims, let alone conducting a thorough and systemic analysis of the mortgage market. Both Denise Brailey and LF Economics is not aware of ASIC having launched an investigation into a borrower who had been defrauded by a major ADI (Authorised Deposit-taking Institutions) lender. Instead of abiding by the rule of law, ASIC is denying victims' rights to have their case investigated even when they provide evidence that under any other instance would result in affirmative action by another law enforcement agency. ASIC's approach could be classified as an obstruction of justice.

Example #2

APRA is the prudential regulator responsible for overseeing Australian ADIs and also collects data from them. Following APRA's implementation of its macro prudential control to stem the growth in property investor debt by limiting it to an annual maximum of 10 per cent, the data in the figure suggests there was an extraordinary decline in lending to property investors as lending to owner occupiers escalated.

After off-the record discussions, it was brought to our attention that lenders began to classify an increasing number of property investor loans as owner-occupier loans. Depending on the circumstances, this was done either with or without the knowledge of the property investor. It was therefore possible lenders could claim to be keeping to APRA's limit when, in reality, lenders have intentionally mislabelled mortgages. Either lenders feel comfortable enough to lie and know APRA isn't going to punish them or APRA is fully aware of this behaviour and has no interest in penalising lenders.



Many but not all economists are employed by an organisation (i.e. lender, regulator, research house or fund) that have skin in the game; in other words, a vested interest. It is in employers' interests not to 'stir the pot', figuratively speaking, nor are they required to conduct thorough analysis of the mortgage market. LF Economics primarily caters to an international clientele

who have no vested interests. As such, we have the unique flexibility and freedom to further scrutinise data in relation to the Australian mortgage market to assure that the numbers make sense.

Via a Freedom of Information Act request, LF Economics asked APRA how many investigations into mortgage fraud it has conducted over the last eight years. APRA's responded:

'APRA has conducted all reasonable searches of its records to identify documents relative to your request. However, these searches have not identified documents which respond to your FOI request. Based on the information before me, I am satisfied that the documents cannot be found or do not exist.'

The failure of our regulators to identify, investigate and prosecute cases of fraud should be of concern to the committee and the public. It is the opinion of LF Economics the regulators have an unspoken agreement to not investigate allegations of mortgage fraud, especially those stemming from the major lenders.

B. The impact of misconduct in the sector on victims and on consumers

As per the PWCC submission, our research painted an alarming picture of the psychological impact mortgage fraud has on victims. The emotional impact on alleged victims is exacerbated by the lengthy process of engaging with regulators and ombudsmen which often refuse to investigate or provide insignificant assistance. Below is a summary of the engagement process between an alleged victim of mortgage fraud and government agencies.

- (1) As default draws near, the borrower receives the lender's copy of their loan application form (LAF), often encountering significant resistance from the lender and/or their legal representatives. The borrower realises their details on the LAF differs significantly from the borrower's real circumstances;
- (2) With evidence the lender has committed fraud by falsely inflating the borrower's assets and income on the LAF, the borrower asks ASIC to investigate;
- (3) ASIC responds with a letter politely advising the borrower it will not be pursuing the

matter and either directs the borrower to the Financial Ombudsmen Service (FOS) or to take the lender to court;

(4) With limited or no financial resources, the borrower faces the lender at FOS where they more often than not have no legal representation, and

(5) Despite having evidence proving they are a victim of mortgage fraud, FOS always sides with the lender. Often the borrower is offered nothing more than a small reduction on the loan amount.

It is important to note that the FO is funded by financial institutions.

3. The impact on consumer outcomes of:

- i. executive and non-executive remuneration,*
- ii. incentive-based commission structures, and*
- iii. fee-for-no-service or recurring fee structures.*

In our PWCC submission, LF Economics demonstrates the incentives facing all stakeholders in the mortgage market. With no real oversight by our financial regulators, there is evidence suggesting profitability takes precedence over the regulators ensuring participants obey the rule of law. Lenders are able to exploit other market participants such as mortgage brokers to conduct fraud to reduce their accountability; the 'six degrees of separation'. While there are some brokers who may break the law, LF Economics argues that the fraud (tampering with LAFs) occurs within lending institutions, not third parties. Many defrauded borrowers have obtained mortgages directly from lenders.

Lenders are supposed to have a thorough process of due diligence that should detect and deny a loan containing incorrect details. Mortgage fraud should therefore be all but non-existent. It is the lenders themselves, however, who are the prime instigators of mortgage fraud.

D. The culture and chain of responsibility in relation to misconduct within entities within the sector.

We refer the committee to our PWCC submission for an analysis on matters of culture and responsibility.

5.i. The availability and adequacy of: redress and compensation to victims of misconduct, including options for a retrospective compensation scheme of last resort.

We refer the committee to our PWCC submission for an analysis on matters of compensation.

E.ii. Legal advice and representation for consumers and victims of misconduct, including their standing in the conduct of bankruptcy and insolvency processes.

There is little expertise within the legal profession to argue on behalf of victims of predatory mortgages. Many victims don't have funding for expensive legal representation, let alone find lawyers willing to take on lenders. Many cases heard by the FO favour the lender because the latter party is not able to articulate they are victims of fraud. Even when sufficient evidence is provided by borrowers, the FO still takes the side of lenders and offers a paltry 'take it or leave' resolution which is highly favourable to lenders. Denise Brailey has many years' experience dealing with the FOs and finds them severely lacking in protecting consumers.

Conclusion

We would like the committee to consider our recommendations in the submission to the PWCC. To conclude, our arguments are:

- (1) There is the strong probability that widespread fraud is taking place in the mortgage market;
- (2) There are already sufficient laws and regulations to defend consumers, borrowers and investors from fraud;
- (3) The government, regulators and other relevant public organisations have been unwilling to investigate and prosecute lenders, and
- (4) Under these circumstances, changing and/or adding to the regulatory framework will do little to protect consumers from the predations of lenders.