Combined Industry Forum response to Treasury consultation on Mortgage broker best interests duty and remuneration reforms.

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1. Executive summary

The Combined Industry Forum (CIF) welcomes the opportunity to provide its submission in response to the *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 (draft bill).* Part 1 speaks to the proposed best interest duty and priority obligation, with part 2 addressing conflicted remuneration issues.

CIF members have been considering how to better address customer interests since its inception, and in November 2017 released a proposed definition of what a good customer outcome[1] could be in respect to mortgage broking.

The CIF is broadly supportive of the best interests duty and priority principle proposed in the legislation. Further, The CIF supports the Government's approach to remuneration reform, and notes a number of areas to improve alignment of the bill and draft regulations with the Government's announcements.

This submission highlights areas of the proposed changes that the CIF is seeking further clarity either through amendments to legislation or explanatory materials, or specific ASIC regulatory guidance. The recommendations are summarized below under part 1 and part 2.

Given that ASIC is also preparing regulatory guidance on the legislation, our submission notes areas that require greater detail.

Based on feedback regarding the impact on systems and documentation requirements, the implementation of changes in the manner proposed by the draft bill and regulations potentially represents a significant change to back office operations for industry members, and the CIF is keen to continue to be involved in further work to be undertaken by government and regulators.

2. Background

The CIF includes mortgage broker practitioners and representatives, aggregators, lenders and industry bodies (Australian Banking Association (ABA), Mortgage and Finance Association of Australia (MFAA), Finance Brokers Association of Australia Limited (FBAA), Customer Owned Banking Association (COBA) and the Australian Finance Industry Association (AFIA)).

In responding to *ASIC report 516 Review of mortgage broking remuneration* in November 2017, the CIF outlined its commitment to a package of reforms to improve customer outcomes in mortgage broking. The proposed reforms comprise remuneration changes aimed at addressing lender choice and product strategy conflicts as outlined in the ASIC report as well as the development of a broader governance framework for the industry. Members have made individual decisions in relation to implementation of the reforms proposed by the CIF in compliance with competition law requirements.

The duty to act in the best interests of the customer closely aligns to the work that the CIF was undertaking on a recommended approach to 'good customer outcomes'. 'Good customer outcomes' focuses on the customer and reflects the activities of a mortgage broker, and also forms part of a governance framework proposed by the CIF.

Part 1: The best interests duty and priority obligation

Recommendation	Instrument	Reference
That s158L be amended to note that "That the assessment of the duty is tied to the credit assistance at the time it is provided, and is not to be viewed retrospectively".	Draft bill	4.1.4
The bill be scoped to apply to credit assistance in relation to regulated loans that are secured by mortgages over residential property.	Draft bill	4.1.5

[1] THE CIF defined Good customer outcomes as "The customer has obtained a loan which is appropriate (in terms of size and structure), is affordable, applied for in a compliant manner and meets the customer's set of objectives at the time of seeking the loan."; Improving Customer Outcomes: The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration P9.

Recommendation	Instrument	Reference
The explanatory memorandum explains the interactions and priority between the best interests obligations and responsible lending.	Explanatory memorandum	3.1.1
The explanatory memorandum be amended at 1.19 to note that the best interests duty applies to "credit assistance in relation to regulated credit secured by a mortgage over residential property rather than the individual products".	Explanatory memorandum	4.1.1
The explanatory memorandum notes that where the residential property is used as security, commercial and small business lending is excluded.	Explanatory memorandum	4.1.2
The best interests duty be supported by ASIC Regulatory Guidance to assist industry in meeting the Government's objectives for the changes.	ASIC Regulatory Guidance	3 &3.1
The proposed ASIC regulatory guidance notes the CIF definition of good customer outcome and provides greater clarity as to how licensees are expected to monitor and supervise brokers.	ASIC Regulatory Guidance	4.1.3
That proposed ASIC Regulatory Guidance clearly explain that consideration of the best interests duty must reflect the scope of the credit assistance provided to the customer.	ASIC Regulatory Guidance	4.1.6
That proposed ASIC Regulatory Guidance should note that the best interests of the customer may involve a range of factors other than the interest rate.	ASIC Regulatory Guidance	4.2.2
That proposed ASIC Regulatory Guidance provide further detail in regard to minimum documentation requirements and examples.	ASIC Regulatory Guidance	5.2
The transition arrangements should be in place for at least twelve months from commencement of the duty.	ASIC Regulatory Guidance	5.3

3. The best interests duty and priority obligation

The CIF broadly supports the introduction of a best interests duty and priority principle and contends that many brokers currently act in a manner consistent with the intent of the duty. This is supported by the fact that an estimated 70 per cent of a brokers business comes from repeat business and referrals[2].

The CIF notes that the draft bill proposes a principles-based duty under ss 158LA, 158LE. The position of the Government as noted in the explanatory memorandum at 1.20:

> *"Consistent with the recommendation of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the duty does not prescribe conduct that will be taken to satisfy the duty in specific circumstances. It 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."*

While noting that the Government is keen to maintain a principles-based test that could be assessed based on the circumstances of the credit assistance, the CIF submits that ASIC should develop guidance on how the duty should be exercised by the broker. An absence of guidance from ASIC would mean that companies will develop their own means of assessing how a best interests duty has been discharged, and risks inconsistent application of measures and expectations.

[2] The Value of Mortgage broking, Deloitte Access Economics P23.

The CIF argues that a balance needs to be found to provide a consistent means of assessing whether the best interests duty has been exercised, with the principles-based duty being central to the behaviour of the broker or industry participant.

3.1 Suggested detail supporting the duty

The CIF proposes that in addition to the duty to act in the best interests of the customer, the proposed ASIC guidance should include a credit appropriate 'test' which will assist brokers to comply with the best interests duty and priority rule. This includes a 'reasonable broker test' mirroring other guidance as to how the regulator could measure whether the credit assistance has satisfied the requirements of the duty.

ASIC Guidance could also note that a '*reasonable broker in the same position (including with the same information disclosed to them by the customer, and with the same range of loan products available to the broker) would consider that:*

- *the loan that is recommended is appropriate (in terms of size and structure of the loan) for the customer*
- *the loan is affordable for the customer*
- *the product the credit assistance provider recommended meets the customer's requirements and objectives as disclosed to the broker by the customer*
- *the loan is applied for in a compliant manner.'*

> *<u>Recommendation</u>: That the best interests duty be supported by ASIC Regulatory Guidance to assist industry in meeting the government's objectives for the changes.*

3.1.1 Interaction with responsible lending

CIF members have suggested that any regulatory guidance should clarify the interactions and priority of responsible lending components of the NCCP, noting that guidance on these obligations is currently subject to change in response to the consultations on *RG 209 Credit licensing: Responsible lending conduct*.

It has also been noted that as the responsible lending requirements will still apply in addition to the best interests duty, there is potential for confusion in regard to what the expectations on the broker would be. Regulatory guidance should ensure that where there is potential overlap between the different elements of the legislation, it is clear which part is the priority[3]. It was noted that in regard to the best interests duty for financial advisers, the previous requirements (*s.945A Reasonable basis of advice* of the Corporations Act 2001) were repealed when the best interests duty was introduced.

> *<u>Recommendation</u>: The explanatory memorandum explains the interactions and priority between the best interests obligations and responsible lending.*

3.1.2 Use of technology

The best interests duty is exercised by an individual who is a credit assistance provider. It is noted that that responsibility also remains with the licensee (particularly in respect to monitoring and supervision). ASIC has noted in RG175 (which applies to financial advisers, but may also by instructive for brokers) in relation to digital systems:

> *"However, if there is no individual that provides the advice, which may be the case if advice is provided through a computer program, the obligations in Div. 2 of Pt 7.7A apply to the legal person that provides the advice (e.g. a corporate licensee or authorised representative): s961*[4]*."*

The CIF are seeking further guidance from regulators below:

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[3] An example of this may be ambiguity between the application of 'not unsuitable' as a standard and the expectations of the best interests duty.
[4] REGULATORY GUIDE 175: Licensing: Financial product advisers—Conduct and disclosure P13, Para34

4. Need for further guidance

Licensees have expressed their concern that it will be difficult to effectively monitor and supervise the behaviour of brokers in a clear and consistent way if a principle-based duty is the sole reference for the duty.

If it remains a principles-only duty, it will be left to the interpretation of the courts and this may bring considerable expense and uncertainty. Such activities may mean that cases (which may take years) encourage significant caution on the behalf of brokers and/or undesired litigation as customers seek redress on areas beyond the credit assistance provider's control.

4.1 Areas where further clarity is sought

CIF members are concerned that implementation of the legislation may result in other impacts, and are seeking to highlight these areas as noted below.

4.1.1 Other credit products

It is noted that the explanatory memorandum references the inclusion of other credit products other than the residential mortgage being subject to the best interests duty. This intent is outlined in 1.19 of the explanatory memorandum:

> *"The obligations apply in relation to credit assistance provided by mortgage brokers in relation to any credit contract. This ensures that when mortgage brokers deal with consumers in relation to mortgages, the broker must act in the best interests of the consumer not only in relation to the mortgage but also in relation to any other credit contracts for which they provide credit assistance. Examples of other credit contracts in relation to which a mortgage broker may provide credit assistance include credit cards and personal loans that are packaged with the mortgage as well as unsecured credit for home renovation."*

The CIF suggests that the focus of the best interest duty should be for "credit assistance in relation to regulated credit secured by a mortgage over residential property" rather than the individual products (which could result in significant complexity and delays in credit assessments). Where individual products such as those noted in the explanatory memorandum (as above) are offered by the broker, they should still be subject to responsible lending.

> *<u>Recommendation:</u> the explanatory memorandum be amended at 1.19 to note that the best interests duty applies to "credit assistance in relation to regulated credit secured by a mortgage over residential property rather than the individual products".*

4.1.2 Potential small business crossover

It should be made clear that the best interests duty obligations exclude commercial and small business lending where the residential property is used as security.

On the other hand, we wish to ensure clarity that a commercial broker that occasionally provides credit assistance on a mortgage is also required to comply with a best interests duty and priority principle when *providing credit assistance in relation to regulated credit contracts secured by a mortgages over residential property*.

> *<u>Recommendation:</u> the explanatory memorandum notes that where the residential property is used as security, commercial and small business lending is excluded.*

4.1.3 Clarity on obligations of licensee

ACL and aggregator members have noted they will have responsibility for compliance, supervision and monitoring of brokers' meeting their best interests duty obligations. Although this is an extension of the current practices they have in place, the absence of guidance means it is difficult to develop monitoring indicators, audit questions and broker guidance to assist them to exercise the duty.

It is suggested that the good customer outcome definition provides a good platform for regulator guidance as to the expectations of what would need to be demonstrated for a broker to have discharged the duty, noting that this would need to be assessed on a case by case basis.

Recommendation: The proposed ASIC regulatory guidance notes the CIF definition of good customer outcome and provides greater clarity as to how licensees are expected to monitor and supervise brokers'.

4.1.4 Without the benefit of hindsight

There needs to be a clear understanding that the mortgage broker should only be assessed on the credit assistance they provided at a point in time (when the assessment was made). This assessment would be without the benefit of hindsight, and not take into consideration factors arising after the assistance has been provided (unless directly addressed as part of the scope and reasonable investigations for the original credit assistance). For example, an interest rate change after the credit assistance was provided. This also extends to retrospectively assessing the discharge of a best interests duty based on standards that were not in existence at the time the assistance was provided. We believe that this is mitigated by the use of a reasonable credit assistance provider test noted above in 3.1.

Recommendation: s158L be amended to note that "That the assessment of the duty is tied to the credit assistance at the time it is provided, and is not to be viewed retrospectively".

4.1.5 The application of the best interests duty to parties other than brokers

A number of members have raised concerns as to whether the duty would apply in circumstances where the establishment of a residential mortgage is a small part of their overall business[5] (such as a finance broker or other regulated activities (i.e. automotive finance). While members support the residential home lending activity being subject to the duty, there was concern that all their other loan activity would also be subject to the same standard. In this respect, the Financial Services Royal Commission Final report noted that:

> *"I consider 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 CIF suggests that in keeping with this intent, the draft bill should be scoped to only apply to credit assistance in relation to regulated loans that are secured by mortgages over residential property.

Additionally, it will need to be clear that in circumstances where a lender is selling their own products directly to the consumer, they would be subject to the requirements of responsible lending and not the best interests duty, in alignment with bank lenders.

Recommendation: The draft bill be scoped to apply to credit assistance in relation to regulated loans that are secured by mortgages over residential property.

4.1.6 Scope of credit assistance provided to the customer

The CIF suggests that regulatory guidance should also address the scope of assistance provided to the customer.

To exercise the best interests duty, the broker must have a clear understanding of the customer's requirements and objectives. In doing so, they will be able to form an opinion based on this information about which products are relevant to their recommendation and which are not. This is referred to as the scope of credit assistance and is central to how the duty is applied and assessed.

On the broker side, there should be an understanding between the borrower and broker that the broker is only able to assist on products available to them i.e. from lenders they are accredited with. The CIF has proposed that members disclose to customers how many lenders a broker has available to them on their panel, and how many of these lenders they are accredited with. The CIF understands that members have generally separately adopted this proposal.

By defining the scope of the credit assistance to be provided, the broker and customer are clear about expectations, which can help to address misunderstandings when assistance is prepared and events that occur after the fact.

Recommendation: That proposed ASIC Regulatory Guidance clearly explain that consideration of the best interests duty must reflect the scope of the credit assistance provided to the customer.

[5] A finance broker may write a small number of residential home loans over the course of a year

4.2 Discharging the duty

4.2.1 Best endeavours

With regard to the responsible lending requirements, it is noted that RG209 states*:*

> *"Depending on a consumer's objectives, an assessment of whether a credit contract or consumer lease is 'not unsuitable' may require consideration of the contract against the background of credit contracts or consumer leases that are commonly available in the market"*[6].

For a best interests duty, the scope of the duty should be, based on the requirements and objectives of the customer. While the credit assistance provider needs to demonstrate reasonable care in reviewing options for a loan recommendation, the expectation of the review should be to not impose an impractical standard on brokers to base their recommendations on an assessment of every single loan product in the market (noting also that a broker can only provide recommendations on products on their panel that they are accredited for).

The statement in RG209 notes that the broker has considered a range of alternative comparable products available to them and in doing so, has selected an appropriate product relative to the customer's requirements and objectives. In practice this may be a statement that indicates that '*in seeking an appropriate solution that meets the customer's requirements and objectives a number of loans have been considered.'*

The broker has to consider a range of factors that will change depending on the customer's circumstances and the broader lending environment. The CIF has captured some of these variables below under 4.2.2 and is willing to work with regulators to develop industry scenarios that could assist in informing market participants about the operation of the best interests duty in guidance provided.

4.2.2 Best interests duty and interest rate

It was noted in ASIC's *report 516 Review of mortgage broker remuneration* that:

> *"Consumer outcomes are multifaceted and comprise a series of factors—such as price, product accessibility, product features, loan performance—which may vary in importance from consumer to consumer."*[7]

The CIF has identified some (but not all) of the additional considerations that a broker may consider when assessing the requirements and objectives of the customer.

Customer preference (current lender or preferred lender)	Geographic factors – can determine which lender can be recommended	Stage of life (age of customer etc.)
Access to particular product features, such as redraw or offset	Rural or metro loan	Lender profile/brand/perceived stability
Branch vs online lender	Loan special incentives (available to customer not broker)	Financial stability/seasonality of income
Employment type/ structure of income	Security type	Power or attorney
Guarantor relationship	Domestic situation	Flexibility of loan
Early exit	Lenders mortgage insurance	Customers experiencing vulnerability
Offset account access	Residency situation	Loan to Valuation Ratio (LVR)
Source of contribution or deposit	Borrower type (i.e. personal/trust fund)	Client future plans for property use
Access to internet banking	Income type (PAYG/contractor)	Intended use of funds

[6] REGULATORY GUIDE 209: Credit licensing: Responsible lending conduct P33 para 92
[7] ASIC 516: Review of Mortgage Broker Remuneration P34

Lender policy	Lender processing times to approval	Access to other products from that lender
Credit history of the borrower	Required service (application) turnaround times of lender	Source of income

The CIF recommends that any guidance captures a broad range of factors that would constitute a loan being in the best interests of a client rather than rate alone.

This is supported by ASIC's recent *report 628: Looking for a mortgage: Consumer experiences and expectations in getting a home loan* which found:

> *"In the qualitative research, we found that as consumers progressed along the home loan journey, the importance of finding a good rate seemed to decrease for some consumers and they became more influenced by other factors such as the convenience of staying with an existing lender (or a lender they had an existing relationship with) and home loan features such as offset accounts."*[8]

<u>Recommendation</u>: *That proposed ASIC Regulatory Guidance should note that the best interests of the customer may involve a range of factors other than the interest rate.*

4.2.3 Enforcement provisions

The CIF notes that ASIC is currently reviewing enforcement provisions, along with the recommendations of the enforcement review and how provisions may change for other parts of the financial services industry. Noting the gravity of the penalties for breaches of the best interest duty CIF members have observed that given mortgage brokers are predominantly small businesses, the effect of significant fines for lower order contraventions would likely be to close the business and potentially bankrupt the broker.

5. The case for a managed transition

5.1 Operational impacts

The potential impact on the operations of the business of the broker and intermediary are critical to the successful operation of the duty and will need time to be implemented. Some members have raised concerns about the magnitude of change required to meet the legislative requirements by 1 July 2020, especially for systems, training and setting up compliance and monitoring programs. Accordingly, the CIF is seeking transitional arrangements and/or facilitative compliance for the first twelve months from 1 July 2020 (see 5.3 below for further detail). Members have indicated that time may be significant (up to twelve-eighteen months from finalisation of best interests duty) given the substantial system changes, testing, training and education and embedding of behavioural changes required.

5.1.1 System changes and IT requirements

Changes to the compliance regime will potentially require systems upgrades and additional monitoring structures to determine if documentation standards have been met. Initial feedback from members suggests that some of these changes will be capital and/or resource intensive.

5.1.2 Compliance and monitoring

The best interests duty will change current compliance and monitoring requirements, particularly in respect to maintaining appropriate records for evidence. The standard of record keeping and file audits may change to ensure that the customer's interests have been placed ahead of that of the broker or the licensee, as this will be central to determining if the duty has effectively been discharged.

As noted earlier, where digital systems are used, the Australian Credit License (ACL) is ultimately responsible for the credit assistance provided.

[8] ASIC 628: Looking for a mortgage: Consumer experiences and expectations in getting a home loan P9, para34

5.1.3 Training and education

It is acknowledged that the best interests duty will require a number of operational changes and brokers will need to be clear on how to discharge their requirements under the duty. Accordingly, training will need to be provided across impacted parties which will require time and sufficient materials to be delivered. Regulator's may wish to stipulate minimum course requirements for training on the best interests duty to simplify the process and ensure a greater degree of consistency.

It is also noted that the requirements for this education to be completed could be factored into any facilitative compliance considerations

5.2 Documentation

CIF members have noted the importance of documentation in ensuring that it is clear for observers to determine the best interests duty has been met. Regulatory guidance that provides greater clarity such as that provided in *RG90: Example Statement of Advice: scaled advice for a new client*[9] would be instructive in this respect.

The intended purpose of documentation is:

- To assist the customer to understand what their obligations are, and what they hope to achieve by adopting a particular loan
- To ensure that for future servicing there is an adequate record of the interaction with the customer, and in the case of a dispute, a clear outline of interactions with the client that may serve as evidence for both parties.

The focus on documentation will mean that brokers will need to exercise diligence in their record keeping so that documents can act as standalone evidence if required. Some lenders may choose to ask brokers to confirm that they have executed the requirements of the best interests duty when submitting a loan application.

There is also an opportunity to refine the documentation currently used and to ensure that documents provided to customers are easy to read and understand. Customers could also be required to acknowledge that the information and documentation that they have provided is accurate and can be relied upon for the purpose of the credit assistance provided by the broker.

CIF members have indicated that any changes to documentation are likely to require significant system and operational modifications, but also note the benefits to the consumer and operations of streamlining and simplifying documents. The CIF has noted that it is willing to consider the documentation used by brokers and to work with ASIC to assist in ensuring the documents can be made easier for the customer to understand, and still meet the standard for capturing all necessary information (NCCP allows for combining disclosure documents). Notwithstanding CIF's proposals in this regard, the CIF would welcome ASIC providing clear guidance on documentation.

The CIF is generally supportive of government initiatives to standardise requirements and objectives documentation, such as the standardised Broker Interview Guide. We further note that ASIC already has a range of documentation requirements across the financial services industry through its regulatory guidance.

> *<u>Recommendation</u>: That proposed ASIC Regulatory Guidance provide further detail in regard to minimum documentation requirements and examples.*

5.3 Transition arrangements and facilitative compliance.

Given the adjustments to operations and systems to support the duty, the CIF suggests that at a minimum, the commencement of a best interests duty be supported by ASIC adopting a 'facilitative compliance' approach.

Such an approach would be consistent with the stance of regulators during the introduction of other major policy reforms. For example, ASIC took a 12-month facilitative compliance approach to the FOFA reforms in 2013-2014 and AUSTRAC's applied an 18-month assisted compliance period to the introduction of additional customer due diligence requirements in 2014.

[9] RG90: Example Statement of Advice: scaled advice for a new client

A facilitative compliance approach may include:

- Apply a facilitative approach to implementation and compliance with the new requirements.
- Take a measured approach to inadvertent breaches, or breaches resulting from the implementation of systems changes.
- Take strong action for deliberate breaches, or failure to make reasonable efforts to comply.

The facilitative compliance approach would not extend to any alleged criminal conduct, which would be dealt with as regulators deems appropriate.

CIF members have noted that a relatively short timeframe for implementation may have adverse consequences such as:

- Inability to smooth implementation costs
- Driving some competent (often smaller) operators from the industry
- Encouraging brokers to be accredited with fewer lenders which would reduce competition and choice for customers
- Ambiguity and/or inconsistencies of interpretation by lenders/brokers/ACL holders/regulators
- Reduced availability, or harsher terms/costs for Professional Indemnity (PI) cover.

It is suggested that the facilitative compliance regime remain in place for at least twelve months following the bill coming into effect. This will also assist in managing implementation costs in organisations that need to comply.

> *Recommendation: The transition arrangements should be in place for at least twelve months from commencement of the duty.*

Part 2: Conflicted Remuneration

The Combined Industry Forum (CIF) further welcomes the opportunity to provide this limited submission regarding the remuneration reforms as contained in the National Consumer Credit Protection (NCCP) Amendment (Mortgage Brokers) Bill 2019, National Consumer Credit Protection Amendment (Mortgage Brokers) Regulations 2019 and associated explanatory materials.

The CIF supports the Government's approach to remuneration reform, and notes a number of areas to improve alignment of the bill and draft regulations with the Government's announcements.

Whilst part 2 of this submission covers a number of key issues, CIF members have raised other points which members will address in their individual submissions.

The recommendations are summarized in the below table:

Recommendation	**Instrument**	**Reference**
The bill and regulations be drafted to ensure the regime applies to the activity of providing credit assistance in relation to regulated credit contracts secured by a mortgage over residential property rather than the entity undertaking the activity.	Draft bill and regulation	7.1
The 90-day timeframe currently proposed in s28VB be changed to 365 days from the initial draw down.	Draft regulation	7.2
The conflicted remuneration provisions apply to upfront payments, and not to trail commissions.	Draft regulation	7.3
That s28VB be amended to allow remuneration to be payable for the provision of credit assistance under regulated credit contracts secured by a mortgage over residential property in relation to loan top-ups (new advances and additional borrowings under the loan beyond the initial draw down).	Draft regulation	7.4
That s28VA(3) be drafted to ensure these provisions do not extend beyond credit assistance in relation to regulated credit contracts secured by a mortgages over residential property.	Draft regulation	7.5

Recommendation	Instrument	Reference
That s28VB(b) be drafted so that remuneration can also be paid on drawdown amounts made available for uses outside a purchase or refinance of a residential property where they are part of the same loan.	Draft regulation	7.5

We note that in developing its policy, the Government had regard to the reforms proposed by the CIF and individually implemented by members of the CIF in compliance with competition laws. CIF members remain committed to implementation of these commitments.

6. CIF member positions

The CIF members have noted their broad support in relation to:

- Implementation of recommendation of 1.2 of the Financial Services Royal Commission (FSRC) final report[10], a best interests duty for mortgage brokers when acting in connection with home lending (as noted above); and
- The Government's response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *"Restoring trust in Australia's financial system";*[11] and its subsequent policy announcement "*Review of mortgage broking trail commissions*"[12] released on 12 March 2019.
- The Government announced the following changes in the home lending market:
    - require the value of upfront commissions be linked to the amount drawn down by borrowers and not the loan amount
    - ban campaign and volume-based commissions and payments
    - limit the period over which commissions can be clawed back from aggregators and brokers to two years
    - prohibit the cost of clawbacks being passed on to consumers, and
    - a review in three years' time by Council of Financial Regulators (**COFR**) and the Australian Competition and Consumer Commission (**ACCC**) of the impact of the above changes, and remuneration structures for mortgage brokers, including upfront and trail commissions.

7. Alignment of Government policy and draft legislation

The CIF supports the stated aims of the draft legislation to reform mortgage broker remuneration consistent with the Government's announced policy. The CIF proposes a number of areas for consideration in order to achieve these aims.

The following issues highlight the specific areas that have been identified.

7.1 Focussing on regulating the activity rather than the entity

Both the Government and the Commissioner intended for these reforms to apply in the home lending market. The Commissioner referred to the best interest duty applying when acting in connection with home lending and the Government contextualised its announcements in relation to the home lending sector / home lending market. For these reasons the CIF proposes that the bill is drafted to ensure that the new requirements apply to the provision of credit assistance for regulated loans secured by a residential mortgage.

The current draft focusing on the entity (specifically the mortgage broker or the mortgage intermediary as defined in 15B & 15C respectively) and may not achieve the policy aims as:

- Market participants may be missed and not subject to the regime, and/or

[10] In the CIF's companion submission on the Best interests duty, the group's support notes the need for further clarity in some areas as well as ASIC regulatory guidance.
[11] The Treasury, *Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, 4 February 2019.
[12] Frydenberg, *Review of mortgage broking trail commissions* 12 March 2019.

- Parties who only write a small number of residential loans in a year will be fully included in the regime, meaning activity not related to credit assistance for regulated loans secured by a residential mortgage will be covered by the new best interest and remuneration requirements for those non-related activities.
- Finance brokers and mortgage brokers not having a level playing field when it comes to the regulation of broking activities in relation to home lending.

<u>Recommendation</u>: The bill and regulations be drafted to ensure the regime applies to the activity of providing credit assistance in relation to regulated credit contracts secured by a mortgages over residential property rather than the entity undertaking the activity.

7.2 Definition of drawdown amount

The new definition of drawdown amount under reg28VB notes:

> *"the drawdown amount for the credit contract is 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 consumer."*

A term of 90 days does not align with common customer behaviors, whereby drawdowns are made over a number of months to fund the purchase / refinance of the residential property and then meet other requirements and objectives such as renovations, consolidation of other debt etc. To align with these customer driven behaviors, CIF members support a longer timeframe of 365 days to calculate the drawdown amount.

It is further suggested that the term "day on which the credit contract is entered into" is not consistent with current industry practice and should reference the initial draw down.

<u>Recommendation</u>: The 90-day timeframe currently proposed in s28VB be changed to 365 days from the initial draw down.

7.3 Applying remuneration to upfront commissions

The Government has announced that it will require the value of upfront commissions be linked to the amount drawn down by borrowers and not the loan amount. To achieve this aim, the bill and regulations should be drafted to clarify that the conflicted remuneration provisions apply to upfront payments (including upfront payments for loan 'top ups') and not to trail commissions. The CIF notes the Government's policy on remuneration structures for mortgage brokers, including that upfront and trail commissions will be reviewed in three years' time.

<u>Recommendation</u>: The conflicted remuneration provisions apply to upfront payments, and not to trail commissions.

7.4 Loan top-ups

The regulation and specifically s28VB does not appear to allow remuneration to be paid in connection with loan 'top ups' i.e. for new advances or additional borrowings where these are approved under the existing credit contract. The payment of upfront commissions and trail on these further borrowings occurs frequently within the industry.

In circumstances where the security against the loan has not changed but the customer wishes to make further borrowings, the broker should receive remuneration for credit assistance on regulated loans secured by a residential mortgage relating to the altered loan amount.

<u>Recommendation</u>: That s28VB be amended to allow remuneration to be payable for the provision of credit assistance under regulated credit contracts secured by a mortgages over residential property in relation to loan top-ups (new advances and additional borrowings under the loan beyond the initial draw down).

7.5 Purpose of funds drawn down

Credit assistance activity often extends to other forms of standalone credit that are outside of residential home lending. There is a risk under the regulations, as currently drafted, that such remuneration may not meet the requirements of s28VA(3) and could therefore be seen as conflicted.

In the government's policy announcement "Review of mortgage broking trail commissions"[13] it was "a new requirement that the value of upfront commissions be linked to the amount drawn-down by borrowers." The CIF considers that the drafting needs to reflect this intent.

In certain circumstances the legislation also appears to be limiting the payment of commissions to amount used for the purpose of purchasing or refinancing residential property which could exclude monetary benefits on credit for other purposes (such as renovations, consolidation of other debts) where it forms part of the same loan.

> *Recommendation: That s28VA(3) be drafted to ensure these provisions do not extend beyond credit assistance in relation to regulated credit contracts secured by a mortgages over residential property.*

> *Recommendation: That s28VB(b) be drafted so that remuneration can also be paid on drawdown amounts made available for uses outside a purchase or refinance of a residential property where they are part of the same loan.*

8. Final remarks

If not addressed, the above issues have the potential to require changes to practice that may create additional processes and complexity for customers. Further, they may significantly change the economics of the industry and create significant systems complexity for lenders (as they will need to rebuild commission systems and potentially have a number of different calculations for each loan), aggregators and brokers to meet the requirements[14].

The CIF has been proactive in proposing reforms to address regulator concerns in improving customer outcomes and is keen to continue working with government and regulators on this path. To date CIF members have independently adopted a range of reforms that improve information flow to the borrower, and address the specific concerns raised in ASIC 516 review of mortgage broker remuneration.

The CIF thanks Treasury for the opportunity to consider the drafting of this important amendment and look forward to assisting in the future.

[13] Frydenberg, *Review of mortgage broking trail commissions* 12 March 2019.

[14] This complexity will be magnified in circumstances where the brokers is asked by the customer to make further changes to the offset arrangement such as seeking an increase in the amount available.