JOINT CONSUMER SUBMISSION TO THE TREASURY

Mortgage broker best interests duty and remuneration reforms

OCTOBER 2019

A joint consumer submission from CHOICE, Consumer Credit Law Centre SA, Consumer Credit Legal Service (WA), Consumer Action Law Centre, Financial Counselling Australia, Financial Rights Legal Centre and the Indigenous Consumer Assistance Network.

Contents

INTRODUCTION

The mortgage broking industry is long overdue for reform.

Landmark inquiries from the Banking Royal Commission and the Productivity Commission, as well as a number of ASIC investigations, have all found that the broking industry is failing Australians. The Treasury's proposed reforms are an important step forward in reforming this troubled sector.

Buying a mortgage is likely the biggest financial decision a person will make in their lifetime. People trust that brokers truly act in the borrower's best interests, not their own. However, the broking industry is not delivering for people. Brokers are not finding people cheaper priced loans. They are selling people into riskier loans that are more likely to fall into arrears and take longer to pay back. They are providing limited loan options and are regularly sending people straight back to a bank they have an existing relationship with. A principles-based best interests duty will hold the industry to account and ensure people who use brokers have home loans that are truly in their best interest.

The impact of mortgage brokers recommending unaffordable or harmful mortgages is devastating for people. This submission includes case studies shared by financial counsellors of people whose lives have been altered by unscrupulous brokers.

What's more, there are countless other Australians who are struggling, having been unwittingly sold into a mortgage by a broker that is not in their best interests. These people are struggling to meet their mortgage repayments and having to cut back on essential everyday expenses, such as electricity bills and health-care costs.

We welcome the Treasury's proposal to ban harmful campaign-based and volume-based commissions. These commissions lead to conflicted advice and encourage brokers to recommend loans to people that maximise their commission. We urge the Treasury to also ban non-volume based bonuses and amend the clawback requirements to promote switching.

We acknowledge the prohibition of upfront and trail commissions are not within the scope of this proposed legislation. However, the consumer movement wholeheartedly supports the Royal Commission's Recommendation 1.3 to reform remuneration in the broking industry. It's been clearly established that commission-based structures lead to poor quality advice and they need to be banned from the industry..

We expect that these reforms will unleash greater competition in the home loan market. Lender-owned aggregators will be jolted out of their complacency. No longer will they be able to send loans straight back to their parent bank. Mortgage brokers will be forced to scan the market and find people a loan that best suit their needs. Mortgage brokers will be unable to justify sending large numbers of customers to big banks with high priced loans. This will place downward pressure on the cost of mortgages and increase the competitiveness of the market.

Key points:

- We strongly support the principles based obligation for brokers and licensees to both act in the best interests of individuals and prioritise the interests of consumers.
- The Government must significantly strengthen civil penalties for licensees and lenders who break the law.
- There must be clear record keeping obligations for brokers and licensees to ensure compliance with the law. These obligations must be principles-based.
- We welcome the prohibition on campaign-based and volume-based commissions and call for the removal of non-volume based bonuses.
- Clawback provisions need to be amended to encourage switching.
- These protections must be applied to all brokers recommending credit products, including car loans and personal loans.

RECOMMENDATIONS

1. The best interests duty must be expanded to include all associated financial products and services that mortgages brokers sell to consumers with mortgages, including lender's mortgage insurance.

2. The best interests duty must include all interactions that a broker has with a client, including offers of review.

3. The Treasury must close the loophole for mortgage brokers and intermediaries who perform a majority of credit contracts for a lender.

4. For licensees and credit providers, civil penalties should be raised to be the greater of:
    - 50,000 penalty units (currently $10.5 million);
    - three times the value of benefits obtained or losses avoided; or
    - 10% of annual turnover in the 12 months preceding the contravening conduct.

5. Brokers and licensees must be required to maintain clear and accurate records. The law should be amended in the following way:

    Section 158LC - "Licensees must maintain clear and accurate records to prove compliance with 158LA and 158LB of the Act"
    Civil penalty - The greater of:
    - 50,000 penalty units ($10.5 million);
    - three times the value of benefits obtained or losses avoided; or
    - 10% of annual turnover in the 12 months preceding the contravening conduct.

    Section 158LG - "Credit representatives must maintain clear and accurate records to prove compliance with 158LE and 158LF of the Act"
    Civil penalty - 5000 penalty units

6. ASIC must establish principles-based guidance on how brokers and licensees maintain these record keeping obligations.

7. Non-volume based benefits must be banned.

8. The Treasury amend the law so that clawback is triggered only if a mortgage has:
    - fallen into significant arrears;
    - become impaired; or
    - been found to be fraudulently sold by a broker or licensee.

9. The law be amended to establish that the cost of clawback can not be passed on to borrowers.

10. The Treasury must amend S28V(3) of the Regulations to define what benefits are prohibited forms of conflicted remuneration.

11. Information technology or support systems should be not programmed to recommend loans from specific lenders. We recommend the following addition to the draft Regulations 28VF(6)(c) - "*the information technology or support is programmed to prioritise consumer's interests*".

12. ASIC must monitor the use of information technology or support systems to ensure that unfair priority is not given to specific lenders.

13. ASIC must maintain strong oversight of mortgage broking education and training events to ensure they have "genuine education or training purposes".

14. ASIC must undertake research into the impact that upfront and trail commissions have on good consumer outcomes and competition in the Australian home lending system. This research must commence in 2020 and be complete by 2021.

15. All brokers must be subject to the best interests duty. This should extend to any brokers recommending credit products, including car loans and personal loans.

1. The broking industry needs wholesale reform

The broking industry is failing Australian borrowers. People go to brokers for trusted guidance to search the market and find the best priced loan.[1] However this is not happening.
A recent ASIC inquiry found that brokers are sending almost half (49%) of borrowers straight back to a bank they have had an existing relationship with.[2] Despite claims of scanning the market, six in ten (58%) consumers received two or less loan options from brokers.[3] A third of all people who took out a loan with a broker receive just one home loan option. ASIC found that brokers very often failed to justify why these loans were picked, leaving consumers unable to "understand the objective criteria behind the recommendation."[4] The ASIC inquiry included a number of interviews of people who engaged with a broker. Here is one such example of a first-home buyer engaging with a mortgage broker:

> "*Never really given an option because this was our only option. Did a bit of online—googling—to google this bank because I've never heard of them before—and the review[s] online were not positive and I said to the broker, they don't have good reviews but he said yeah, but this is the bank that is happy to proceed with your home loan*."[5]

This is emblematic of the industry. While brokers may act in their own interests, customers are led to believe that a broker will look out for them. Advertising for mortgage brokers services claim that brokers will find customers a good quality or even the best loan, even though there is no current obligation to do so. We conducted a brief review in September 2019 of online claims made by mortgage brokers and we found advertisements in which they stated that brokers would:

- "...search hundreds of loans from lenders and banks alike to find one that's perfect for you"[6]
- "Save your time and get specialist help to find the best home loan - FREE"[7]
- "We work with a range of borrowers...helping them find the best deal"[8]
- "...find the best loan to fit your personal needs."[9]

In all of these statements the implication is that brokers act for the customer and help them get a good quality loan based on their individual needs. With advertising like this, it's no surprise that consumers think brokers will get them a good quality loan or act in their interests.

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[1] ASIC 2019, Rep 628, Looking for a mortgage: consumer experiences and expectations in getting a home loan, p.6
[2] ASIC Rep 628, p.7
[3] ASIC Rep 628, p.8
[4] ASIC Rep 628, p. 9
[5] ASIC Rep 628, p. 51
[6] Google search, 20 September 2019, https://www.aussie.com.au/find-store/nsw/toronto.html
[7] Google search, 20 September 2019, https://www.yourmortgage.com.au/mortgage-brokers/find/
[8] Google search, 20 September 2019, https://www.huntergalloway.com.au/mortgage-broker-brisbane/
[9] Google search, 20 September 2019, https://www.wiseloan.com.au/

ASIC research has found that brokers are not providing people with cheaper priced loans than going direct to the lender.[10] This proposed legal obligation holds brokers to account for the promises they routinely make to their customers.

Case study #1 - Margot’s story

Margot and her daughter entered into a joint loan with a Bank for $248,000. The loan had a 30 year term. Margot was on the disability support pension (DSP) at the time the loan was taken out, and would be 92 by the end of its term. The purpose of the loan was the purchase of an investment property, but the only security for the loan was Margot’s home. The funds were not used to purchase an investment property in joint names. Margot’s daughter did buy an investment property, but it was in her name only. She made off with the proceeds of the loan, made virtually no repayments, hid the default notices and other documents from Margot, and has since disappeared. The Bank obtained default judgment and an order for possession of Margot’s home.

The loan was arranged by a Mortgage Broker. The Broker purported to submit the application on behalf of both Margot and her daughter, but no one from Broker had ever met or spoken to Margot. Margot did not even know the Broker was involved in the loan until documents were produced by the Bank when a dispute was raised following the order for possession. The signatures on the application form purporting to be Margot’s are not her signature. No inquiries were made about Margot’s expenses; a combined Household Expenditure Measure (HEM) figure for Margot and her daughter was the only expense information used in Broker’s application. Needless to say, the Broker made no inquiries about Margot’s requirements and objectives. In particular, despite the fact that Broker was arranging a 30-year loan for an investment property to a 62-year old on the DSP, secured only by a mortgage over her home, no exit strategy was put in place, leaving Margot extremely vulnerable to losing her home (particularly given the transaction involved a transfer of a 10% ownership interest in that home to her daughter).

Case study supplied by Financial Rights Legal Centre

Unleashing competition in the home loan market

The competitive benefits that mortgage brokers brought in the 1990’s have largely disappeared. As the Productivity Commission found, “the revolution has become part of the banking establishment.”[11]

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[10] ASIC Report 516, Review of mortgage broker remuneration, p.15
[11] Productivity Commission, 2018, Competition in the Australian Financial System, p.300

Now almost seven in ten loans arranged by brokers have come from lender-owned aggregators. [12] The ownership of aggregators allows lenders to have a strong influence over the quality and range of loans selected by brokers. Aussie Home Loans is emblematic of this. They burst onto the scene in the early 1990's, revolutionising the lending market and offering real price competition for homeowners. But since then it has been acquired by the Commonwealth Bank, dulling any competitive power they may have had. Now Aussie Home Loans direct two in five loans straight back to the Commonwealth Bank.[13] It's clear that the major banks have captured the mortgage broking industry.

The Treasury's reforms will also drive competition in the residential home loan market, making mortgages more affordable for borrowers. Lender-owned aggregators will be held to account. No longer will they be able to send loans straight back to their parent bank. Brokers instead will have to scan the market and recommend loans that are truly in the best interests of borrowers. This will increase demand-side competition and more loans will likely flow to smaller lenders, community-owned banks and credit unions. These reforms will lead to greater switching of mortgages and a higher level of discounting from lenders to both attract new and retain existing customers.[14]

In order to satisfy their requirements under the new law, many aggregators will be forced to expand the number of lenders on their panel. The Productivity Commission found that the minimum number of lenders on the panel was 9.[15] This is not good enough. In order to satisfy the best interests duty, many aggregators will be forced to loosen their onerous restrictions that prevent brokers selecting banks and products that are off-panel.

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[12] Productivity Commission, 2018, Competition in the Australian Financial System, p.307
[13] ASIC Rep 516: Review of mortgage broker remuneration, p.18
[14] E Knight 2019, 'The sleeper issue that could be a nightmare for banks', Sydney Morning Herald, https://www.smh.com.au/business/banking-and-finance/the-sleeper-issue-that-could-be-a-nightmare-for-banks-20190904-p52nxm.html
[15] Productivity Commission, 2018, Competition in the Australian Financial System, p.305

2. Ensure that brokers act in the best interests of consumers

Case study #2 - Robert's Story

Robert was the first bank customer to provide evidence to the Royal Commission. Robert, a 72-year-old aged pensioner, worked 3 jobs for most of his working life. Before he retired in 2010, Robert had worked as a cleaner, school bus driver and gardener. Robert lives with an acquired brain injury after being the victim of an assault many years ago.

Robert's wife passed away in April 2016. Sometime after his wife's passing, Robert was targeted by an online romance scam. Robert was convinced by the scammers to send money overseas. In February 2017, Robert had used up nearly all of his $110,000 in savings. He was then signed up to a 30-year $50,000 home loan with the ANZ through a broker, most of which ended up in the hands of the scammers. Shortly after the loan was approved, Robert went to his local ANZ branch and the bank manager assisted him to transfer over $30,000 to the scammer's overseas bank account, despite the loan documentation suggesting the loan was for "renovations".

The broker completed the loan application for Robert. It contained incorrect records of Robert's expenditure. As a result, the application portrayed the proposed loan as being affordable, when in fact it appears to be unaffordable. For example, the loan application states that Mr Regan's food expenses were $300 per month however Mr Regan considered that his food expenses were higher than that. In addition to that error, the loan application prepared by the broker did not take into account the significant expenses being paid by Mr Regan at the time of the loan application due to the dating scam.

Case study shared by Consumer Action Law Centre

Strong support for best interests duty and prioritising needs

We strongly support the Treasury's proposal for both a principles based best interests duty and a duty to prioritise the interests of consumers. This is consistent with the Banking Royal Commission's recommendation to have the duty as a "broad statement of principle".[16] A principles-based duty will ensure that brokers are held to account for standards that consumers already expect when dealing with the industry.

It is imperative that this duty is principles based and takes a holistic view of the quality of advice a broker provides to a person. A weaker prescriptive duty would result in brokers viewing this duty simply as a compliance box-ticking exercise. The Treasury's proposed principles based

[16] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2018, Final Report, p.72

duty has useful analogues in financial services law, including responsible entities duties and directors duties of the *Corporations Act 2001.*[17]

Expand duty to include all associated financial products

The best interests duty needs to be expanded to include all associated financial products and services that mortgage brokers recommend to consumers. The Final Report of the Royal Commission clearly states that the best interests duty applied to brokers, "when acting in connection with home lending."[18] The current proposed obligation is limited to the selling of residential home loans and "any other credit contracts for which they provide credit assistance." [19] This is too narrow a definition. This will create a loophole for a number of financial products that brokers recommend or sell, including lender's mortgage insurance (LMI), home insurance or savings accounts linked to home loans.

Brokers' accountability should be expanded to include any financial products (12BAA) or financial services (12BAB) as defined by the *Australian Securities and Investments Commission Act 2001*. Lenders mortgage insurance masquerades as a consumer-facing product, yet it exists to benefit the banks while providing no real protection to consumers. Brokers must be required to ensure that any lenders mortgage insurance that people purchase are in their best interests, and not simply benefiting the banks. Brokers must ensure that people understand the cost of LMI including the amount of interest paid over the life of loan, as well as how much people would need to save in order to avoid paying it and clearly articulate that the insurance does not protect borrowers.

Mortgage brokers regularly bundle credit and savings products together, including a mortgage, savings account, transaction account and a credit card. Any banking account, credit card or personal loan that broker recommend must be subject to the best interests duty. Consumers expect that brokers are acting in their best interests for all financial products they recommend.

The best interests duty must include all interactions brokers have with people in relation to credit assistance. This includes any communications either in person or electronically or offers of reviews. Consumers trust that a broker are looking after their best interests in any communication that they have. It would create a serious loophole if certain communications from brokers were not subject to best interest protections.

Close the loophole for the definition of brokers

We are concerned about Treasury's proposed exemption for mortgage brokers and mortgage intermediaries who perform the "obligations, or exercise the rights of a credit provider in relation

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[17] S181 and S601FC of the *Corporations Act 2001*

[18] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2018, Final Report, p.72

[19] *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019, Exposure Draft,* Explanatory Material, P. 8

to the majority of those credit contracts."[20] Mortgage brokers who both represent the credit provider and act as mortgage brokers will not be subject to these provisions. This definition will create a loophole that industry will seek to profit from. It needs to be closed.

Recommendations 1-3

1. The best interests duty must be expanded to include all associated financial products and services that mortgages brokers sell to consumers with mortgages, including lender's mortgage insurance.

2. The best interests duty must include all interactions that a broker has with a client, including offers of review.

3. The Treasury must close the loophole for mortgage brokers and intermediaries who perform a majority of credit contracts for a lender.

[20] *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2009*, s15B(1)(b), s15B(2)(b), 15C(1)(b), 15C(2)(b)

3. Strengthen penalties for misconduct

Case study #3: Claire’s story

Claire is a single mum raising 5 children. Claire was born overseas and came to Australia a few years ago. Claire does not read or write English, and her spoken English is very limited.*

CCLSWA uses the services of interpreters to communicate with her. Claire was married to Andy. Andy would physically and emotionally abuse Claire.*

In 2013, Andy forced Claire to see a friend of his, a broker, and Claire signed documents in English without understanding what she had signed. She had become the sole borrower on a $400,000 home loan to purchase a home for Andy, her and the children. At the time, they had one child and another on the way. Claire was 6-months pregnant which would have been obvious to the broker, yet Andy presented the broker with forged payslips showing that Claire worked for Andy’s business and received a monthly income from the business of $6,000.

Despite Claire’s obvious pregnancy the broker ticked “no expected change in circumstances” on the home loan application. The loan was granted without the lender taking any steps to contact Claire directly. Claire separated from Andy in 2017 and has violence restraining orders in place against him. Claire receives a Centrelink income of $3,000 per month to support herself and her 5 children. Her home loan repayments are $2,000 per month. Claire has no alternative but to make the repayments on the home loan each month or face homelessness.

Case study shared by CCLSWA

**Names are changed to protect identity

As the following case study shows, brokers selling inappropriate or harmful mortgages has devastating impacts on the financial and emotional wellbeing of people. We strongly welcome Treasury’s proposal to attach civil penalties for breaches. This is consistent with the Banking Royal Commissions’ recommendation. Penalties must be significant enough to deter misconduct and prevent brokers and licensees from selling people harmful home loans. We strongly support Treasury’s proposal for civil penalties of 5,000 penalty units for mortgage brokers who break the law. This is a significant deterrent to prevent misconduct.

The Treasury must significantly strengthen civil penalties for licensees and credit providers who break the law. As the Banking Royal Commission has shown, financial services firms flagrantly breached the law and viewed penalties as the ‘cost of doing business’. For larger licensees, the current proposed penalty is too small and will be viewed as a slap on the wrist. The financial payoff for licensees and lenders systemic selling inappropriate loans greatly exceeds 5000 penalty units (currently $1,050,000). Non-compliance with the law must challenge the revenue and profitability of the licensee for senior management to be properly incentivised to ensure that a culture that values serving consumer needs is instilled in their organisation. For licensees and credit providers, civil penalties should be raised to be the greater of:

- 50,000 penalty units (currently $10.5 million);
- three times the value of benefits obtained or losses avoided;
- or 10% of annual turnover in the 12 months preceding the contravening conduct.

This will ensure penalties for licensees are consistent with ASIC Taskforce Review and the new penalties regime in the *Corporations Act 2001.*[21] Appendix 1 outlines the obligations that civil penalties need to be strengthened.

Recommendation 4

For licensees and credit providers, civil penalties should be raised to be the greater of:

- 50,000 penalty units (currently $10.5 million);
- three times the value of benefits obtained or losses avoided; or
- 10% of annual turnover in the 12 months preceding the contravening conduct.

[21] ASIC Taskforce Review, Final Report, December 2017, p58.

4. Establish record keeping obligations

Licensees and brokers must be required to maintain robust and clear record keeping obligations. For too long mortgage brokers have minimised their culpability when selling harmful mortgages by hiding behind the guise of incomplete or insufficient evidence at the time of purchase. People sold by brokers into inappropriate loans will miss out on the best rate by a percentage point or two. These loans may not fall into arrears but instead place significant financial pressure on people to meet everyday expenses, like paying electricity bills or their children's school supplies.

Robust record keeping obligations will ensure that brokers who sell inappropriate mortgages will be held to account. This crucial step will make it easier for ASIC to oversee the quality of mortgage advice and take enforcement action. A failure to keep adequate records must be treated as evidence that a broker or licensee is not acting in the best interests of borrowers.

It appears that the existing record keeping requirements in section 88 of the NCCPA would not be sufficient as this is limited to financial records as defined. What is needed is more akin to the requirements on licensees to keep copies of preliminary and full suitability assessments.[22] Written evidence of how the broker formed their best interest view, like suitability assessments, can play an important role in dispute resolution.

This obligation must be principles-based. The broking industry must not use these obligations as a compliance-driven, box-ticking exercise. The following amendments should be added to the legislation:

Section 158LC - "*Licensees must maintain clear and accurate records to prove compliance with 158LA and 158LB of the Act*"
Civil penalty - The greater of:

- 50,000 penalty units ($10.5 million);
- three times the value of benefits obtained or losses avoided; or
- 10% of annual turnover in the 12 months preceding the contravening conduct.

Section 158LG - "*Credit representatives must maintain clear and accurate records to prove compliance with 158LE and 158LF of the Act*"
Civil penalty - 5000 penalty units

ASIC has an important role to play in ensuring that brokers keep strong records. The regulator recently undertook a thorough examination of mortgage brokers selling people into riskier

[22] See sections 120, 132, 143 and 155 of the NCCPA

interest only loans.[23] They found that, "record keeping was inconsistent and in some case records were fragmented and incomplete".[24] The report highlighted what it considered to be best practice record keeping obligations. Once a particular loan was selected, ASIC said the "best files" observed:

"*included a logically set out and detailed narrative account of the consumers' short and longer term requirements and objectives, which drew together the consumers' responses to various questions. These accounts also described in detail the reasoning behind selecting a loan with particular features, terms and costs from a particular lender.*"[25]

The ASIC report urged industry to adopt the following actions to adhere to best practice record-keeping. These include that brokers:

- provide specific guidance on loan products and features;
- ensure all questions are answered;
- keep all information in one place;
- focus on the consumer's underlying objectives;
- have documented processes where objectives conflict;
- include a concise narrative summary;
- provide a summary statement to the consumer;
- ensure the consumer understands products and features; and
- ensure the consumers knows what they must do;[26]

These recommendations are strong and should form the basis of ASIC guidance on maintaining record-keeping obligations. Importantly, they should not be prescriptive or exhaustive and form the basis of a box-ticking compliance exercise for the broking industry to minimise culpability.

Recommendation 5 - 6

5. Brokers and licensees must be required to maintain clear and accurate records. The law should be amended in the following way:

Section 158LC - "Licensees must maintain clear and accurate records to prove compliance with 158LA and 158LB of the Act"
Civil penalty - The greater of:

- 50,000 penalty units ($10.5 million);
- three times the value of benefits obtained or losses avoided; or
- 10% of annual turnover in the 12 months preceding the contravening conduct.

[23] ASIC Report 493, Review of interest only loans: mortgage broker inquiries into consumer's requirements and objectives
[24] ASIC Report 493, p.5
[25] ASIC Report 493, p.8
[26] ASIC Report 493, p.9-10

Section 158LG - “Credit representatives must maintain clear and accurate records to prove compliance with 158LE and 158LF of the Act”
Civil penalty - 5000 penalty units

6. ASIC must establish principles-based guidance on how brokers and licensees maintain these record keeping obligations.

5. Reform remuneration in the broking industry

Support for the removal of harmful volume-based and campaign-based commissions

We welcome the removal of harmful volume-based and campaign-based commissions from the broking industry. ASIC has clearly established that these payments lead to conflicted advice and poor consumer outcomes. The regulator found:

- campaign-based benefits of 0.3% from a lender to the broker to sell $3 million worth of loans within a four-month period;[27] and
- volume-based benefit of 0.35% if an aggregator sold $150 million worth of loans in one year.[28]

These commissions distort the quality of advice that brokers provide to people. They incentivise brokers to recommend mortgages from lenders who pay them the highest commission, irrespective of whether it is the borrowers best interest. It is imperative the Treasury bans them.

The Combined Industry Forum (CIF) has also acknowledged that these commissions created troubling conflicts of interests that needed to be resolved. However, the industry has only made the non-binding and unaccountable commitment to “move away” from these conflicted benefits.[29] As the Productivity Commission recently noted, “evidence on actual implementation is thin on the ground”.[30] It’s clear that leaving the industry to self-regulate has failed and that legislation is required to ban these harmful commissions.

Ban non-volume based bonuses

Non-volume based bonuses lead to conflicted advice. They must be banned in the same tranche of legislation as volume-based and campaign-based commissions. Non-volume based bonuses are payments that lenders pay aggregators or brokers for an outcome that is not dependent on the volume of home loans sold. ASIC has found that non-volume based benefits “present an increased risk of poor consumer outcomes”.

These bonuses are designed to induce brokers to recommend mortgages with certain characteristics that benefit lenders. Examples include bonuses for having a specific rate of home loan applications converted into settled loans or bonuses for having a specific average

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[27] ASIC Report 516, Review of mortgage broker remuneration, p.89
[28] ASIC Report 516, Review of mortgage broker remuneration, p.91
[29] Combined Industry Forum Progress Report: Working towards a better mortgage broking industry for customers, July 2018, https://www.mfaa.com.au/sites/default/files/users/user133/CIF_Progress_Report_-_July_2018.pdf
[30] Productivity Commission, ‘Competition in the Australian Financial System’, p.320

loan to value ratio (LVR) of home loans settled. A failure to ban these unfair bonuses will create a loophole where banks will be incentivised to increasingly reward brokers with these conflicted payments.

Prohibit brokers from recommending excessive mortgages

We support the Treasury's proposal to prohibit upfront commissions being charged on credit above the drawdown amount, including on offset accounts. We support Regulation 28VB that the drawdown amount be calculated "within 90 days after the day on which the credit contract entered into." A longer drawdown period does not adequately address the problem of mortgage brokers pushing larger mortgages.

This is an important safeguard to prevent mortgage brokers from recommending people larger mortgages than what they need in order to receive a higher upfront commission. A CHOICE shadow-shop revealed this is common practice within the industry. In one example, a prospective couple sought out a mortgage broker to help purchase a $600,000 investment property. The broker suggested the couple purchase $1 million mortgage, well over what the couple required. It's clear the broker stood to make a much larger upfront commission if the couple followed through with this erroneous recommendation.

While we support this reform to prohibit upfront commissions being charged on credit above the drawn down amount, it fails to address the deeper persistent conflicts that upfront commissions have on the quality of mortgage broker recommendations.

Ensure that clawback arrangements encourage switching

Clawback arrangements should not discourage brokers from switching their clients to a cheaper loan. Unless addressed, the Treasury's proposal will mean that brokers are incentivised to keep people in the same mortgage within the first two years, irrespective of whether there are more suitable loans on the market.

Regularly shopping around for the best available loan can have real financial pay-offs. The ACCC has found that simply renegotiating with your lender to pay the same interest rate as a new borrower can save you up to $850 a year for an average-sized loan, and even more for some borrowers. It is unfortunately too common for home loan borrowers to be kept on interest rates that were stranded at the time they entered into the loan. Given recent movements in the cash rate, switching mortgages to more competitive loans can save borrowers tens of thousands over the life of their loan.

Switching mortgages to find a cheaper priced loan within the first two years of a mortgage is not a legitimate reason to warrant clawback. We are calling for the law to be amended so that clawback only occurs if a mortgage has:

- fallen into significant arrears;
- has become impaired; or
- been found to be fraudulently sold by a broker or licensee.

Clawback reveals the deeper structural problem with conflicted remuneration in the broking industry. Clawback is a commercial arrangement that aligns the brokers interests with the lenders, serving to lock the borrower into a loan and prevent switching. Lenders use clawback to retain customers. Brokers fear clawback because they would lose their upfront and trail commissions. The consideration of borrower's financial wellbeing remains an afterthought. It shares many of the anti-competitive features of early exit fees for mortgages. These unfair fees were outlawed by the Federal Government on 1 July 2011. As with early exit fees, the law should be amended to clearly establish that the cost of clawback can not be passed on to borrowers.

Defining conflicted remuneration

We strongly support the Treasury's definition of conflicted remuneration in S158N of the Draft Bill. It is a clear definition that mirrors obligations in the *Corporations Act 2001*.

The Banking Royal Commission, the Productivity Commission, and a number of ASIC inquiries have all established that upfront and trail commission are conflicted remuneration. These payments incentivise brokers to recommend loans to people that maximise their commission. However, the Treasury's current drafting in 28VA(3) of the Regulations ignores this. The current drafting suggests that trail and upfront commissions are not conflicted remuneration. This is problematic and misleading.

We acknowledge that banning upfront and trail commission is not within the scope of this legislation. However, the Treasury needs to reframe the drafting of the proposed regulations. The Treasury must amend S28V(3) of the Regulations to define what benefits are prohibited forms of conflicted remuneration. This will result in upfront and trail commission no longer being erroneously defined as "not conflicted remuneration". We suggest the following amendment:

(3) A monetary benefit given (whether directly or indirectly) to a licensee, or a representative of a licensee, is a prohibited form of conflicted remuneration if:

(a) the benefit relates to a credit service provided by the licensee or representative to a consumer in relation to a credit contract; and

(b) the benefit is a volume-based benefit; or

(c) the benefit is a campaign-based benefit;

(d) for a credit contract that relates to:

(i) The provision of credit wholly or predominantly for the purpose of purchasing residential property; or

(ii) *The provision of credit wholly or predominantly for the purpose of refinancing credit that was provided wholly or predominantly for the purpose of purchasing residential property;*

(e) the clawback requirements are satisfied in relation to the benefit (if applicable).

Guarantee fairness in information technology software or support

The Treasury has proposed that "information technology software or support" would be exempted from conflicted remuneration protections.[31] There remains a risk that these programs can be structured to recommend loans to a specific provider. This is especially pertinent in lender-owned aggregators. The Productivity Commission noted,

"It is plausible that such software, when faced with two largely equivalent loan products (from the consumer's perspective), might be programmed to recommend the product offered by the aggregator's owner over the product offered by another lender."[32]

Any information technology software or support that is exempt from conflicted remuneration should remain product-neutral and not priortise any lenders, especially lenders that own aggregators. We recommend the following addition to the proposed regulations

28VF(6)(c) - "*the information technology or support is programmed to prioritise consumer's interests.*"

ASIC needs to monitor these information technology systems to ensure that unfair priority is not given to specific lenders at the detriment of consumers.

Ensure that education and training events are genuine

The Treasury has proposed that education or training events that have a "genuine education or training purposes" are exempt from conflicted remuneration restrictions. It is common industry practice for aggregators and lenders to use soft-dollar benefits, such as free holidays disguised as conferences to influence brokers. Brokers are incentivised to sell more mortgages and more expensive mortgages to gain access to overseas holidays, irrespective of whether they are in the consumer's best interests.

For example, ASIC recently found that one aggregator spent over $1 million, at $13,000 per person, on one such dubious 'conference' in the Carribean. It remains supremely unclear what genuine education or training benefit a broker would gain on an all-expenses paid cruise around the Carribean islands. It is problematic that brokers are motivated to recommend people into a

[31] *National Consumer Credit Protection Amendment (Mortgage Brokers) Regulations 2019*, S28VF(6)
[32] Productivity Commission, Competition in the Australian Financial System, p.318

mortgage to achieve an all-expenses paid holiday rather than what is in the individual's best interests. We strongly urge ASIC to take oversight on this issue. The regulator must ensure that education or training events are truly for a "genuine education or training purpose".

Establish an evidence base for reforming commissions

The Federal Government has announced that the Council of Financial Regulators and the Australian Competition and Consumer Commission (ACCC) will undertake a review of upfront and trail commissions in 2022.[33] A number of inquiries, including the Banking Royal Commission, the Productivity Commission and ASIC have all found that current commission structures in mortgage broking lead to poor consumer outcomes and conflicted advice. Upfront and trail commissions incentivise brokers to recommend loans that will give them the highest commission, irrespective of whether they are in the individual's best interests.

While not in the scope of this legislation, we urge ASIC to undertake research into the impact that both upfront and trail commissions have on good consumer outcomes and competition in the Australian home lending system. This research should begin in 2020 and be complete by 2021. As a starting point, ASIC should quantify the financial impact that commissions have on the cost of all residential home loans. The industry routinely claim that their services are free yet fail to acknowledge that the cost of these services is borne across all borrowers.

Recommendations 7 -14

7. Non-volume based benefits must be banned.

8. The Treasury amend the law so that clawback is triggered only if a mortgage has:
    - fallen into significant arrears;
    - become impaired; or
    - been found to be fraudulently sold by a broker or licensee.

9. The law be amended to establish that the cost of clawback can not be passed on to borrowers.

10. The Treasury must amend S28V(3) of the Regulations to define what benefits are prohibited forms of conflicted remuneration.

11. Information technology or support systems should be not programmed to recommend loans from specific lenders. We recommend the following addition to the draft Regulations 28VF(6)(c) - "*the information technology or support is programmed to prioritise consumer's interests*".

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[33] J Frydenberg, "Review of mortgage broking trail commissions", 12 March 2019, http://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/040-2019

12. ASIC must monitor the use of information technology or support systems to ensure that unfair priority is not given to specific lenders.

13. ASIC must maintain strong oversight of mortgage broking education and training events to ensure they have “genuine education or training purposes”.

14. The Treasury must undertake research into the impact that upfront and trail commissions have on good consumer outcomes and competition in the Australian home lending system.

6. Reform remuneration in the broking industry

Case study #4 - Nicola's story

Nicola is 50 years old and suffers from chronic migraines. Nicola told us that she was, and remains, reliant on Centrelink payments for her income.

In March 2014, Nicola was recommended to visit a finance broker in Melbourne, who told Nicola that he could arrange a loan of $10,000 with Westpac. Nicola wanted to obtain a loan to purchase a car. The broker walked with Nicola to the Westpac branch in Coburg, where Nicola was provided with Westpac loan documents that she signed on the spot. Shortly afterwards, she obtained a loan for $31,600 from Westpac. In 2015, the broker in question was banned by ASIC and his company's credit licence cancelled after ASIC found that the broker had submitted false documents to secure loan applications and failed to comply with licence conditions. Despite serious questions being raised about the broker's conduct and Nicola being unable to afford the loan, Westpac sold the debt to a third-party debt collector. The debt collector proceeded to commence proceedings in the Melbourne Magistrates' Court against Nicola. Consumer Action assisted Nicola with her dispute, which has now been resolved.

Case study shared by Consumer Action Law Centre

The Treasury's proposal covers only brokers that provide credit assistance in relation to loans secured by mortgages over residential properties. There is widespread and damaging consumer harm caused by brokers providing advice on other forms of credit, including car loans and personal loans. The same conflicts and consumer harm exists for mortgage brokers as they do for other brokers of credit assistance. Financial counsellors and community legal centres regularly assist people who have been sold by unscrupulous brokers into financially harmful loans. It is imperative these brokers are also held to the same standards as mortgage brokers.

Brokers very often advertise their services for recommending both mortgages as well as a number of credit products, including personal loans and car loans. A consumer has the same expectation that a broker will be acting in their best interests, irrespective of whether they are seeking a home loan or car loan. Under the proposed law, a mortgage broker who recommends both a mortgage and an associated car loan will be subject to these strong laws. This is an important and common-sense protection. However, it creates a perverse outcome where if that same broker recommends that same car loan then they are not captured by this law. This is a clear loophole that needs to be closed. Brokers recommending any credit products need to be subject to these laws.

Consumer advocates recognise that Treasury considers its task is to implement the Royal Commission recommendations narrowly in line with the recommendations, and the recommendations 1.2 and 1.3 referred to “mortgage brokers”. However, doing so runs contrary to recommendation 7.3 of the Banking Royal Commission to eliminate any ‘exceptions or qualifications’ that deviate from fundamental norms. Moreover, in its Implementation Plan, the Government said that it would implement reforms in a way that is consistent with the elimination of exceptions and qualifications.

It is clearly now a fundamental norm that advisers in the financial sector have a fundamental duty to act in their client’s best interest. Indeed, “when acting for another, act in the best interests of that other” is one of the six norms identified in the Royal Commission —Commissioner Hayne did not say that this norm was to be limited only to particular forms of advisers. Treasury should not be proposing to implement the law in a way that provides an exception other adviser in the financial sector such as finance brokers more broadly. This is clearly contrary to the Hayne report. This only serves to make the law more complex (contrary to Hayne’s comments about simplification) and provide opportunities for continued consumer harm.

Recommendations 15

All brokers must be subject to the best interests duty. This should extend to any brokers recommending credit products, including car loans and personal loans.

Appendix - strengthening penalties regime

Obligation	Draft Penalty	Recommended Penalty
Failure of a licensee to act in the best interests of the consumer	5,000 penalty units	The greater of: ● 50,000 penalty units ($10.5 million); ● three times the value of benefits obtained or losses avoided; or ● 10% of annual turnover in the 12 months preceding the contravening conduct.
Failure of a licensee to give priority to the consumer's interest	5,000 penalty units	The greater of: ● 50,000 penalty units ($10.5 million); ● three times the value of benefits obtained or losses avoided; or ● 10% of annual turnover in the 12 months preceding the contravening conduct.
Failure of a licensee to take reasonable steps to ensure that the credit representative acts in the best interests of the consumer	5,000 penalty units	The greater of: ● 50,000 penalty units ($10.5 million); ● three times the value of benefits obtained or losses avoided; or ● 10% of annual turnover in the 12 months preceding the contravening conduct.
Failure of a licensee to take reasonable steps to ensure that credit representatives give priority to the consumer's interests	5,000 penalty units	The greater of: ● 50,000 penalty units ($10.5 million); ● three times the value of benefits obtained or losses avoided; or

		• 10% of annual turnover in the 12 months preceding the contravening conduct.
Licensee accepting conflicted remuneration	5,000 penalty units	The greater of: • 50,000 penalty units ($10.5 million); • three times the value of benefits obtained or losses avoided; or • 10% of annual turnover in the 12 months preceding the contravening conduct.
Failure of licensee to take reasonable steps to ensure that credit representatives do not accept conflicted remuneration	5,000 penalty units	The greater of: • 50,000 penalty units ($10.5 million); • three times the value of benefits obtained or losses avoided; or • 10% of annual turnover in the 12 months preceding the contravening conduct.
Credit provider giving licensee conflicted remuneration	5,000 penalty units	The greater of: • 50,000 penalty units ($10.5 million); • three times the value of benefits obtained or losses avoided; or • 10% of annual turnover in the 12 months preceding the contravening conduct.
Credit provider giving representative conflicted remuneration	5,000 penalty units	The greater of: • 50,000 penalty units ($10.5 million); • three times the value of benefits obtained or losses avoided; or • 10% of annual turnover in the 12 months preceding the contravening conduct.

Engaging in avoidance scheme	5,000 penalty units	The greater of: ● 50,000 penalty units ($10.5 million); ● three times the value of benefits obtained or losses avoided; or ● 10% of annual turnover in the 12 months preceding the contravening conduct.