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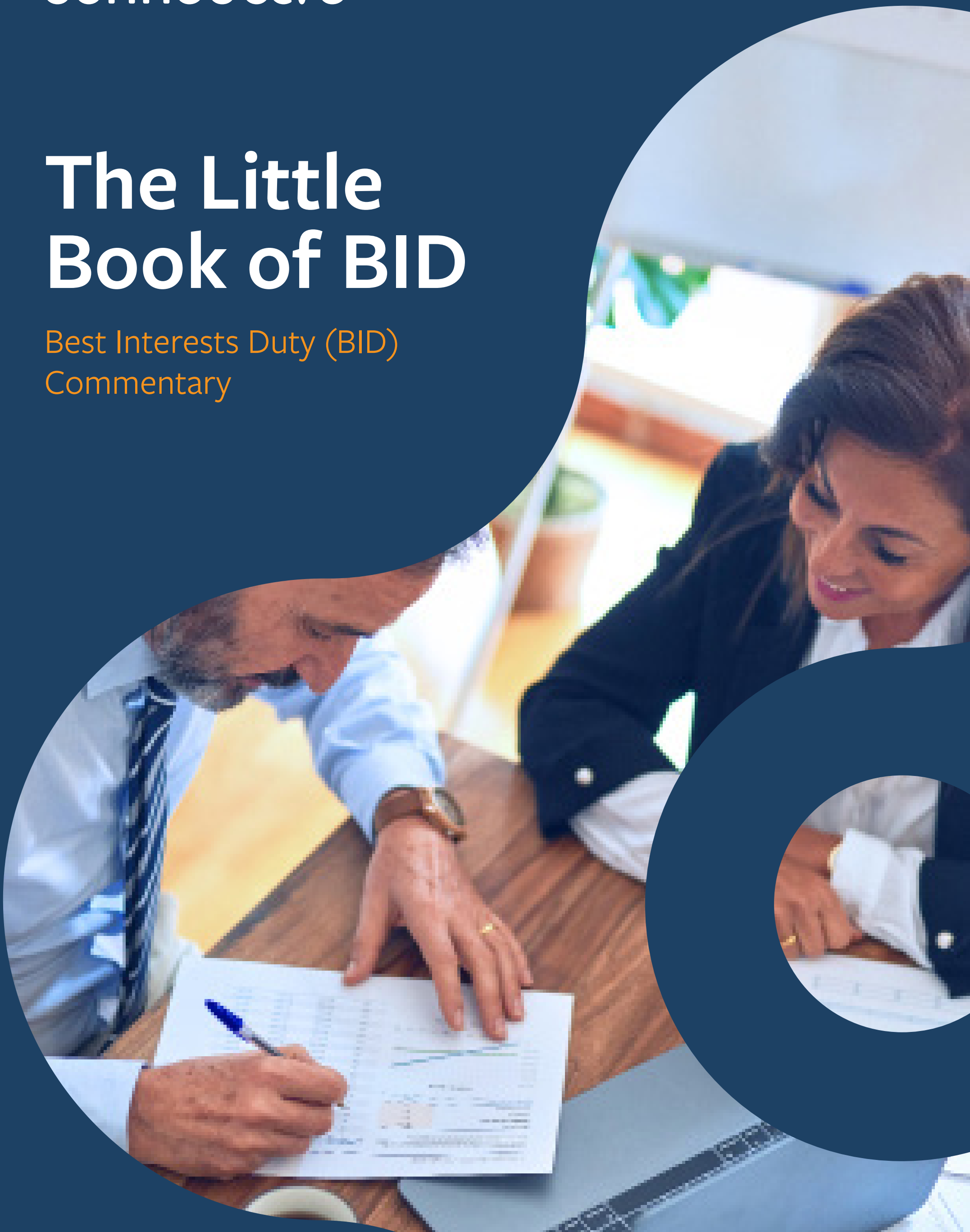
The Little Book of BID

Best Interests Duty (BID) Commentary



Contents

The little book of BID

This booklet is designed to assist in documenting your Best Interests Duty (BID) commentary for your client.

For more information on what your BID obligations are, please refer to the Connective best interests duty e-Book “How to prepare for the Best Interests Duty: A mortgage broker’s guide” available on the Connective website under the BID education hub.

In writing the Regulatory Guide 273 “Mortgage Brokers: Best interests duty”, ASIC make it clear that presenting recommendations and keeping documented records is a key component. ASIC expect to be able to see the journey of how you got from the client’s responses in the needs analysis to the final choice of lender the application was lodged to.

This includes the steps you took throughout the process, how you educated the client, why particular products were recommended, the decision made by the client and the steps you took to act in the client’s best interests.

So, in the real world of a busy mortgage broker, what do you need to document to satisfy the obligations? We’ll walk you through the following:

1. How to document the client’s needs, requirements and objectives and the reason for the final choice of lender; and
2. Common scenarios and points you could include in your commentary.

How to Document the Client's Needs, Requirements, Objectives, and the Reason for the Final Choice of Lender.

Needs

What is it the client needs? The answer is simple – the client needs money. However, let's be a little more specific than that.

Examples: What does the client need?

- ☐ Client name, you are seeking a loan to purchase your first home
- ☐ Client name, you are looking to refinance your existing loan with lender
- ☐ Client name, you want to purchase a property at auction and need an approval in principle

Requirements

When thinking about requirements, the easiest way to document this is to break this down into three components:

Loan or product requirements

Lender requirements

Priority requirements

> Consider the responses provided by the client in the needs analysis and your next conversation you have with them. Any conflicting information between the two should also be noted.

Loan / Product requirements:

- [ ] Consider the information provided in the needs analysis specific to the loan or product features the client requires
  Examples: Offset, redraw, split, variable, fixed, PI, IO etc.

Lender requirements:

- [ ] Did the client have a lender preference, or did they not have a preference and were open to options?
  Examples: No preference, major lender, branch network, good customer service, ethical lender

Priority preferences:

- [ ] Did the client have any priorities they required
  Examples: lender with a cash back, lender who would loan the most amount of money, lender with the cheapest rate

Objectives

When thinking about the client's objectives, think both immediate and long-term objectives.

- [ ] What did the client note in the needs analysis about how long they intend to be in the property for?
- [ ] What did the client tell you during your conversation?

General Examples

Owner Occupied

- [ ] To pay off the loan as quickly as possible
- [ ] To be mortgage free before retirement
- [ ] To get into the property market (first home buyers)

Debt Consolidation

- [ ] To reduce monthly outflow on small debt
- [ ] To make repayments easier to manage with one payment (home loan) each month

Investment Property

- [ ] To use equity to purchase an investment property in the future
- [ ] To build a property portfolio and generate an income stream
- [ ] Tax purposes (ensure your client has spoken to a financial planner or accountant as brokers are not permitted to provide financial advice)

Lender and Product Recommendation and the Reason for the Final Choice of Lender

Consider the following:

- ☐ When you presented the client with the options, what conversation did you have? This is the detail which needs to be documented in this section.
- ☐ Pros and cons of each of the recommended lenders – what was discussed?
- ☐ Was there a considerable difference in the overall cost between the three lenders presented?
- ☐ Did the client have a preference for one of the lenders presented due to (examples)
  - ☐ Existing banking arrangements / convenience
  - ☐ Interest rate and overall savings
- ☐ Was there a limited number of lenders presented due to the client's situation?
  - ☐ Credit check / repayment history
  - ☐ Self-employed income (limited financials)
  - ☐ Property type / valuation restrictions

Other Hints and Tips in Your Commentary

Tip One

Remember your client will read this commentary, so we recommend you personalise this and use their names.

From your client's perspective consider the difference between **"Client requires an AIP to bid at auction,"** and **"Amy and John, you are seeking an approval in principle to bid at auction"**

Tip Two

Although you need to cover (1) Needs, (2) Requirements (3) Objectives and then (4) final choice of lender, consider ways to make this flow rather than being bullet points or one-line notes.

Examples Include:

- ☐ Based upon your responses to the questionnaire and our conversation....
- ☐ Scott, you informed me that....
- ☐ Jane, you intend on living in the property for 3 years, based on this....

- [ ] I provided you with comparisons to demonstrate.....
- [ ] Of the lenders available a process was completed to narrow this down. The first step was to review available lenders. From those, it was further narrowed to the lenders who met your requirements and priority preferences. Finally, from those, it was narrowed to lenders with the most competitive rates and competitive overall cost for your consideration.

Tip Three

Include the steps you have taken to educate your client. This not only shows you have acted in the client’s best interest but documents the conversations you have had with the client.

Here are some examples you can consider using:

- [ ] Sean, as you are buying your first home, we discussed the first homeowners grant / stamp duty concessions (document if the grant will be lodged with the home loan application or if Sean needs to lodge this via his Solicitor / Conveyancer)
- [ ] As you are borrowing over 80% of the property value, lenders mortgage insurance (LMI) is payable. This is a type of insurance which protects the lender, and it is important to note this does not protect you. We discussed the approximate cost of the LMI premium and how this could be paid (from the loan amount or capitalising this). You selected to have the LMI premium capitalised, which means the premium will be added to the loan amount and you are also borrowing the premium amount. Your loan payments will be based on the higher loan amount which includes the LMI premium.

- [ ] As you are wanting a fixed rate Sean, we discussed rate lock fees. You were not interested in a rate lock and accept the rate applicable by the lender. I provided you with the fact sheet to assist you in making an informed decision on this fee.

Remember, you can always use information that is in our fact sheets as part of your commentary. Fact sheets cover topics such as debt consolidation, fixed rates, split loans, offset accounts and redraw, LMI and family pledges. To access the fact sheets, open the admin tab in Nexus, click on documents and select product fact sheets.

Tip Four

Snippets! Nexus has a range of pre-formatted snippets which you can use in your commentary. You can also create your own snippets or personalise existing snippets. For more information on snippets, refer to the wiki or ask your local BSM.

Documenting Your Best Interests Duty Commentary

You can ensure you are meeting your obligations by simply remembering NEEDS + REQUIREMENTS + OBJECTIVES and the reason for the FINAL CHOICE OF LENDER.

Covering these items can be as easy as:

Requirements and objectives

Jasmine and Jack, you are seeking a loan to consolidate your existing home loan with (lender), your car loan with (lender) and your credit card with (lender).

This will enable you to manage your monthly budget and reduce your immediate outgoings. We discussed the pros and cons of consolidating the car loan and credit card over a 30-year loan term, however the immediate monthly cost saving was a priority for you.

You do not have a lender preference and are open to options, though a lender with excellent customer service is important to you.

You would like a split rate loan to give you the option of making additional repayments and the certainty of a fixed rate. We discussed the pros and cons of fixed rates and I provided you with a fact sheet on this.

In the example of Jasmine and Jack needs, requirements, objectives and education has been covered in less than 150 words!

- [ ] **Needs:**
  - [ ] Refinance
  - [ ] Debt consolidation

- [ ] **Requirement:**
  - [ ] Loan / product: split loan
  - [ ] Lender: no preference
  - [ ] Priority: customer service

- [ ] **Objective:**
  - [ ] Reduce monthly commitments
  - [ ] Easier budgeting

- [ ] **Education:**
  - [ ] Consolidating short term debt over 30 years
  - [ ] Pros and cons of fixed rates supported by fact sheets

- [ ] **Additional information you could include:**
  - [ ] Current home loan with lender = $1230 per month
  - [ ] Current car loan with lender = $595 per month
  - [ ] Current credit card with balance outstanding of $7,800 and monthly payment being made of $350 per month
  - [ ] Total monthly expenditure = $2175
  - [ ] New loan amount over 30 years = $1540
  - [ ] Immediate monthly saving of $635

Reason for the Final Choice of Lender

Jasmine and Jack, I presented you with three lenders who meet your requirements and objectives, and we discussed each option in detail. A copy of the product comparison was provided to you to assist you in making an informed decision.

Although lender one had the overall cheapest rate, you have decided to choose lender two as you have previously banked with lender one and did not like the service they provided. Lender two is still an excellent offering, however, should you remain in the loan for the full 30 years and pay the minimum monthly payment only, you will incur $25,000 in higher fees over the term. You were comfortable with this option as you advised you will likely only remain in the property for a further 4-5 years.

In less than 150 words, the reason for the final choice of lender and not selecting the cheapest option has been covered.

Additional information you could include:

As the monthly saving between your current commitments and the new loan is $635, I provided a calculator demonstrating making an additional $135 in loan payments per month, will reduce the overall interest and loan term to XX years and still provide you with a net monthly saving of $500 per month.

Scenario 1

First Home Buyer with LMI payable

Requirements and Objectives

Liz and Theo, you are purchasing your first home and require an approval in principle. Theo, as you have some discretionary income from your annual bonus you want a split loan which will give you the option of making additional payments and the certainty of a set payment. This will allow you to benefit from any potential bonus income by making extra repayments.

You are open to lender options; however you indicated a lender who can facilitate technology such as cardless transactions is important. You have stated you intend on living in this property for approximately 3-4 years. Based on this, we have discussed both 2 and 3 year fixed rates and you decided a 2-year fixed rate is preferable. You are hoping to have advanced in your respective careers during this time and have more discretionary income to be able to pay into the loan.

Additional information you could include:

- [ ] Government grants or stamp duty concessions and how these are applied for
- [ ] Pros and cons of fixed rates and fact sheets
- [ ] Mortgage insurance, how this protects the lender and fact sheets
- [ ] Documenting a discussion on capitalising LMI or paying this from the client’s funds

Reason for the Final Choice of Lender

After discussing your needs, requirements and objectives, we discussed four lenders who met your goals. The pros and cons of each lender were discussed, including how they aligned with your requirements and the total cost differential between the lenders.

Although the interest rate was cheaper with lender X, you have chosen to proceed with lender Y given Liz has her existing banking with this lender and the LMI cost was lower than lender X. This outweighed the small difference in interest over the term, especially as you only intend on remaining in this property for 3-4 years.

Scenario 2

Refinance

Requirements and Objectives

Sally and Harry, you have a current mortgage with (lender) which you are looking at refinancing to obtain a more competitive interest rate. You are also seeking to borrow an additional $15,000 to renovate your ensuite.

You requested I only consider products with a variable interest rate as you want the flexibility to make extra repayments. Your existing mortgage has an offset account, and this remains a priority for you with your new lender.

You understand that even though a variable interest rate provides the possible benefit of an interest rate reduction and reduced repayments, your interest rate and repayments may increase if the variable interest rate increases. Although you do not have a preference for any lender, you would prefer a lender who is currently offering a cash back offer.

As you want to ensure your loan is paid before you retire, we discussed the options of a new 30-year loan term compared to a 23.5-year loan term which is the balance of your current mortgage. In providing comparisons of both, we also looked at a 30-year loan term with increased monthly repayments to pay the loan out sooner, based on your anticipated monthly offset balance of $18,000.

Reason for the Final Choice of Lender

In considering your needs, requirements and objectives, a range of lenders where presented and we discussed the pros and cons of each lender including the interest rate, fees and overall cost of the loan.

The decision to apply with lender 2 was based on several factors including:

1. Lowest fees of the lenders presented
2. Lowest overall cost when compared to the other lenders
3. Availability of branch network. Although you do the majority of your banking online, you prefer to have the option of a branch should this be required.

Scenario 3
Debt Consolidation

Requirements and Objectives

Penny and Leonard, you told me you want to refinance your owner-occupied property located in (suburb). You have a current mortgage with (lender) and want to consolidate your credit / store cards and your car loan. You advised me the reasons you want to refinance are to obtain a better interest rate and extend the loan term. However, your primary objective in consolidating your facilities as this will enable you to reduce your monthly outgoing commitments and manage your finances more easily with only one payment per month.

The amount you are paying on your car loan is $695 per month and your minimum credit card payment is $220. We discussed extending these short-term debts over a 30-year term. The difference in your current home loan repayment and the new repayment means there is an immediate saving of $450 per month which you confirmed was more suitable for you then retaining these debts.

In our discussion, you expressed concern about rising interest rates and want the certainty of knowing your monthly commitment which will further help with your ongoing budget. We discussed the pros and cons of variable and fixed rates and have settled on a 20% variable / 80% fixed for two-year loan.

You are also passionate about doing what is right for the environment and expressed an interest in an ethical lender who has strong customer service ethic.

Reason for the Final Choice of Lender

Of the lenders available, a process was completed to narrow this down. The first step was to review the lenders who could meet your requirements and priority preferences. Finally, from those, it was narrowed to lenders with the most competitive rates and competitive overall cost for your consideration.

Three lenders were suggested, and I provided you with a comparison which presented the interest rate, ongoing fees and the total amount payable if you remained in the loan term for 30 years. After a discussion about each of the lenders, you selected lender B as this had the lowest two-year fixed rate. Although the loan is a split, the majority of the loan (80%) is fixed, and this was the most attractive lender for your needs at this point in time.

Scenario 4

Construction with existing land loan

Requirements and Objectives

Preetha and Arun, you are now seeking to build your first home on the land we financed 18 months ago with (lender). You have confirmed your requirements remain unchanged from our previous conversation and you are interested in the lender who will provide you with the highest loan amount and the cheapest interest rate. Your objective is to remain in this property for approx. 5 years and to pay as much into the loan as you can during that time. For that reason, you seek a variable rate.

We discussed two possible scenarios. The first was to look at new lenders who would refinance your existing land loan and provide you with the construction funds. The second was to remain with your current lender and a comparison of both options was presented. We also discussed additional fees which would be applicable in the first scenario to refinance and the average time lenders are taking for loan approvals.

Reason for the Final Choice of Lender

Based on the two scenarios and the comparisons of your current lender to other options available, you decided to remain with your current lender. Although lender C will loan you a slightly higher loan amount, your existing lender will provide you with the loan amount you require, and you are satisfied with the service they have provided you so far.

The difference in the interest rates were marginal and because you only intend on being in the property for five years, the cost and time of changing lenders was a key consideration in your decision to remain with your current lender.

Scenario 5

Time critical approval and settlement

Requirements and Objectives

Bella and Juan, you have purchased an investment property in Queensland on a 30-day settlement contract and require finance approval within 7 days. As you have three other investment properties and are experienced investors, you have indicated your requirements as variable interest only for five years and the maximum loan amount against this property. You are open to lender options as your existing property portfolio is not concentrated with one lender, though your preference would be to consider these existing lenders as part of this proposal. The key priority for you is a lender who can meet the finance approval and settlement timeframe.

Reason for the Final Choice of Lender

In presenting you with options, I considered your existing lender and a range of new lenders. Although lender one and lender two do not have the cheapest rates, these lenders have indicated they are able to meet the settlement timeframe required.

Based on these two lenders, you have selected to use lender two as the overall cost of this lender is lower than lender one. This lender also has the cheapest ongoing fees and a reputation for excellent customer service.

Scenario 6

Break costs

Requirements and Objectives

Rose and Jack, you have requested a review of your existing home loan to identify if there are options which are more competitive. You have an existing mortgage with lender which is split 50/50 fixed and variable and has a remaining balance of $328,000. The fixed rate you are currently paying is 4.09% and has 18 months remaining.

In considering alternatives to your current loan, you advised me the following:

- Your first priority is the interest rate
- You do not prefer any particular lenders and are open to options
- You do not require access to a branch network, but good internet banking is important
- You are concerned about rising interest rates and want a split loan
- You are interested in a three-year fixed rate, but would consider a two-year fixed rate if the interest rate was competitive
- You do not anticipate any changes to your future circumstances
- You intend on remaining in the property for another 4 years or so when your youngest child finishes school

Given your current loan has 18 months remaining, the break cost is $X, plus standard fees of refinancing will be approx. $x to cover discharge and new registration costs.

Reason for the Final Choice of Lender

In assessing your financial situation, requirements and priority preferences, I have considered a range of lenders which are in your best interest. Of the lenders provided, all have competitive rates which would result in a cost saving of approximately $x per year. Based on this cost saving, it would take approx. 15 months to recover the break cost from your current lender.

Given the time to recover the break cost, you confirmed you would like a split rate with 50% variable and 50% three years fixed.

In considering the lenders offered, we considered:

1. The total cost of the loan over the 30-year loan term and the cost for the next 6 years which is how long you intend on remaining in the property

2. Overall costs to refinance including discharge, registration and set up fees and

3. How each of the lenders meets your requirements

You have selected lender C as the lender offers a rate lock guarantee and you are aware from our discussion that this fee has a cost. Although the variable rate on this loan was higher than the other two lenders, the three-year fixed rate was the most competitive available.

Scenario 7

Client’s priority is a competitive interest rate

Requirements and Objectives

Binh and Chay, you have recently sold your existing property and have purchased a new home to live in. You have informed me that you require a variable loan with an offset, and you are open to considering different lenders as your priority is the most competitive interest rate available.

As you both have strong employment with discretionary income, we discussed the benefits of an offset account with an average monthly offset balance of $35,000 compared to a lower standard variable rate with a redraw.

Although your priority is the most competitive interest rate, and you are aware of the higher interest rate with an offset and fees, the monthly average balance compensates for the rate difference, and you expressed the convenience of the offset as opposed to a redraw is what you want.

Your long-term objective is to accumulate funds in the offset which will allow you the flexibility to purchase an investment property in the next 2-3 years.

Reason for the Final Choice of Lender

To show you the benefit of an average offset balance of $35,000, I provided you with calculators to evidence the overall cost differential and savings (interest and reduced term).

Based upon the assumptions in the calculators combined with the four lenders presented, you have selected to proceed with lender 1 based on the lender having the lowest interest rate which was your priority.

Scenario 8

Security / postcode restrictions

Requirements and Objectives

Brooke and Elliott, you have recently purchased a serviced apartment on the Gold Coast to add to your property portfolio. Your requirement and priority is to borrow as much as possible against this property on an interest only loan to leverage tax minimisation purposes, which you had discussed with your accountant.

Given the lender restrictions on these types of properties, a discussion was held with the management company regarding whether the apartment could be released from the serviced management agreement. This would have allowed you to potentially borrow a higher amount. As this was not possible, the lenders were limited to those who would consider a loan at 70% of the property value.

Reason for the Final Choice of Lender

Based upon the requirement to borrow as much as possible on a serviced apartment, only one lender was presented to you for consideration as this lender will consider the loan amount required.

Should your situation change, and additional equity can be applied to reduce the loan amount to less than 60 or 70% of the value, we can consider other options which would be available.

We can also re-assess the situation in the future when further equity in the property is held.

Scenario 9

Income policy restrictions

Requirements and Objectives

Archana and Pradish, you are seeking to refinance your current mortgage to obtain a more competitive interest rate.

You have advised you want the following:

- Major lender
- Easy internet banking platform
- P&I repayments
- Variable rate loan

Your key objective is to be debt free prior to retirement in approx. 20 years. You intend on accelerating your mortgage repayments to ensure this loan is repaid before that time.

Reason for the Final Choice of Lender

Your financial situation has changed since we established your last loan with lender. Although your income is now considerably more since becoming self-employed, you have not prepared your 2022 financials and have indicated you do not intend to do this for some months.

As such, only one lender is available for you based upon your availability of one year's financial returns. Should you decide to prepare your 2022 financials, we can consider additional lender options.

Scenario 10

Client requests a lender

Requirements and Objectives

Emma and Anth, you are wanting to borrow additional funds for non-structural home improvements and have indicated you are satisfied with your current lender and do not want to consider alternative options.

Your requirements and objectives remain unchanged from 12 months ago when we completed the initial application for the purchase of this home being:

- Variable loan with low redraw fees
- Easy internet banking platform
- Remain in the property for approximately 5 years

Reason for the Final Choice of Lender

Option one comments to remain with current lender:

I have reviewed your existing loan against other products available in the market and confirm your interest rate remains competitive. As such, I am comfortable this loan remains in your best interest and the cost and time involved in refinancing to another lender would not be negated by any savings.

Option two change:

Although you indicated you are not interested in considering other lenders, I have an obligation to ensure this loan is in your best interests. I have reviewed lenders who would provide you with overall cost savings and more competitive interest rates. After providing you with alternative options and discussing the fees involved in changing lenders, you have decided to (stay with your existing lender) or (refinance to lender X due to...)

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