THE LAW SOCIETY
OF NEW SOUTH WALES

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9 October 2019

Manager
Financial Service Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ConsumerCredit@treasury.gov.au

Dear Sir/Madam,

Mortgage broker best interests and remuneration reforms

Thank you for the opportunity to comment on the exposure draft Bill, exposure draft Regulations and draft explanatory material implementing the reforms to provide for a best interests duty for mortgage brokers and reform mortgage broker remuneration. The Law Society's Business Law Committee contributed to this submission.

'Best interests'

All credit assistance providers currently have responsible lending requirements that require them to consider the consumer's requirements and objectives, as part of their preliminary assessment (s 116 of the *National Consumer Credit Protection Act 2009*). Those requirements and objectives are subjective i.e. inquiries must be made into the consumer's actual requirements and objectives in relation to obtaining finance. There is also guidance provided in relation to the obligation to act in the best interests of the client under section 961B of the *Corporations Act 2001*.

However, there is no definition or guidance on what 'best interests' means in clause 158LA of the Bill. We suggest that further guidance be provided. On a plain English reading, brokers will need to seek out the best possible option for a consumer in all the circumstances. The practical impact of the requirement may be somewhat artificial in any case, as brokers generally do not have access to all lenders and all products, and brokers are likely to still conduct their analysis based on their lender panel.

We acknowledge that the Government has announced that it will implement recommendation 1.2 of the Final Report of the Financial Services Royal Commission.[1] In our view, however, meaningful reforms could be made in the industry with a focus on preventing and penalising broker misconduct i.e. conduct to the consumer's detriment, rather than simply creating a new positive statutory duty.

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[1] Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report,* vol 1, 20.

Conflicted remuneration

The definition of conflicted remuneration in clause 158N of the Bill is very wide and is capable of capturing any form of remuneration that brokers may accept from lenders (including brokers who, as credit representatives of lenders, may receive a salary from those lenders). We note the effect of cl 28VA of the draft Regulation. Brokers provide a service to consumers which, under current models and industry practice, consumers do not pay an upfront fee for. This means that brokers must necessarily be remunerated by lenders, who benefit from the credit business directed their way by brokers. Significant changes to the rules in relation to commissions will require a fundamental overhaul of the business model for mortgage brokers.

An alternative way to reform broker remuneration would be to consider linking broker remuneration to consumer loan performance metrics i.e. associating remuneration with the consumer's outcome, rather than looking at the point in time when finance was drawn down. Trail commissions are one form of remuneration associated with consumer loan performance.

Generally on commissions, we agree with the following from the New Zealand Ministry of Business, Innovation and Employment '*Options Paper: Conduct of Financial Institutions'* in April 2019:

> We are not considering a total ban on commissions at this time because there is significant risk that this will reduce access to financial advice for consumers, drive all sales in-house and reduce competition in the market. A ban on commissions would be likely to make financial advice more expensive and difficult to obtain for the average consumer, as it would probably require consumers to pay upfront fees to obtain advice.[2]

Regulating broking industry as a whole

We note that the reforms made by the Bill target 'mortgage brokers', defined as those who carry on a business of providing credit assistance in relation to residential mortgages. This excludes brokers who provide credit assistance in relation to other loan products, including, for example, car financing. Car purchases are, anecdotally, the second largest financing purchase any consumer will make and their most frequent significant finance transaction (with car loans re-financed roughly every five years). Further, many egregious add-on insurance products are financed in connection with car purchases, rather than home loan purchases, as indicated by vigorous Australian Securities and Investments Commission ("ASIC") enforcement action in this sphere over the past five years. We note that this was also recognised by the Treasury in its Proposal Paper *Reforms to the sale of add on insurance products*[3]and the current complementary consultation by ASIC on its proposal to use its product intervention power in Part 7.9A of the *Corporations Act 2001* in relation to the distribution of add-on insurance and warranties by caryard intermediaries.[4]

Some broking businesses do provide both home and car financing – so the scope of the 'best interest duty' will capture their conduct in relation to all their credit assistance activities.

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[2] Ministry of Business, Innovation and Employment, Government of New Zealand, *Options Paper: Conduct of Financial Institutions*, April 2019,40 at < https://www.mbie.govt.nz/dmsdocument/5154-conduct-of-financial-institutions-review-options-paper>.

[3] The Treasury, Commonwealth Government, *Reforms to the sale of add on insurance products*, September 2019, 3 < https://treasury.gov.au/sites/default/files/2019-09/c2019-t408984_-_tsy_proposal_paper.pdf >.

[4] ASIC Consultation Paper 324 Product intervention: The sale of add-on financial products through caryard intermediaries, October 2019,< https://download.asic.gov.au/media/5286418/cp324-published-1-october-2019.pdf>.

However, in our view, the current drafting of the Bill is likely to drive a wedge in the broking industry between general / home loan brokers and speciality car finance brokers, creating substantial financial incentives for home loan financing broking businesses to be separated from other broking activities. The anti-avoidance provisions may not be sufficient to prevent that level of operational re-structuring – i.e. it will be difficult to prove to a sufficient evidentiary standard that the Bill is the 'sole purpose' of the split, given there are currently other specialist finance businesses.

Please contact Liza Booth, Principal Policy Lawyer, on (02) 9926 0202 or by email at liza.booth@lawsociety.com.au if you would like to discuss this submission.

Yours faithfully,

Elizabeth Espinosa

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President