

Submission on draft mortgage brokers legislation and regulations

Introduction

This submission is made by Jon Denovan of Dentons Australia (lawyers). The contents of this submission are not necessarily the views of any of our clients. This submission is made in light of my extensive experience both as an advisor and director of many leading lenders, aggregators, servicers, mortgage managers, and brokers since 1973.

My suggestions are primarily focused on ensuring that the legislation and regulations achieve the stated objectives which I understand is to implement recommendation 1.2 from the Banking Royal Commission:

'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'

Submissions

1. Exclusion of servicers, mortgage managers, and other entities which do not conduct the business of mortgage broking.

The current draft of the Act contemplates that the provisions apply to mortgage brokers as defined in proposed section 15B and (in respect of conflicted remuneration) mortgage intermediaries as defined in proposed section 15C.

Section 15B defines a mortgage broker as a licensee or credit representative who *'carries on business of providing credit assistance in relation to credit contracts secured by mortgages over residential property'*.

There are many businesses which provide credit assistance but which are neither mortgage brokers nor intermediaries as those terms are used colloquially.

In this context it is important to note Section 8 of the NCCP Act which provides that credit assistance occurs even when licensees or credit representatives do so on their own behalf. This has been recognised:

- in relation to lenders by the exclusion from Chapter 3 of credit assistance provided by licensees who will be the credit provider under the contract – section 112;
- in relation to servicers of special purpose funding entities by exclusion from Chapter 3 of credit assistance provided by licensees if a special purpose funding entity will be the credit provider under the contract – item 3.24 of Schedule 3 of the NCCP regulations; and
- in relation to mortgage managers as defined in regulation 26 in relation to commission disclosure by regulation 28H(3). [For completeness, note that Treasury has in the past recognised that there is a typo in regulation 28H(3)(c) which should refer to the mortgage manager's web site, not the credit provider's or lessor's web site.]

Other than the usual concept of lenders, servicers, and mortgage managers, there are other circumstances where licensees and credit representatives provide credit assistance but are doing so other than as a finance brokers (for example, outsourced service suppliers for lenders and lessors).

The draft provisions attempt to exclude these kinds of businesses by subclauses (b) in section 15B and 15C by excluding businesses which *'perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts'*. However this exclusion will not have the intended effect because there are many businesses that provide these services but do not perform the

obligations, or exercise the rights, of a credit provider in relation to the majority of the credit contracts handled by the business.

Accordingly, these types of businesses should be excluded in full from the proposals in the proposed act because:

- it is not the government's intention that the legislation should extend to those activities;
- the businesses conducting those activities have a conflict of interest in the same way as any lender or lessor because of the desire of financiers to maximise the return whereas consumers generally have the opposite requirement; and
- the conflicted remuneration provisions are not appropriate.

It is very important that current and appropriate business structures are not unintentionally disrupted.

Some commentators have expressed the view that section 15C excludes these businesses from the best interest and conflict duties because those provisions do not apply to mortgage intermediaries. However even if those businesses fall within the definition of mortgage intermediary, they also fall within the definition of mortgage broker and so section 15C does not achieve that objective.

2. What is a mortgage broker?

The best interest and conflict duties applies to mortgage brokers who are defined in section 15B to be a business *'that carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property'*.

Whether an entity carries on a business will be a question of fact, depending on how the business is conducted and the number of residential property loans arranged. It is undesirable that an unclear and imprecise test will determine whether these important provisions apply.

A much simpler test is to provide that these duties will apply to any licensee or credit representative acting as a finance broker when they provide credit assistance in relation to credit contracts secured by mortgages over residential property wholly or predominantly for Code regulated purposes as specified in section 5(1) of the Credit Code. This would avoid entities gaming the legislation and should ensure that consumers receive the same standard of care and rights whenever they engage finance brokers to arrange regulated credit secured by residential property (regardless of whether that entity is in the business of providing that credit assistance or not).

A possible definition (which is simple to understand and regulate) is that *'A mortgage broker is a licensee or credit representative that provides credit assistance in relation credit contracts secured by mortgages over residential property'*. This definition removes the doubt as to what amounts to carrying on business. It means that whenever security is taken over residential property for regulated credit, BID will apply.

3. Extension of best interest and conflict duties to ancillary products.

Once a business is categorised as a mortgage broker, the best interests and conflict duties will apply to **any** credit assistance provided by that broker – see proposed sections 158L and 158LD.

This extension to credit not relating to housing finance appears to be outside the scope of the recommendation from the Banking Royal Commission. It seems unfair that finance brokers who are not mortgage brokers can arrange non-mortgage finance without being subject to the duties whereas mortgage brokers will be subject to the duties when they arrange non-mortgage finance.

Not only will these duties apply to separate credit arranged by mortgage brokers but they will also apply to any ancillary products provided with the primary loan secured by residential property. For example, if a credit or debit card is provided as part of the package, the best interest duty could

require brokers to ensure that those products are considered best value on a stand-alone basis. This has the potential to significantly and unnecessarily complicate the primary function of arranging a good mortgage loan. If these ancillary products are not to be excluded from the duty, it is essential that it is made clear that the application of those rules to the ancillary products is in some way subsidiary to the primary objective to obtain an appropriate home loan.

4. Associates of mortgage brokers – s158LB(b)

Section 158LB(b) provides that if there is a conflict between an associate of the licensee and the interests of the consumer, priority must be given to the consumer's interest. Section 204(2) of the NCC provides that persons are associated with a credit provider if they are related body corporates or there is a link credit provider arrangement.

Although this definition is expressed to apply only for the purposes of the NCC, the section could be taken into account in determining what comprises an associate for the purposes of section 158LB. Most lenders will have a linked credit provider relationship with their panel brokers because there is an arrangement with brokers to distribute the lender's products.

It is of course appropriate that in these circumstances brokers would ensure that any conflict is resolved in favour of consumers (particularly the key conflict being the price of the credit). However it is important to recognise that the mere existence of this relationship is not odious because arrangements between brokers and panel lenders produce good outcomes for consumers.

6. Supervision by licensees – s158LF(2)

Section 158LF(2) provides that licensees must take reasonable steps to ensure that their credit representatives comply with the conflict duty. Most aggregators have very many credit representatives and so it is important that reasonable steps are not unduly onerous.

There is a strong argument that there should be no civil penalty for failure to take reasonable steps because of the uncertainty as to what amounts to reasonable steps and because of the difficulty of meaningfully managing this risk.

Imposing significant civil penalties for simply breaching the obligation of supervision irrespective of whether credit representatives breached the Act is not appropriate. There is already a significant onus on licensees because they are liable for breaches of their credit representatives under section 75. It might be better to remove the provision altogether and rely on section 75 which provides that licensees are liable for the conduct of their credit representatives.

7. Best interests

It has already been widely recognised that acting in a customer's best interest does not mean obtaining the cheapest loan and that other factors are important (such as loan features, customer service etc). The concept also needs to allow borrower's directions to be followed even if the selection is not the best value loan, so long as the loan is not unsuitable.

Given that difference between best interests for financial planners (where the value of the product is hard to ascertain) and for finance brokers (where at least in theory the evaluation is more finite), it is unfortunate that the same term is applied to quite different duties.

Assuming the term 'best interests' is retained, it would be good if there was some recognition in the bill or the regulations that best interests does not equate to the cheapest loan and that other factors are to be taken into account (including customer directions).

8. Conflicted remuneration regulation 28VF(3)

Proposed regulation 28VF(3) permits non-monetary benefits in connection with genuine education or training purposes. Often the assistance provided to licensees will be money to assist meeting the cost of these events.

It is appreciated that payments are not prohibited unless they are conflicted remuneration as defined in proposed section 158N. Usually, payments by lenders to aggregators to support educational events would not comprise conflicted remuneration because they do not usually influence the credit assistance provided to consumers. However, despite the argument that education and training support is not conflicted, the addition of regulation 28VF(3) may cause doubt in relation to that proposition. Accordingly, reg 28VF(3) should be amended to permit money payments..

9. Commission limits

(a) Special loan types

Regulation 28VB requires commission to be tied to the drawdown amount being '*so much of the credit as is used for that purpose within 90 days after the date on which the credit contract is entered into by the consumer*'.

To ensure the regulatory purpose, this provision needs reworking to exclude construction loans, lines of credit, and reverse mortgages.

(b) Purpose test

The reference in regulation 28VE to '*so much of the amount of credit as is used for that purpose*' is unclear. We interpret '*that purpose*' to be the purpose of purchasing or refinancing residential property which may in effect exclude related costs such as stamp duty or other purposes included under the same loan such as debt consolidation. It may also prohibit commission on that part of the loan that is not used for residential purposes. We suggest '*for that purpose*' should be deleted.

(c) Trail commission

Regulation 28VB may have an unintended impact on trail commissions, which are usually paid on the daily balance of accounts. Trail commissions should be excluded from this limitation.

(d) Commencement date

Section 3 of Schedule 9 of the draft bill provides that the ban on conflicted remuneration applies to benefits paid on or after 1 July 2020 even if the arrangement was made before that date. Existing arrangements for trail commissions should be excluded.

(e) Date from which drawdown amount is calculated

It is inappropriate to tie the commencement of the period to the date on which the credit contract is entered into because the contract date is not relevant and is not necessarily the date when the loan is made. The appropriate start date is the date the initial advance is made pursuant to the credit contract.

(f) Principal increases

Some lenders document increases in amounts of credit by a new credit contract while others document by varying the original credit contract. As currently drafted the regulation would prohibit the payment of commission in relation to increases documented by way of a variation. This is an unintended consequence which should be addressed. Commission is properly payable on principal increases because brokers must undertake responsible lending.

(g) System issues

Lenders may have difficulty updating their systems to comply unless there is at least six months from when the final form of the legislation is known until the commencement date.