

4 October 2019

Manager
Financial Services Reform Taskforce
The Treasury

By email: ConsumerCredit@treasury.gov.au

Dear Treasury,

Mortgage Broker Best Interest Duty and Remuneration Reforms

AHL Investments Pty Ltd (**Aussie**), Australian Credit Licence 246786, welcomes the opportunity to provide comment in response to the exposure draft of the National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 (**Draft Bill**) and associated draft Regulations (**Draft Regulations**).

Aussie supports regulation which will ensure high standards within the mortgage broking industry and deliver good outcomes for consumers who engage the services of a mortgage broker.


Aussie welcomes the reforms in the Draft Bill and Draft Regulations as, on the whole, consistent with the objective of improving the outcomes for consumers who engage the services of a mortgage broker.

There are, however, certain aspects of the Draft Bill and Draft Regulations that have the potential to produce unintended moral hazard and significant consequences for the industry at large, industry participants and by extension consumers, which appear to be beyond the intention of Government.

The specific aspects of the Draft Bill and Draft Regulations of concern are detailed in the attached submission along with suggestions about how the draft legislation could be amended to address these concerns.

Should you require further information to supplement this submission, please do not hesitate to contact me on 0403 078 002 or by email at David.Smith@aussie.com.au.

Yours faithfully



David Smith
Chief Customer Officer
Aussie

Mortgage Broker Best Interest Duty and Remuneration Reforms

Submission of AHL Investments Pty Ltd

1. About Aussie

AHL Investments Pty Ltd (**Aussie**) was founded in 1992 as Australia's first non-bank home lender. Aussie has evolved since that time to become a branded mortgage broker.

Aussie is the holder of an Australian Credit Licensee and provides mortgage broking services to consumers through authorised credit representatives (**Aussie Brokers**) who operate exclusively under the Aussie brand and Australian Credit Licence.

Aussie's model gives every Aussie consumer the benefit of recourse to Aussie in the event of a poor consumer outcome. This requires Aussie to exercise the same level of care and responsibility for each Aussie Broker. This is different from the position with unbranded mortgage intermediaries/aggregators who may have brokers operating under the aggregator's Australian Credit Licence or under the broker's own licence.

2. Meaning of *mortgage broker*

The Draft Bill proposes a definition of *mortgage broker* as a licensee or credit representative of a licensee "if" the licensee or credit representative "carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property".¹

This is a kind of business purpose test. The legal authorities in relation to the act of 'carrying on a business' for the purposes of the *Corporations Act 2001* do not require a predominant purpose, however it does appear to require some degree of regularity and/or repetition. Consequently, the definition as currently drafted may exclude finance brokers who only occasionally provide credit assistance in relation to home lending in a way that is ancillary to providing credit assistance in relation to, for example, commercial credit. Consequently, the Best Interest Duty and conflicted remuneration obligations would not apply to the provision of credit assistance in relation to home lending provided by such finance brokers.

Such an outcome is not consistent with the intent of Recommendation 1.2 of the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, nor is it in the best interests of consumers. For many Australians, obtaining finance to purchase, refinance or otherwise utilise the equity in a residential property is one of the biggest financial decisions that they will make, and they deserve, and would expect, equal protections under the law regardless of whether the broker providing the credit assistance with regards to home lending is defined as a mortgage broker or a finance broker.

In addition, the definition extends to credit provided for all personal, household or domestic purposes not just credit provided for the purpose of purchasing residential property or refinancing credit that was used for that purpose (for example, it would include car loans and personal loans). This appears to go further than was intended by the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation*

¹ National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 Exposure Draft, Sch. 1, sections 15B(1)(a) and 15B(2)(a)

and Financial Services Industry where the Commissioner recommended that:

“The law should be amended to provide that, when acting in connection with **home lending**, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision.”² (**emphasis added**)

Accordingly, Aussie submits a licensee or credit representative of a licensee is a mortgage broker “when” ever they provide credit assistance in relation to regulated credit contracts for the purpose of purchasing residential property or refinancing a credit contract that was for that purpose.

Aussie proposes a revision to the meaning of mortgage broker under section 15B as follows:

- 1) A licensee is a mortgage broker when:
 - a) the licensee provides credit assistance in relation to a credit contract that relates to the provision of credit wholly or predominantly for the purpose of purchasing a residential property or refinancing credit that was provided for that purpose; and
 - b) the licensee does not perform the obligations, or exercise the rights, of a credit provider in relation to the actual or proposed credit contract.
- 2) A credit representative of a licensee is a mortgage broker when:
 - a) the credit representative provides credit assistance in relation to a credit contract that relates to the provision of credit wholly or predominantly for the purpose of purchasing a residential property or refinancing credit that was provided for that purpose; and
 - b) neither the credit representative nor the licensee perform the obligations, or exercise the rights, of a credit provider in relation to the actual or proposed credit contract.

A similar proposed structure could also be adopted in regards to the meaning of mortgage intermediary under section 15C.

3. Practical application of the Best Interest Duty

According to the Exposure Draft Explanatory Materials, the proposed Best Interest Duty is “a *principle-based standard of conduct that applies across a range of activities that licensees and representatives engage in. As such, what conduct satisfies the duty will depend on the individual circumstances in which credit assistance is provided to a consumer in relation to a credit contract.*”³

Aussie notes that because this new obligation is framed as a principle-based standard of conduct rather than a defined activity, “[i]t is the responsibility of mortgage brokers to ensure that their conduct meets the standard of ‘acting in the best interests of consumers’ in the relevant circumstances.”⁴

Aussie supports a principles based approach to the Best Interest Duty. However, for such an important obligation and given the universally held view that it is necessary for ensuring good customer outcomes for consumers, there ought to be some prescriptive subordinate regulation in support of the principles based approach. The subordinate regulation should at least address those matters where there is a clear consensus of the right way to do things or the prohibited forms of conduct in relation to acting in the best

² Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Vol 1, 1 February 2019, Recommendation 1.2, p. 73.

³ National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft Explanatory Materials, p.8 [1.20]

⁴ National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft Explanatory Materials, p.8 [1.20]

interests of the consumer.

While less preferable, an alternative to prescriptive subordinate regulation is regulator guidance on how the principles are to be satisfied. This would be analogous to the current regulatory guidance in respect of the responsible lending requirements under the *National Consumer Protection Act 2009* (the **Act**).

Aussie would welcome the opportunity to work with ASIC to develop such regulatory guidance which should seek to clarify Best Interest Duty requirements and provide examples of how these may differ from existing responsible lending requirements as outlined in *RG209 Credit licensing: Responsible Lending Conduct* and the Act. This is particularly important given section 158KC of the Draft Bill which expressly states that “the obligations imposed on a person under this Part are in addition to any other obligations to which the person is subject under this Act or any other law” – in other words, Best Interest Duty is designed to be additional and not substitutional to any existing responsible lending obligations.

Any prescriptive subordinate legislation or regulator guidance should be prepared in light of, at least, the issues outlined below.

3.1. “Best value” may not equate to cheapest

Aussie is concerned that, without further guidance, the proposed Best Interest Duty could potentially result in a legal requirement that credit representatives provide the ‘best’ product through their credit assistance or ensure the ‘cheapest price’. Such terms, or those such as ‘best available’ product or ‘best possible’ loan, are highly subjective and do not always provide useful guidance as to what the ‘best’ outcome may be for a consumer’s particular circumstances.

In August 2019 ASIC released REP 628 *Looking for a mortgage: Consumer experiences and expectations in getting a home loan* which outlined their findings from consumer research undertaken to better understand customer experiences and expectations when securing a home loan. The report identified that, while many consumers value the cost of a loan as the most important feature, other factors were also important for some consumers and thus “when we refer to ‘best’ home loan, we are generally referring to a home loan that offers the consumer the *best value* taking into consideration what a consumer desires in a home loan.”⁵

Accordingly, there are many factors in addition to price that may be considered based on the consumer’s stated requirements and objectives which may drive the recommendation/s upon which the credit assistance is based. These could include:

- a lender’s ability to approve and/or complete the loan within the timeframe stipulated by the consumer;
- the importance of certain product features to a consumer’s requirements and objectives (e.g. offset, redraw, payment holidays, early prepayment abilities, defined loan term, fixed rates and repayment certainty, etc.);
- a consumer’s specific lender preference that may be influenced by a current or prior relationship between the customer and lenders, or other factors;
- ongoing service provision by the lender post settlement (e.g. access to branches; range of internet

⁵ Australian Securities and Investments Commission, *Report 628: Looking for a mortgage: Consumer experiences and expectations in getting a home loan*, August 2019, p. 19, para 67.

- banking or self-service options available, etc.)
- the credit criteria of the lender as it applies to the consumer's particular circumstances (e.g. type of income or employment, previous credit history and loan conduct, size of loan and property location, loan to value ratio, source of deposit, requirements for lenders mortgage insurance, residency, serviceability, etc.); and
 - other fees and charges applicable to the loan (e.g. ongoing package fees; establishment and exist costs; special customer offers such as refinance cashback, etc.).

Aussie submits that any regulatory guidance developed by ASIC should reference the way in which such factors would interplay with the interest rate in order for a credit representative to reasonably meet their Best Interest Duty.

3.2. Range of products and options – what constitutes a reasonable comparison?

Treasury's Exposure Draft Explanatory Materials state that "prior to recommending any home loan product or other credit contract to a consumer based on consideration of that consumer's particular circumstances, it could be expected that the mortgage broker consider a range of such products (including the features of those products) and inform the consumer of that range and the options it contains".⁶

Aussie currently provides consumers with access to over 2,500 different mortgage products from the 24 lenders we have on our panel and our credit representatives will be accredited with all lenders available to them within their state of residence/operation. Consumers would generally expect their mortgage broker to present them with a small range of options that meet their requirements and objectives and accordingly we would request that ASIC construct any regulatory guidance with this in mind together with an acknowledgment that the credit representative can only present options from the range of products for which they are accredited by a lender and are authorised and knowledgeable to represent.

3.3. Best Interest Duty occurs when credit assistance is provided – no ongoing obligation for review

The Exposure Draft Explanatory Materials state that "during an annual review, a broker would not suggest that the consumer remain in a credit contract without considering whether this would be in the consumer's best interests."⁷ Aussie submits that ASIC ought provide regulatory guidance that seeks to clarify under what circumstances a conversation between a mortgage broker and consumer during a post-settlement interaction might be considered to be credit assistance and thus subject to a Best Interest Duty. This currently constitutes a "grey area" and will only be heightened by the introduction of the Best Interest Duty, notwithstanding the fact that no changes are proposed to the existing definitions of credit assistance under section 8 of the Credit Act.

Aussie notes that many mortgage brokers will engage in regular dialogue and interaction with existing consumers for a range of reasons. Not every interaction will, based on its circumstances, constitute credit assistance in that there will be no suggestion to remain in a current credit contract nor any suggestion or assistance to apply for a new credit contract. One such example might be where a consumer asks the mortgage broker to enquire as to whether a cheaper rate might be available with their existing lender. In

⁶ National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft Explanatory Materials, p.8 [1.21]

⁷ National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft Explanatory Materials, p.9 [1.21]

such a scenario we would hold that credit assistance has not been provided and no new Best Interest Duty would exist. However, in a circumstance where the consumer requests the mortgage broker to see whether there are better alternatives available to them, this would likely constitute credit assistance.

4. Conflicted remuneration

Aussie welcomes the overall intent of the reforms to conflicted remuneration proposed in the exposure draft legislation, however, there are some areas that, in Aussie's view require further review and/or clarification. These issues are explored further in the sections below.

4.1. Impact of 28VA and 28VB on upfront commission payments

Section 28VA(3) of the Draft Regulations sets out the circumstances in which a monetary benefit is not conflicted remuneration. Section 28VA(3)(d) limits the types of credit contract in respect of when a monetary benefit may permissibly be paid to those that relate to the provision of credit wholly or predominantly for the purpose of purchasing residential property.

As currently drafted, therefore, credit contracts which relate to all other household, personal or domestic use are not included. For example, by reason of the National Credit Code definition of residential property⁸, Aussie understands that a construction loan would not be credit for the purposes of "purchasing residential property".

Loans for construction purposes can comprise a not insignificant part of the new credit assistance provided by a mortgage broker to consumers. As currently drafted, section 28VA(3)(d) would, therefore, result in monetary benefit for construction loans being conflicted remuneration and mortgage brokers receiving significantly less remuneration for providing credit assistance to consumers for this type of lending which may result in less access to such assistance for consumers, notably first home buyers, or see some mortgage brokers change consumers' fees for such assistance.

It cannot be the intention of the proposed reforms to permit monetary benefit in respect of credit for the purpose of purchasing residential property but not permit monetary benefit for all other purposes, including for construction purposes.

Section 28VA(4) of the Draft Regulations outlines the manner in which a monetary benefit received in relation to the purchase or refinancing of residential property is permissibly determined so as not to be conflicted remuneration, namely that it be either (or a combination of):

- a. an amount given on the basis of the service provided without reference to the amount of credit provided or drawn down by a consumer; or
- b. an amount that is calculated as a percentage of an amount that is no more than the drawdown amount of the credit contract.⁹

The drawdown amount is defined in draft regulation 28VB as being "so much of the amount of credit as is used for that purpose within 90 days after the day on which the credit contract is entered into by the

⁸ National Credit Code, definitions, section 204

⁹ National Consumer Credit Protection Amendment (Mortgage Brokers) Regulations 2019 Exposure Draft, Sch. 1, regulation 28VA(4)

consumer”.

The definition of “drawdown amount” has some significant implications that are outlined below.

4.1.1. Impact on Further Advances

Some types of loans, such as a line of credit, do not have a single or even linear drawdown amount. There is no consideration given to treatment of further advances under an existing credit contract. For example, where \$100,000 is drawn down within 90 days, the loan balance is reduced by \$20,000 over time but there is a later further advance of \$30,000, then the permissible monetary benefit in the form of trail can only be determined by reference to the original \$100,000 amount and not the actual drawn down amount of \$110,000. That would result in a windfall gain to the credit provider at the expense of the mortgage broker. In addition, it may create moral hazards in respect of loan structuring and further advances which cannot now be fully appreciated.

4.1.2. Impact on subsequent drawdowns occurring more than 90 days after the credit contract

Following the release ASIC’s REP 516 *Review of mortgage broker remuneration* in March 2017, the Combined Industry Forum (CIF) undertook work across the industry to address the issues raised in this report in relation to upfront commissions.

As a result of this work lenders have since independently implemented changes to the way in which upfront commission is calculated by basing such a payment on the amount initially drawn by the consumer within 1 to 14 days of settlement. Many lenders, including a number of majors, have also implemented practices that have allowed for additional upfront commission payments to be paid as additional funds are drawn down by the consumer under the credit contract, either on a “as drawn down” basis or upon the 6 or 12 month anniversary of settlement net of any offset amounts.

Such reforms remain appropriate as they directly address the concern of ASIC regarding remuneration structures leading to higher than needed loans being sought while also striking a fair balance in ensuring that brokers are fairly remunerated for the credit assistance provided.

In many cases the requirements and objectives of a consumer are met through a loan that is designed to be utilised for a subsequent purpose. Some examples of this could include additional funds on a refinanced facility to complete some non-structural home improvements or additional funds on a refinanced facility to finance a deposit on a proposed future investment property purchase. In both cases these additional funds may not be utilised within 90 days of settlement and thus any subsequent drawn down could not be included for commission purposes as it would be considered conflicted remuneration despite the fact that the additional lending was very much in line with the consumer’s requirements and objectives and in their best interest.

As a result Aussie believes that regulation 28VB should be modified to extend up to 365 days after the date on which the credit contract is entered into by the consumer.

4.2. Impact of 28VA and 28VB on trail commission payments

Further to comments above, we note that regulations 28VA(3), 28VA(4) and 28VB of the Draft Regulations are also intended to apply to trail commission payments.

This has a number of significant issues associated with it which are outlined in more detail below.

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4.2.1. No grandfathering of existing arrangements

As currently drafted the conflicted remuneration regulations outlined in 28VA(3), 28VA(4) and 28VB of the Draft Regulations are designed to apply to any payment received after the effective date for the legislation being 1 July 2020. This means that it would apply to any existing trail payment received after this date regardless of the date upon which the credit contract was entered into by the consumer.

This would appear to be contrary to previous statements by Government in relation to this issue, notably the statement of The Treasurer during a press conference on March 12, 2019 in which he stated:

“As you know, Commissioner Hayne in the Royal Commission into Misconduct in the Financial Services Sector made a number of recommendations with respect to mortgage brokers fourthly, he suggested that trailing commissions be abolished and we said that we would grandfather existing trailing commissions and then abolish new trailing commissions from July 2020.

After consultation with the mortgage broking sector as well as small lenders, the Government has decided that the trailing commission issue will now be the subject of the review by the ACCC and the Council of Financial Regulators in three years time. And so, the abolition of trail from July 2020 won't proceed as first announced. The reason is we are concerned about the impact on competition in the mortgage lending market.”¹⁰

Currently industry practice is for trail to be paid on the outstanding loan balance net of any offset amount on a monthly basis. The effect of the proposed definition of drawdown amount in regulation 28VB would have the effect of potentially changing the basis of calculation for many existing loans with the result that remuneration for some mortgage brokers may be adversely affected in a way not intended by Government.

Given this, Aussie believes that the fairest way to approach this would be to exclude trail commission payments from the definition of conflicted remuneration. If Treasury remain resolved to apply conflicted remuneration provisions to trail payments then this should only apply in regards to credit contracts entered into on or after the effective date of the legislation, or the definition of the drawdown amount should be amended to include so much of the credit used up to 365 days from the date the consumer enters into the credit contract consistent with our earlier comments above.

4.2.2. Operational difficulties in operationalising across industry participants

Significant operational challenges would exist for aggregators, licensees and lenders in giving effect to trail commission payments being calculated on an amount that could not exceed the amount of credit drawn down within 90 days of the credit contract being entered into by a consumer regardless of the date upon which this contract was entered into.

Current industry practice is for trail to be paid on the outstanding loan balance net of any offset amount on a monthly basis. This is done without reference to any other limiting mechanisms outside of whether the loan in question is in contractual arrears. A change to include a reference to the loan balance as at 90 days after settlement would represent a significant change to commission systems and it is unlikely to be able to

¹⁰ Transcript – Doorstop interview, Commonwealth Parliamentary Offices, Melbourne, 12 March 2019

be implemented by a significant number of lenders, aggregators and licensees by the effective date for the legislation.

This is exacerbated by the retrospective nature of the change which would require the balance as at 90 days to somehow be ascertained where such data may not be readily available, particularly for older loans. One potential consequence could be that a lender, in seeking to comply with the requirement not to pay conflicted remuneration, may not pay trail where they are uncertain of ascertaining such a balance. This would be a significant adverse outcome for mortgage brokers and licensees and one that would be completely inconsistent with the aim of Government to maintain a vibrant broking sector to maintain high levels of competition and good customer outcomes.

Consistent with our earlier comments this would be alleviated by ensuring that regulation 28VB would only apply to credit contracts entered into after 1 July 2020 or, slightly less effectively in this case, by broadening the definition of the drawdown amount to include so much of the credit used up to 365 days from the date the consumer enters into the credit contract consistent with our earlier comments.