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Manager
Financial Services Reform Taskforce
The Treasury
Langton Crescent
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By email: ConsumerCredit@treasury.gov.au

To whom it may concern,

**MFAA Submission on Mortgage broker best interests duty and remuneration reforms**

As the peak national body representing the mortgage broking industry, the Mortgage & Finance Association of Australia (MFAA) welcomes the opportunity to provide this submission in response to the exposure draft of the National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 and associated draft Regulations (the exposure draft).

The MFAA is committed to improving standards within the mortgage broking industry and supports efforts to strengthen existing protections for consumers who engage brokers. Following recommendations made in the *Final Report* of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, we believe the exposure draft is a constructive part of this ongoing process to raise industry standards and deliver positive consumer outcomes. According to the explanatory materials, the proposed amendments aim to ensure mortgage brokers "act in the best interests of consumers and to address conflicted remuneration for mortgage brokers and mortgage intermediaries such as aggregators."[1] In doing so, the laws will "improve consumer outcomes by requiring brokers to act in the best interests of their clients and by reducing the potential for conflicts of interests to arise which may impact the advice consumers receive from brokers."[2] The MFAA agrees that these changes will bring the law further into line with consumer expectations of the industry.

We therefore welcome the Government's release of the exposure draft and support its aims. We will use this opportunity to voice concerns over certain provisions that we believe are inconsistent with the Government's 4 February 2019 response to the Royal Commission into Misconduct in the Banking,

[1] National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft Explanatory Materials, p. 4 [1.6].
[2] Ibid.

Superannuation and Financial Services Industry, “Restoring trust in Australia's financial system”;[3] and its subsequent 12 March 2019 policy announcement “Review of mortgage broking trail commissions”.[4] We will also highlight where we believe certain provisions will not achieve the stated aims of the draft legislation as listed above, or will likely result in unintended consequences for industry participants, and by extension, consumers. We will also, where possible, offer solutions to issues identified in the exposure draft, which we believe must be addressed in order to give effect to the stated aims of the proposed legislation.

The MFAA extends its thanks to Treasury for the opportunity to respond to consultation on this exposure draft Bill and Regulations. Should you require further information to supplement this submission, please do not hesitate to contact me on (02) 8905 1301 or by emailing Mike.Felton@mfaa.com.au.

Yours sincerely

**Mike Felton**
Chief Executive Officer
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[3] 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.
[4] The Hon Josh Frydenberg, Media Release, *Review of mortgage broking trail commissions*, 12 March 2019.

## 1. About the MFAA

With more than 13,500 members, the MFAA is Australia's leading professional association for the mortgage broking industry with membership covering mortgage and finance brokers, aggregators, lenders, mortgage managers, mortgage insurers and other suppliers to the mortgage broking industry. The stated purpose of the MFAA is to advance the interests of our members through leadership in advocacy, education and promotion. To achieve this aim, the MFAA promotes and advances the broker proposition to a range of external stakeholders including governments, regulators and consumers, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

The MFAA is a founding member of the Combined Industry Forum (CIF) which was established by the mortgage broking industry to drive better customer outcomes through improved governance and remuneration practices in mortgage broking. The CIF responded to the proposals of the ASIC Broker Remuneration Review REP 516 and the Sedgwick review in December 2017 and has over the past 2 years delivered a number of industry reforms aimed at addressing the ASIC recommendations and improving customer outcomes.

## 2. Executive Summary

The MFAA welcomes the Government's release of the exposure draft and supports its aims. We, however, have concerns over certain provisions that we believe are inconsistent with the Government's 4 February 2019 response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Restoring trust in Australia's financial system";[5] and its subsequent 12 March 2019 policy announcement "Review of mortgage broking trail commissions".[6] We also believe certain provisions will not achieve the stated aims of the draft legislation as listed above, or will likely result in unintended consequences for industry participants, and by extension, consumers.

### 2.1. Definitions

The exposure draft introduces a new definition of 'mortgage broker' for the purpose of ascribing to the defined group certain new duties and equally forbidding the group from receiving certain remuneration. Given that much relies on this definition, it is vital that it is defined appropriately. While this definition evidently seeks to exclude finance brokers in principle (if they do not provide credit assistance on residential lending), if *"carries on a business"* is defined as "any business", it will not exclude them in practice, inadvertently also capturing their primary non-home-lending activities.[7] Alternatively, if "carries on a business" is defined as the majority of business, it could lead to finance brokers and mortgage brokers not having a level playing field when it comes to the regulation of home-lending broking activities.

The MFAA is also concerned that the definition of 'mortgage broker' may capture other, non-residential, activities undertaken by a licensee or credit representative as part of their business, such as standalone car finance secured by a motor vehicle, unsecured personal loans or other products such as credit cards. This goes well beyond the stated intention of the legislation, and may attract the new obligations that a mortgage broker will have to discharge under the draft legislation.

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[5] The Treasury, *Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.
[6] Frydenberg, *Review of mortgage broking trail commissions.*
[7] National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 Exposure Draft, Sch. 1, cl 15B.

To address the above issues, we propose that 'finance brokers' be defined, and an 'activity test' be included to determine which credit assistance activities trigger the relevant obligations.

We also suggest that licensees and credit representatives of lenders, mortgage managers and servicers (all of whom provide credit assistance in respect of their own loans, managed or serviced loans) should be exempted from the legislation to the extent of their non-broker related activities.

## 2.2. Best interest duty (BID)

The exposure draft directly responds to a key recommendation set out in the Final Report of the 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."[8] We submit that the exposure draft erroneously goes one step further, capturing all regulated lending activities of mortgage brokers. The MFAA therefore proposes that the exposure draft as a whole should be limited to apply only to credit assistance in relation to regulated loans to the extent they are secured by mortgages over residential property.

We understand that this new best interest duty will only apply in relation to the provision of credit assistance **at a point in time** (when a broker provides credit assistance) rather than over the life of a loan. We strongly support this 'point in time limitation' on the otherwise potentially wide application of a Best Interests Duty, as it would be impossible for a broker to effectively discharge a duty which extends beyond a point in time to cover the life of a loan. Due to the significant implications for the mortgage broking industry should the duty extend beyond a point in time, we seek confirmation of the above interpretation, and that a 'point in time limitation' is explained and reflected in the Bill Exposure Draft Explanatory Materials.

The MFAA is also concerned that, without further guidance, and in the absence of a safe harbour provision, the proposed Best Interests Duty has the potential to translate into a legal requirement that brokers must provide the 'best' or 'most appropriate' product or assistance to ensure the 'best outcome' or 'cheapest price'. Such terms are highly subjective descriptions and do not provide useful guidance as to what the 'best' outcome actually is for a given customer or indeed what is in their best interests. We urge policymakers to appreciate that 'best' value is subjective, and that further clarity and concrete standards are required to properly execute the duty in practice, for example, within an ASIC regulatory guide.

To accompany ASIC guidance on the Best Interests Duty, we further suggest that a 'reasonable broker' test be inserted into the exposure draft in order to assist mortgage brokers to meet their obligations under the law.

Guidance could note that a reasonable broker test has been met if a mortgage 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

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

- the product(s) the credit assistance provider recommended meets the customer's requirements and objectives as disclosed to the broker by the customer, and
- the loan is applied for in a compliant manner.

By providing a clear, minimum prescription of activity, and introducing the concept of a "reasonable broker" test, the legislation can ensure the duty is more clearly defined and therefore assist the industry to meet the standard. By extension, this added guidance will inform and assist consumers and provide a clear understanding of a broker's responsibilities.

The exposure draft also leads to a number of unforeseen problems in relation to the implementation of a best interest duty, as it:

- introduces the concept of the mortgage broker considering 'a range of products'[9] before making a recommendation to a customer; but is unclear as to how many products a broker will be required to compare on behalf of a customer seeking a loan, in order to meet the standard
- provides that "the licensee must take reasonable steps to ensure that the credit representative complies"[10] with the Best Interests Duty, but provides no guidance as to what is considered reasonable
- specifies that a broker must not suggest a white label product if it has the same features as a branded product from the same lender but with a higher interest rate,[11] which may include products in the market that are not included on a broker's panel, or for which a broker lacks the required accreditation
- introduces the concept of an 'annual review'[12] into law, which the MFAA does not believe should be a formal requirement. We also believe that the term "periodic review" is a more appropriate term
- lacks a 'materiality threshold' for brokers to use before considering whether to recommend a customer switch loans or lenders during a periodic review, which may encourage costly 'churn'
- applies in relation to any NCCP regulated credit contract, not just those packaged with a home loan
- includes a failure to undertake certain activities, but does not provide protection for the mortgage broker when information has been deliberately withheld, or fraudulently obtained by the customer.

## 2.3. Conflicted remuneration

The MFAA supports the aim of the draft legislation to reduce the potential for conflicts of interest, however, we are concerned that in a number of instances they are inconsistent with the Government's 4 February 2019 response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Restoring trust in Australia's financial system";[13] and its subsequent 12 March 2019 policy announcement "Review of mortgage broking trail commissions".[14]

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[9] Bill Exposure Draft Explanatory Materials, p. 8 [1.21].
[10] Bill Exposure Draft, cl 158LE.
[11] Bill Exposure Draft Explanatory Materials, p. 8 [1.21].
[12] Ibid, P. 9 [1.21].
[13] The Treasury, *Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.
[14] Frydenberg, *Review of mortgage broking trail commissions.*

In relation to monetary benefits, the combination of draft Regulatory clauses 28VA(4) and 28VB not only standardises and gives partial regulatory effect to the net of offset reforms as introduced by the mortgage broking industry with respect to upfront commissions but goes a number of steps further with the effect of substantially reducing both upfront and trail commissions being paid to brokers. Further, these new offset arrangements, as currently drafted, will apply retroactively[15] to brokers, forcing all lenders to recalculate all existing loans to assess offset balances as of 90 days post establishment of the loan. This would involve a review of loan data over the past 30 years, and is both impractical and unnecessary.

To summarise our concerns with the exposure draft legislation as it applies to monetary benefits:

- The 90 day net of offset period allowed for is well below the 365 days predominantly implemented by the industry and is not viewed as a reasonable period or sufficient time for the offset funds to be used. We also suggest that any drawdown period should commence from the date of initial drawing of the loan and not the date the contract is entered into.
- The definition of ***drawdown amount*** which limits remuneration to being paid based on the amount of credit used within 90 days of entering the credit contract is seemingly also being applied to the calculation of trail commission, which is currently paid monthly on the outstanding balance net of offset at the time of calculation.
- In addition, it is evident that the draft legislation applies retroactively[16] which means trail commissions on existing contracts as at 1 July 2020 will no longer be paid based on the outstanding balance after that date but on an amount that is no more than the balance that existed 90 days after the contract was entered into whenever that may have been.
- The definition of ***drawdown amount*** also makes no allowance for the payment of upfront or trail on new advances or additional borrowings (i.e. over and above the use of offset balances) which are an exceptionally common occurrence over the life of a loan as equity in the property increases and is accessed for other purposes.
- Draft Regulatory clause 28VE applies to loans wholly or predominantly for the purpose of purchasing or refinancing residential property, however remuneration appears to be limited to an amount that can only be calculated on the credit actually used for “that purpose” being the purchasing and refinancing of residential property. This has the effect or preventing broker’s being remunerated for credit assistance provided on any portion of a loan that was used for any other purpose.
- The definition of **drawdown amount** does not appear to apply to loans secured against residential property but not used wholly or predominantly for the purpose of purchasing or refinancing residential property.
- Monetary benefits in relation to credit assistance provided for non-home-lending related credit are in certain instances unlikely to meet the requirements of draft Regulatory clause 28VA(3) and would therefore be seen as conflicted.
- In order to address a potential conflict with the BID, clawback provisions should be limited to a period of 12 months and that the clawback percentage should step down in a more linear and fairer manner.

In relation to non-monetary benefits the draft regulations state that a non-monetary benefit provided to a licensee or representative of a licensee who provides credit services will not be considered conflicted remuneration if the value of the benefit is less than $300 and that identical or similar

[15] Bill Exposure Draft, Sch. 9, cl 3.
[16] Ibid.

payments are not given on a regular or frequent basis.[17] Whilst we agree with a cap of $300 for lender derived benefits, as this addresses the associated lender-choice conflict, we do not believe that this should apply to payments by intermediaries or other licensees, as no lender-choice conflict is derived from their provision of such non-monetary benefits.

Educational conferences and seminars will not be considered conflicted remuneration if provided to licensees or their representatives, should certain factors under the draft regulations be met. We believe that the restriction on who pays the costs of travel, accommodation and functions held in conjunction with the course is too narrow, and precludes non lender licensees paying for other licensees. This would discriminate unfairly against individually licensed brokers accredited with an aggregator, who would have to pay for their own travel etc, whereas credit representatives accredited with the same aggregator could be paid for by the aggregator.

The draft legislation also appears silent on monetary benefits paid by lenders to aggregators for education. Multiple lenders have traditionally supported each aggregator's education and training events and clearly, it is to the benefit of the industry and consumers that such significant lender support continues.

The draft legislation is also silent on 'tiered servicing'. Lender tiered servicing models enable lenders to provide certain brokers faster application turnaround times and other benefits which accrue directly to the customer. Eligibility is assessed on a balanced scorecard basis, with volume set at less than 30 percent of total eligibility. As the legislation is silent on tiered servicing, we are concerned that this may mean that it is considered a conflicted non-monetary benefit.

Due to the potential impacts of the draft legislation on mortgage brokers, intermediaries and lenders, the MFAA recommends that transitional arrangements be considered and/or facilitative compliance be permitted for the first 12 months from 1 July 2020.

## 3. Definitions

### 3.1. Mortgage Broker

Schedule 1 of the exposure draft proposes that a new definition of 'mortgage broker' be inserted into the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act), to include a licensee or credit representative that "carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property".[18] While this definition evidently seeks to exclude finance brokers in principle (if they do not provide credit assistance on residential lending), we consider that it may not effectively exclude them in practice, and will lead to a situation whereby the non-home-lending activities of finance brokers are inadvertently subject to legislation intended to apply to those defined as mortgage brokers. Alternatively, it could lead to finance brokers and mortgage brokers not having a level playing field when it comes to the regulation of home-lending broking activities. Our reasoning is explained below.

It is unclear in the exposure draft what degree of activity is required to be classified as 'carrying on business' and if there is a minimum threshold (i.e. more than "any") then there is a risk that brokers with low volumes of credit assistance in relation to credit contracts secured by mortgages over residential property will not be regulated in the same way as those where it is their predominant form

[17] National Consumer Credit Protection Amendment (Mortgage Brokers) Regulations 2019 Exposure Draft, Sch. 1, cl 28VF.
[18] Bill Exposure Draft, Sch. 1, cl 15B.

of business. We therefore believe that an alternative approach to the above definition is required in order to clearly delineate the application of the legislation between mortgage broker activities and wider finance brokers activities to ensure that all NCCP Act regulated home-lending broking activities are covered regardless of who provides them.

Separately, the MFAA is concerned that the above definition may lead to unintended consequences in relation to other activities undertaken by a licensee or credit representative as part of their business. For example, if a mortgage broker provides assistance to customers in relation to standalone car finance secured by a motor vehicle, unsecured personal loans or other products such as credit cards, these may all attract the new obligations that a mortgage broker will have under the draft legislation. Equally, under the exposure draft, remuneration for these products may be considered conflicted if it does not meet the requirements of draft Regulations 28VA(3)(a to e). We therefore believe that the activities of a mortgage broker assisting customers to access other forms of standalone credit should not be captured by the definition of mortgage broker.

To address the above issues, we propose that a finance broker should be defined rather than a mortgage broker and that an 'activity test' should be included to limit the scope of what is caught under the definition, to credit assistance in relation to regulated loans secured by mortgages over residential property. This could be dealt with as follows:

> *A mortgage broker is a licensee or credit representative that provides credit assistance in relation to regulated credit contracts secured by mortgages over residential property.*

This proposal removes the issue of what amounts to 'carrying on business'. It means that whenever security is taken over residential property for regulated credit, a Best Interests Duty will apply – which more closely aligns with the intention of the Royal Commission and creates a level playing field for brokers.

3.2. Mortgage Managers and Servicers

In relation to the definitions of both a broker and intermediary, the exposure draft creates a credit provider 'carve out' – that is, a licensee or credit representative will not fall under the definition of a mortgage broker or intermediary if they act as a credit provider "in relation to the majority of those credit contracts".[19] In practice, we anticipate that this carve out will not prevent the legislation from extending to include those such as mortgage managers and servicers if the majority of their loans are brokered.

To address this unintended consequence, we suggest that licensees and credit representatives of lenders, mortgage managers and servicers (all of whom provide credit assistance in respect of their own loans, managed or serviced loans) should be exempted from the legislation to the extent of their non-broker related activities.

## 4. Best Interests Duty

The exposure draft directly responds to a key recommendation set out in the *Final Report* of the 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."[20] We submit that the exposure draft addresses the Royal Commission's intention but erroneously goes one step further. Rather than amending the law on

[19] Ibid.

[20] Royal Commission, Recommendation 1.2, p. 73.

broker activity "when acting in connection with home lending" as suggested by the Royal Commission, the exposure draft goes further to capture *all* regulated lending activities of mortgage brokers, defined as brokers who arrange home loans.

The MFAA therefore again proposes that the exposure draft as a whole should be limited to apply to credit assistance in relation to regulated loans to the extent they are secured by mortgages over residential property. If applied in this manner, the legislation will genuinely reflect the Royal Commission's recommendation and not lead to widespread, unintended consequences by potentially creating additional obligations in relation to credit assistance provided for non-home-lending credit, or creating separate rules for 'mortgage brokers' as defined in the exposure draft, as distinct from finance brokers. Our reasoning is explained in further detail below.

4.1. Best Interests Duty – Licensees

Schedule 1 of the exposure draft provides that: "The licensee must act in the best interests of the consumer in relation to the credit assistance."[21] It subsequently states that if the licensee knows, or reasonably ought to know, of a conflict between the interests of the consumer and the interests of the licensee, or their associate or representative (or an associate of a representative), the licensee must prioritise the consumer's interest when providing credit assistance.[22]

4.1.1 Priority of interests

The MFAA believes that in practice, there will rarely not be a potential conflict of interest between the consumer and the licensee due to remuneration being paid, and priority will therefore always need to be given to the customer's interests. Mortgage brokers have had a long-standing, strong business incentive to act in the interests of customers, given that a broker's business is based on the relationship model and is contingent on customer referrals, established by a history of good customer outcomes. Further, mortgage brokers and lenders are required under the NCCP Act to provide a loan which is "not unsuitable" to a customer's circumstances; and licensees are subject to extensive general conduct obligations, including that they act fairly, honestly and ensure that customers are not disadvantaged by any conflict of interest.[23]

As currently drafted, the proposed Best Interests Duty has wide application. In practice, it will ensure that mortgage brokers are required under the law to resolve conflicts of interest in the consumer's favour by giving priority to the consumer's interest.

4.1.2. Point in time

Despite the wide application of the defined duty, we understand this new obligation will only apply in relation to the provision of credit assistance at a point in time (when a broker provides credit assistance) rather than over the life of a loan. 'Credit assistance' is defined in the NCCP Act to include activities that only occur at certain points during the loan or principal increase application process, by *suggesting* or *assisting* a consumer apply for a particular credit contract, *suggesting* or *assisting* with an increase to their credit limit under a credit contract, or *suggesting* they remain in a particular credit contract.[24] We strongly believe a 'point in time limitation' on the otherwise wide application of a Best Interests Duty is wholly appropriate, as consumer outcomes are impacted by a range of other variables beyond a mortgage broker's control and a Best Interests Duty could not reasonably be expected to

[21] Bill Exposure Draft, cl 158LA.
[22] Ibid, cl 158LB.
[23] *National Consumer Credit Protection Act 2009* (Cth) s 47.
[24] *National Consumer Credit Protection Act 2009* (Cth) s 8.

apply over the life of a loan in practice. Due to the significant implications for the mortgage broking industry should the duty extend beyond that point in time, we seek confirmation of the above interpretation, and that a 'point in time limitation' is clarified and reflected in the Bill Exposure Draft Explanatory Materials.

4.1.3. ASIC Regulatory Guidance

We also note that while this high-level definition of a Best Interests Duty will be enshrined in legislation, we seek confirmation that more granular guidance will be provided by the Australian Securities and Investments Commission (ASIC) in the form of a regulatory guidance paper. We also seek assurances that in developing regulatory guidance, both ASIC and the Treasury will engage in a formal process of consultations with sufficient time given to industry to respond.

4.2. Best Interests Duty – Credit Representatives

Schedule 1 of the exposure draft similarly provides that a credit representative must adhere to the same Best Interests Duty as the licensee, and must give priority to the consumer's interests in the event of a conflict of which the credit representative knows or reasonably ought to know.[25] Additionally, the exposure draft provides that "the licensee must take reasonable steps to ensure that the credit representative complies" with the Best Interests Duty.[26]

The MFAA is of the view that this second requirement imposed on licensees represents a significant and potentially unworkable new obligation, particularly on large licensees (typically mortgage aggregators) that have a large number of credit representatives, and these licensees will not be able to practically monitor all loans written by those credit representatives. Aggregators who are licensees already monitor their credit representatives and are liable for the conduct of their credit representatives under s75 of the NCCP Act. A prudent licensee would take steps to minimise risk under that liability but there is no current legislative prescription on how they are to go about it. There should also not be a 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. We believe that imposing significant civil penalties for simply breaching the obligation of supervision irrespective of whether credit representatives have breached the Act is not appropriate.

If the provisions are to however remain in their current format, then we seek further clarification and guidance as to how this provision will work in practice, and specifically more information as to what will constitute "reasonable steps" for licensees that can have in excess of 1,500 credit representatives operating under their licence. For example, to what level of detail will a licensee be required to scrutinise the loans written by its mortgage brokers, in order to satisfy the Best Interests Duty? Also, would it be acceptable to use CIF-developed data driven Key Risk Indicator reporting to monitor loans written by mortgage brokers on an exception basis once outliers have been detected? It is also unclear whether monitoring of mortgage broker activities alone will constitute 'reasonable steps' or whether an additional compliance and dispute resolution function will need to be developed. We would argue that the existing compliance frameworks within licensees and aggregators, as well as the overarching governance and reporting framework being developed by the CIF, should be utilised, rather than aggregators being required to develop new, duplicative, systems and processes.

In addition, if these monitoring provisions are to remain, we would also suggest an amendment to include a statement that compliance with this obligation will not create the relationship of employer and employee between the aggregator and the mortgage broker nor does it suggest that mortgage

[25] Bill Exposure Draft, cl 158LE and 158LF.
[26] Ibid, cl 158LE.

brokers are conducting the business of the aggregator in order to ensure there are no additional unintended consequences.

We believe the new obligation may be difficult to discharge in practice, unless substantial further clarification is provided in, for example, an ASIC regulatory guide. Separately, we also consider that it may lead to structural changes in the industry over time, whereby mortgage aggregators could be encouraged to shift from engaging credit representatives to engaging licensees.

### 4.3. Best Interests Duty – Other Issues

#### 4.3.1. The duty is a principle-based standard

According to the explanatory materials provided by Treasury, 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."[27] We note that because the new obligation is framed as a principle-based standard of conduct rather than a defined activity, "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."[28]

The MFAA is concerned that, without further guidance, and in the absence of a safe harbour provision, the proposed Best Interests Duty has the potential to translate into a legal requirement that brokers must provide the 'best' or 'most appropriate' product or assistance to ensure the 'best outcome' or 'cheapest price'. Such terms, or those such as 'best available' product or 'best possible' loan, outcome or assistance, are highly subjective descriptions and do not provide useful guidance as to what the 'best' outcome actually is for a given customer or indeed what is in their best interests. This subjectivity has recently been recognised by ASIC in REP 628 released in August 2019 outlining the regulator's 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 such as flexibility were also important for some consumers. Therefore, … the 'best' home loan [generally refers to] a home loan that offers the consumer the *best value* taking into consideration what a consumer desires in a home loan."[29]

Report 628 also stated:

> *"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."*[30]

We urge policymakers to appreciate that 'best' value is subjective, and that further clarity and concrete standards are required, for example, within an ASIC regulatory guide, to properly execute the duty in practice.

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[27] Bill Exposure Draft Explanatory Materials, p. 8 [1.20].
[28] Ibid.
[29] 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.
[30] ASIC Report 628, p. 9, para 38.

The CIF has identified some (but not all) of the alternative considerations that a broker may consider when considering the requirements and objectives of the customer and these include:

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|---|---|---|
| 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 |
| Credit approval turnaround time | Source of income | Credit history of borrower |
| 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 of 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 |
| Source of contribution or deposit | Borrower type (i.e. Personal/trust fund) | Client future plans for property use |

4.3.2. Range of products and options/Reasonable comparison

It is unclear as to how many products a broker will be required to compare on behalf of a customer seeking a loan, in order to meet the standard. The explanatory materials state that "prior to recommending any home loan product or other credit contract … 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".[31] There can be more than 2,000 products available across 40 lenders on an aggregator panel with many brokers accredited by a substantial subset of these lenders for their products, which does not necessarily include all lenders and products in the market. It is important that the comparison of products required to meet a Best Interest Duty threshold is reasonable and that further guidance is provided in this area.

To accompany ASIC guidance on the Best Interests Duty, we further suggest that a 'reasonable broker' test be inserted into the exposure draft in order to assist mortgage brokers to meet their obligations under the law.

Guidance could note that a reasonable broker test has been met if a mortgage 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:

[31]Bill Exposure Draft Explanatory Materials, p. 8 [1.21].

- 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(s) the credit assistance provider recommended meets the customer's requirements and objectives as disclosed to the broker by the customer; and
- the loan is applied for in a compliant manner.

The above wording largely aligns to an approach used by the CIF that linked the "reasonable broker test" with the CIF definition of a "good customer outcome".

By providing a clearer, minimum prescription of activity, and introducing the concept of a "reasonable broker" test, the legislation can ensure the duty is more clearly defined and therefore assist the industry to meet the standards. By extension, this added guidance will inform and assist consumers and provide them with a clear understanding of the broker's responsibilities.

#### 4.3.3. Panel

The explanatory materials also specify that a broker must not suggest a white label product if it has the same features as a branded product from the same lender but with a higher interest rate.[32] We are concerned that the statement "branded product from the same lender" may include products in the market that are not included on a broker's panel, or indeed for which the particular broker may not be accredited, and believe it must be amended to clarify that a broker will only have regard to relevant panel products for which they are accredited. Without this distinction, we believe the Best Interests Duty will be unworkable in practice. To address the above issues, we propose that the Bill Exposure Draft Explanatory Materials be amended to state:

> *…that a broker must not suggest a white label product if it has a higher interest rate than an equivalent branded product with the same features from the same lender, and the broker has the branded product on their panel and is accredited with the lender.*

In this regard, it is worth noting that white label products can at times have credit policies or credit approval turnaround times that may be more aligned to a customer's needs and circumstances which could also influence a broker's recommendation of the white label product over the branded alternative.

#### 4.3.4. Periodic review

Further, the explanatory materials state that during an "annual review", a broker must not suggest a customer remain with a credit provider without considering if this would be in the customer's best interests.[33] This statement introduces the concept of an annual review into law, which the MFAA does not believe should be a formal requirement. We also believe that the term "periodic review" is a more appropriate term for any post settlement review given that the timing and frequency of any such review would very much depend on each consumer's circumstances and wishes. We recommend that the Bill Exposure Draft Explanatory Materials be amended to replace the term "annual review" with "periodic review".

[32] Ibid, p. 9 [1.21].
[33] Ibid.

4.3.5. Conflict between Best Interest Duty and current clawback structure/Risk of churn

At present, most lender clawback arrangements are structured to clawback 100% of a broker's upfront commission if a loan is refinanced in year 1 and 50% in the second year (as well as in other circumstances).

At the time of any post settlement periodic review by a mortgage broker there will usually be a better loan (be that better value or cheaper rate) somewhere in the market even if it is only marginally better than the customer's existing lender/product combination. This would be particularly the case in a downward or stable interest rate environment. In order to ensure that the broker is not contravening their Best Interest Duty, it is highly possible that a broker may, as a result, be forced to review and switch a customer for nominal consumer gain (if the incumbent lender will not match the offer). It is also unclear as to whether there will be an obligation under the law to negotiate with an existing lender if the interest rate is the only issue of concern for a customer.

As has been pointed out in previous reviews, refinancing is not a costless exercise for the customer, lender and mortgage broker. In addition, due to the nature of variable loans, 'honeymoon' rates and temporary low rates, a cheaper product in the market today may not remain the cheapest for consumers in the future.

In the event a broker is forced to refinance the consumer with a different lender within 12 months, the broker will usually face a 100% clawback of upfront commission earned with a very real risk for successive 12-month clawbacks going forward. This inherent conflict between the Best Interest Duty and the current clawback structure and the associated risks it poses to churn could be costly to the entire industry and challenge the viability of some broker businesses and clearly needs to be addressed.

In order to address this, it is suggested that consideration should be given to providing guidance on a **materiality threshold** with regards to the application of a Best Interest Duty at the time of any periodic review. It is also suggested that the maximum clawback period be reduced to 12 months and that the clawback percentage steps down in a more linear manner, from 100 to zero per cent over the clawback period rather than the current "all or nothing" approach that is inequitable and particularly when considered in light of the proposed Best Interests Duty, otherwise this could challenge the ongoing viability of intermediated lending.

4.3.6. The duty applies in relation to any NCCP-regulated credit contract

As drafted, the proposed Best Interests Duty applies to credit assistance provided by mortgage brokers in relation to any credit contract regulated under the NCCP Act. This will include, for example, credit cards and personal loans packaged with a mortgage, or unsecured credit for home renovation purposes. The Best Interests Duty provision, as currently drafted, will also result in a situation whereby a mortgage broker who arranges other standalone credit that is unrelated to a home loan, such as an NCCP-regulated personal loan or a car loan, will still be captured by the Best Interests Duty requirement despite the product having no link to a home loan. We believe this is an unintended consequence and that the exposure draft should be amended to either only apply to regulated loans secured by mortgages over residential property, or to specifically exclude standalone credit, in order to give proper effect to the original intention of the Royal Commission and Government's response to those recommendations. Our reasoning is explained below.

As discussed above at point 3, it is unclear whether finance brokers, who routinely recommend products such as car loans or personal loans, will be caught by the proposed legislation. If not, they will therefore not be subject to a Best Interests Duty. However, a mortgage broker who arranges a credit product that is not linked to a home loan, will always be subject to the new obligations. The MFAA considers this distinction to be inequitable, whereby one broker may be subject to a new duty and take on additional liability risk, and another will not. Moreover, mortgage brokers do not have access to the same level of detail around standalone credit products that finance brokers do.

In addition, we believe that the intent of the legislation is to apply the Best Interest Duty to other NCCP-regulated credit products only if they are packaged with a home loan by a broker. Whilst we understand the desirability of assessing the suitability of add-on credit products to the overall credit package when discharging a Best Interest Duty, we believe that in practice this will be exceptionally difficult to achieve, and that it is therefore unreasonable for mortgage brokers to be subject to the duty in this way. It will also likely lead to the removal of other credit products, such as credit cards, from all home loan packages facilitated across the broker channel. We propose that the exposure draft be amended to restrict the application of the Best Interests Duty to the extent to which a mortgage broker's activities relate to credit assistance, in relation to regulated credit contracts secured by mortgages over residential property. Alternatively, if credit products ancillary to a home loan are not excluded from the Best Interests Duty, it is essential that it is made clear that the application of the rules as they relate to ancillary products is subsidiary to the primary objective to obtain an appropriate home loan and should be considered in the context of the range of products and options recommended and not all such product combinations available.

It is also noted that, should a broker be caught by the exposure draft definition of 'mortgage broker', the Best Interests Duty will apply and the remuneration received for a credit product may be considered conflicted if it falls under the draft Bill clause 158N and does not meet requirements of draft Regulation 28VA(3)(a to e). Limiting the application of the legislation to credit assistance in relation to regulated credit contracts secured by mortgages over residential property would address this issue.

#### 4.3.7. The duty includes a failure to undertake certain activities

According to the explanatory materials, the Best Interests Duty will entail brokers refraining from making recommendations about a loan if they have not obtained 'critical information' from a customer and there is a consequent risk that the loan will not be in the customer's interest as a result.[34] We again seek further clarity and greater prescription around the limitations on broker activities imposed under the legislation. For example, guidance is necessary as to what a broker must do should a customer intentionally withhold information or knowingly provide false information, and more detail as to the meaning of 'critical information' in this context is required. We suggest that a 'reasonable broker' test would be useful in this analysis [refer to our definition at 4.3.2 above].

#### 4.3.8. Implied obligation on mortgage brokers not to provide assistance

During our formal consultation with Treasury on the NCCP Amendment Bill, the issue of the Best Interests Duty on brokers not to *assist* a customer should they not follow the broker's suggestion and ask to be put into a less favourable loan was raised. The MFAA believes that this issue is already covered by the responsible lending conduct obligations in Ch 3 of the NCCP Act, and as such should not be duplicated under the BID. For example, if the customer wished to be placed in a loan which a broker considers 'unsuitable', the mortgage broker would be obliged not to assist with this. Increasing this obligation to be whether the loan was in the customer's best interest does not seem appropriate, especially given the customer may have valid reasons for not wishing to follow the 'more suitable' suggestion of the broker.

[34] Ibid.

### 4.3.9. Timing of credit assistance and credit assistance scenarios

While the materials outline what conduct is covered by 'credit assistance', it would be useful to define when credit assistance commences and is concluded. Credit assistance could commence when a mortgage broker first begins to formally establish the customer's needs and objectives and concludes once recommendations have been made and the credit contract has settled. This implies that it is our view that for the purposes of this legislation, credit assistance should not have been viewed as having been provided if the credit contract has not settled and no indebtedness has been assumed by the consumer. It is acknowledged that at the time of a subsequent periodic review, a settlement does not need to have occurred in order for credit assistance to have been provided. Some clarification in this regard would be of assistance.

A question has also been raised as to whether credit assistance has been provided in circumstances where a mortgage broker's existing customer instructs the broker to contact their lender to request the lender to match a rate available in the market without the broker being asked to perform a full assessment of the customer's needs, objectives and financial circumstances. This is a common occurrence in the market and we believe should not be viewed as providing credit assistance for the purposes of a Best Interests Duty. Guidance in this area would again be desirable.

## 5. Conflicted Remuneration

Schedule 1 of the exposure draft provides that a licensee or credit representative must not accept conflicted remuneration if they are a mortgage broker or intermediary as defined in the draft legislation, and that an employer, credit provider or intermediary must not give conflicted remuneration to the mortgage broker or intermediary.[35] The MFAA supports the aim of the draft legislation to reduce the potential for conflicts of interest, however, we are concerned that in a number of instances they are inconsistent with the Government's 4 February 2019 response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Restoring trust in Australia's financial system";[36] and its subsequent 12 March 2019 policy announcement "Review of mortgage broking trail commissions".[37] The following section expresses our concerns over how these changes are structured and the anticipated issues with their execution.

### 5.1. Monetary benefits

We anticipate that the legislation relating to monetary benefits as currently drafted will have a number of unintended consequences on the mortgage broking industry, and by extension, consumers and we expand on this below.

In order for monetary remuneration paid by a lender to be considered non-conflicted, the monetary benefits would need to meet section 28VA(3) of the draft Regulations. A monetary benefit given for a credit contract that is wholly or predominantly for the purpose of purchasing or refinancing residential property would additionally need to meet the provisions of draft Regulatory clause 28VA(4) which requires the benefit to either not reference a particular loan amount or to be calculated as a percentage of the drawdown amount or a combination of the two.

[35] Bill Exposure Draft, cl 158NB, 158NC, 158ND, 158NE and 158NF.

[36] The Treasury, *Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.

[37] Frydenberg, *Review of mortgage broking trail commissions*.

Draft Regulatory clause 28VB goes on to state that for credit provided wholly or predominantly for the purpose of purchasing or refinancing residential property the ***drawdown amount*** 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."

The combination of draft clauses 28VA(4) and 28VB not only standardises and gives partial legislative effect to the net of offset reforms as introduced by the mortgage broking industry with respect to upfront commissions but goes a number of steps further with the effect of substantially reducing both upfront and trail commissions being paid to brokers. These additional steps are as follows:

- The 90 day net of offset period allowed for is well below the 365 days predominantly implemented by the industry and is not viewed as a reasonable period or sufficient time for the offset funds to be used. We also suggest that any drawdown period should commence from the date of initial drawing of the loan and not the date the contract is entered into. It would also be helpful to receive regulatory guidance as to how the 365 day net of offset period should be implemented in terms of timing of initial payments, frequency of top-up and other features to limit the possibility for any lender choice conflict.
- The definition of ***drawdown amount*** which limits remuneration to being paid based on the amount of credit used within 90 days of entering the credit contract is seemingly also being applied to the calculation of trail commission, which is currently paid monthly on the outstanding balance net of offset at the time of calculation.
- In addition, it is evident that the draft legislation applies retroactively[38] which means trail commissions on existing contracts as at 1 July 2020 will no longer be paid based on the outstanding balance after that date but on an amount that is no more than the balance that existed 90 days after the contract was entered into whenever that may have been.
- As drafted, the definition of ***drawdown amount*** also makes no allowance for the payment of upfront or trail on new advances or additional borrowings (i.e. over and above the use of offset balances) which are an exceptionally common occurrence over the life of a loan as equity in the relevant property increases and is accessed for other purposes.
- In order to reflect new advances and additional borrowings, some lenders either do not have the capability to vary a contract or choose to rewrite the contract which in the circumstances could, at best, be costly if not required, or at worst, be viewed as an avoidance measure.
- Whilst draft Regulatory clause 28VE applies to loans wholly or predominantly for the purpose of purchasing or refinancing residential property, the definition of ***drawdown amount*** is "so much of the amount of credit as is used for that purpose within 90 days…". 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 for other purposes included under the same loan such as debt consolidation which will again impact broker earnings.
- Whilst the definition of **drawdown amount** clearly applies to benefits paid wholly or predominantly for the purpose of purchasing or refinancing residential property, there will always be circumstances where a loan is secured against residential property but not used wholly or predominantly for the purpose of purchasing or refinancing residential property, circumstances which evidently are not impacted by current drafting.

The above impacts of the current drafting of the legislation will be a substantial reduction in broker earnings which is inconsistent with the Government's 4 February 2019 response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry,

[38] Bill Exposure Draft, Sch. 9, cl 3.

“Restoring trust in Australia's financial system”;[39] and its subsequent 12 March 2019 policy announcement “Review of mortgage broking trail commissions”[40] and will be expanded on in greater detail in the following sections.

As stated above, in order for monetary remuneration to be considered non-conflicted, the monetary benefits would need to meet section 28VA of the draft Regulations. Whilst monetary benefits given to a licensee or representative of a licensee for the purposes of providing credit assistance in relation to regulated home-lending broking activities would likely meet the requirements of draft Regulation 28VA(3), there is a strong possibility that monetary benefits in relation to credit assistance for other forms of non-residential related credit contracts (and standalone regulated contracts) would not meet all the requirements of 28VA and would therefore be deemed to be conflicted.[41]

In practice, brokers may also provide credit assistance and receive remuneration in the form of commissions on loans that are *not* secured by residential property or are not part of a transaction that is wholly or predominantly for residential property. For example, consumers may wish to take out a personal loan, a car loan, separately to a residential property loan. Under the exposure draft, any monetary remuneration for these non-residential credit products may be classified as conflicted (for example if it does not meet clawback or volume bonus provisions) and will ultimately impact how a broker is therefore able to assist consumers. As suggested earlier, the MFAA believes the best way to address issues such as this is to restrict application of the legislation to the extent to which a broker’s activities are connected to credit assistance in relation to regulated credit contracts secured by mortgages over residential property.

### 5.1.1. Clawback provisions

The draft regulations also provide that monetary remuneration will not be conflicted if clawback requirements are satisfied in relation to the benefit, where applicable.[42] These clawback requirements ensure that the cost cannot be passed on to a consumer, and that the repayment obligation must not apply for more than two years after the credit contract is executed. The MFAA acknowledges clawback as a control mechanism but proposes that further amendments are made to ensure that clawback is implemented in a more equitable and linear way than under current practices and to ensure that the inherent conflict between the Best Interest Duty and current structure of clawback provisions is addressed. For example, we suggest that clawback be limited to a period of 12 months and that the clawback percentage steps down in a more linear manner, from 100 to zero per cent over the clawback period to ensure greater fairness and that it cannot be deployed by credit providers in an abrupt fashion and is consistent across the industry.

### 5.1.2. Drawdown amount net of redraw and offset

*Upfront commissions*

In order for remuneration to be considered non-conflicted under the draft regulations, it must be based on the drawdown amount of a loan, net of redraw and offset, within 90 days of entering the credit contract.[43] We submit that the 90-day timeframe for upfront commissions is inappropriate and should be increased to 365 days, as it currently fails to account for commission top-up payments made

[39] The Treasury, *Government Response to the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*.
[40] Frydenberg, *Review of mortgage broking trail commissions*.
[41] Regulations Exposure Draft, Sch. 1, cl 28VA.
[42] Ibid, cl 28VA(3)(e).
[43] Ibid, cl 28VB.

to a broker for usage of the offset balance after the 90-day period. It is also unclear under the draft regulations how remuneration will be calculated if funds are paid into an offset account following a drawdown. Additionally, it is unclear as to when credit providers are required to provide remuneration to brokers within this timeframe, and whether remuneration must be one-off or included over multiple payments.

Furthermore, any maximum commission top-up period should be from the date of initial drawing of the loan not the date of the credit contract. The date of the credit contract is not relevant and is not used by many lenders' systems. In addition, use of the contract date would produce inconsistent and unintended results. Lenders have also advised that there will be systems constraints in making required adjustments which is not likely to permit implementation by 30 June 2020 and a delayed start of the commission provisions should be considered to allow for this.

The MFAA seeks further clarity as to how these issues will be handled under the legislation, and proposes that the draft regulations should be amended to recognise "commission top-up" as a concept, with such top-up period to be 365 days which is a more realistic period to allow for funds to be used – particularly in circumstances where the funds are to be used for a renovation. Imposing a 90-day restriction on commission top-up payments for the use of funds held in an offset account will further reduce declining broker earnings and simply transfer wealth from mortgage brokers to the relevant lenders. It may also result in brokers de-emphasising the interest and tax saving benefits of offset accounts when making recommendations which would not be a good consumer outcome. In addition, it should be recognised that a Best Interest Duty will be in place to address conflicts including the product strategy conflict which reduces the need for a limited commission top-up period.

CIF guidance in December 2017 included a statement: "Generally, funds drawn down would be measured and commission paid on initial settlement and at a later point in time for subsequent drawn down amounts, up to the maximum facility limit".[44] Since this guidance was issued, major lenders such as ANZ and NAB have implemented structures that allow for top-up of upfront commissions for a period of up to 365 days for customer's use of offset balances.

Whatever maximum period is prescribed for top up of commission payments for the use of offset balances, it is important there is no limitation on the payment of upfront for new advances or additional borrowings which may result from an increase in the facility limit which can often eventuate as customers access their equity in their property for various purposes over the life of a loan.

It is common practice that principal increases are documented in one of two ways. Firstly, as a variation of the credit contract; or secondly, by paying out the existing contract and creating a new contract. It is our understanding that some lenders use the new contract method for system reasons. If a new contract is created, it is clear that commission can be paid based on the new amount of credit. Based on current drafting, if a variation is used, because this occurs later than 90 days after the contract was entered into, no further commission can be paid. We view this as an unintended consequence, and commission should be payable on the amount of the principal increase irrespective of how the transaction is documented. If upfront is not paid on additional advances or borrowings this will in effect constitute a partial banning of upfront remuneration. It would also not be in line with the Government's comments post the release of the Royal Commission mentioned above regarding maintaining the "status quo" with regards to broker commissions and will result in brokers earning less as wealth is effectively transferred from mortgage brokers to lenders.

[44] Combined Industry Forum, *Improving Customer Outcomes: The Combined Industry Forum response to ASIC Report 516: Review of mortgage broker remuneration*, 28 Nov 2017, p. 12.

As mentioned earlier, the limitation in draft Regulatory clause 28VE to funds used for the purpose of purchasing or refinancing residential property in effect restricts the amount of credit used for calculating upfront and trail commission to that used for that purpose and appears to exclude the amount of credit used for related costs such as stamp duty or other purposes such as debt consolidation that may all fit under a single loan. It is our understanding that this was not the intent of the draft legislation and we believe this can be rectified by removing the words "for that purpose" in the way ***drawdown amount*** in defined.

Finally, there is also potential for construction loans, reverse mortgages and lines of credit to fail to fit within any prescribed maximum commission top-up period for use of approved funds and these product types should be carved out of this specific area of the legislation.

*Trail*

Trail remuneration, which is effectively delayed up-front commission payments, has traditionally been paid monthly based on the outstanding value of the loan net of offset each month which aligns to the economic value of the loan the lender holds. In his 12 March 2019 media release "Review of mortgage broking trail commissions",[45] the Treasurer announced that "the Coalition Government has decided to not prohibit trail commissions on new loans, but rather review their operation in three years' time". Speaking to the media on 14 March 2019 the Prime Minister further clarified this by saying "we want to see the mortgage broking industry continue to thrive, so under our plan they'll have the status quo when it comes to the commissions … so they can continue to run their businesses."[46] Unfortunately draft Regulatory clause 28VB does not reflect the "status quo" for brokers in terms of the definition of drawdown amount for funds used wholly or predominantly for the purpose of purchasing or refinancing residential property. Draft clause 28VB in fact imposes a restriction on the value of the loan to be used for the purposes of calculating trail to a maximum of that which existed 90 days after the contract was entered into, and will in effect result in a partial banning of trail. Not only will this be a departure from the Government's pre-election commitments on trail, it would again simply transfer wealth from mortgage brokers to lenders without being passed on to consumers or further addressing conflicts.

The outstanding balance of a loan will fluctuate over time as the loan amortises or as offset balances vary. Whilst many loans will decrease in line with their amortisation, in other instances loans will increase in value as equity is accessed in a home loan to fund deposits for other home-lending or indeed to fund other non-home lending funding needs a consumer may have. This is a good outcome for consumers and can involve a significant amount of work for mortgage brokers as and when a facility increases or additional drawings are arranged. Not recognising these increases in loan amount for the purposes of trail commission is tantamount to a partial banning of trail which will have an impact on broker earnings and business viability, and risks incentivising 'churn' for no benefit to the consumer outcome.

As stated previously, limiting the definition of ***drawdown amount*** to the purpose of purchasing or refinancing residential property, as Draft regulation 28VE appears to require, will in effect reduce trail further and should be addressed by removing the words "for that purpose".

We also seek clarification on the impact of draft Regulation 28VB (3) (e) on trail commission. As there are no applicable clawback requirements to trail commission, we assume that the current structure and payment of trail commission would satisfy 28VB (3) (e), and as such not be considered conflicted remuneration under this provision? The industry seeks clarification on this.

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[45] Frydenberg, *Review of mortgage broking trail commissions*.

[46] Prime Minister of Australia, The Hon Scott Morrison, 'Doorstop', Melbourne Markets, 14 March 2019.

*New versus existing loans*

The impact of draft Regulation 28VB on trail commissions is further exacerbated by the application of the law to all loans post 30 June 2020. In this respect the draft legislation further breaches the Government commitment of 12 March 2019 to "not prohibit trail commissions on new loans" as not only are new loans subject to the partial bans, but all loans, regardless of when they were contracted appear to be caught. This would mean, by way of example, that as of 1 July 2020 a lender would be required to recalculate all trail commission payments to brokers to the *drawdown amount* figure at 90 days after the day which the credit contract was entered into by the customer. This task would involve the review of every loan contract facilitated by a broker for the past 30 years or longer and determining the *drawdown amount* for 90 days after the contract was signed. The impact of this on brokers would not only be a significant reduction in trail earnings on new loans, but a retrospective devaluation of their trail book.

To rectify this, we believe that trail commission should be removed from the application of the National Consumer Credit Protection Amendment (Mortgage Brokers) Regulations 2019 Exposure Draft, Sch. 1, cl 28VA (4).

### 5.2. Non-monetary benefits

#### 5.2.1. Infrequent benefit less than $300

The draft regulations state that a non-monetary benefit provided to a licensee or representative of a licensee who provides credit services will not be considered conflicted remuneration if the value of the benefit is less than $300 and that identical or similar payments are not given on a regular or frequent basis.[47] Whilst we agree with a cap of $300 for lender derived benefits, as this addresses the associated lender-choice conflict, we do not believe that this should apply to payments by intermediaries or other licensees, as no lender-choice conflict is derived from their provision of such non-monetary benefits. We are concerned that by not confining the $300 restriction to lenders, aggregators and licensed mortgage brokers will be precluded from providing certain hospitality and entertainment benefits to mortgage brokers and credit representatives. These benefits should not be classified as conflicted remuneration because the same conflicts do not arise when compared with gifts afforded by credit providers. We therefore submit that this provision should only apply to lenders, as there is no relevant conflict at the aggregator level that is not already covered by a Best Interest Duty.

We note that the $350 cap imposed by the CIF only applied to lenders and does not apply to aggregators.

#### 5.2.2. Education and Training

Educational conferences and seminars will not be considered conflicted remuneration if provided to licensees or their representatives should certain factors under the draft regulations be met. These include that the conference has a genuine education and training purpose; the benefit is relevant to the carrying on of a business of providing credit services to consumers; the activities for professional development take up at least the lesser of 75% of the time spent on the course or 6 hours per day; and the participant or the participant's employer or licensee must pay the costs of the participant's travel and accommodation relating to the course and for the participant attending events and functions held in conjunction with the course.

[47] Ibid, cl 28VF.

Whilst we support such restrictions on conferences and seminars, and their strong focus on education, we are concerned that the drafting of the provisions may have led to two unintended consequences. Firstly, we believe that the restriction on who pays the costs of travel, accommodation and functions held in conjunction with the course is too narrow, and precludes non-lender licensees paying for other licensees. This would discriminate unfairly against individually licensed brokers accredited with an aggregator, who would have to pay for their own travel etc, whereas credit representatives accredited with the same aggregator could be paid for by the aggregator. We believe that an aggregator should be allowed to pay for both credit representatives and licensed brokers accredited with them.

Secondly, the draft legislation appears to be silent on the issue of lender **monetary benefits** for education. Whilst we understand that individual lender events could be problematic, given the lender-choice conflict, it is unclear as to whether lenders can still fund aggregator events, or a series of events, to reduce average participant costs or the costs borne by the licensee on behalf of the participant. Multiple lenders have traditionally supported aggregator education and training events and clearly, it is to the benefit of the industry and consumers that such significant lender support continues and, in our view, this should not be precluded.

5.2.3. IT Support

The provision of information technology software or support is also not considered conflicted if the benefit is related to the provision of credit services to consumers in relation to credit contracts with the benefit provider. The MFAA is unclear as to which benefit this may refer? We can only assume that if a licensee or credit representative is provided with any IT software and support to assist them in their role as a mortgage broker, this is considered non-conflicted? Therefore, some additional clarity is necessary.

5.2.4. Tiered Servicing

In terms of other non-monetary benefits currently received by mortgage brokers, the draft legislation is silent on 'tiered servicing'. Lender tiered servicing models enable lenders to provide certain brokers with faster application turnaround times and other benefits which accrue directly to the customer. Eligibility is assessed on a balanced scorecard basis, with volume set at less than 30 percent of total eligibility. As the legislation is silent on tiered servicing, we are concerned that this may mean that it is considered a conflicted non-monetary benefit. As the benefits of such programmes are received by the customer, not the broker, we are of the view that they should also be exempted given it could be argued that they fall under the provisions of draft Bill clause 158N.

## 6. Managed Transition

The potential impacts of the draft legislation are significant for mortgage brokers, intermediaries and lenders which raises concerns about industry's ability to implement the changes by 1 July 2020. The MFAA therefore recommends that transitional arrangements be considered and/or facilitative compliance be permitted for the first 12 months from 1 July 2020.