11 July 2017
The Treasury
By email: ConsumerCredit@treasury.gov.au

To the Treasury,

Re: Review of mortgage broker remuneration

CHOICE, Consumer Action, Financial Counselling Australia and Financial Rights Legal Centre appreciates the opportunity to comment on ASIC's review of mortgage broker remuneration (the review).

Consumers use brokers as guides for what is often their life's most significant financial decision - buying a home. Getting a poor loan, even if customers can afford to pay it, can have significant financial consequences, with consumers paying tens of thousands or even hundreds of thousands of dollars more over the life of a mortgage. In some instances, as will be highlighted in case studies collected from financial counsellors and community legal centres, mortgage brokers appear to be targeting customers in clearly vulnerable situations and recommending harmful borrowing strategies that leave the broker with a sizable commission but the customer with debt they can't afford to repay.

The high-level solutions to these problems are two-fold. First, conflicted remuneration that drives poor consumer outcomes must be addressed through an industry-wide solution with strong enforcement arrangements and sanctions for non-compliance. Second, mortgage brokers must be held to higher standards to protect consumers from harmful advice.

We also call on ASIC to address problems with the mortgage broking sector that were outside the scope of the review's proposals. Case studies (see Appendix One) demonstrate the harm that brokers can cause consumers. One theme running through a number of submissions is misuse of Business Purpose Declarations so that the broker can avoid obligations under the National Consumer Credit Act. ASIC needs to prioritise monitoring and enforcement action against brokers misusing Business Purpose Declarations to avoid responsible lending obligations.

SUMMARY OF RECOMMENDATIONS

1. Consumer representatives must be included in any industry discussions to address problems raised by ASIC.
2. To ensure that all problems identified in the report are dealt with in a consistent way, an industry code that applies to all lenders, aggregators and brokers should be developed. The code must be approved by ASIC and include clear monitoring and enforcement provisions. If this doesn't occur within a reasonable period then the Federal Government should pursue legislative reform.
3. At minimum, commission payments must be restructured so that payments are not linked to the amount a customer borrows.
4. To best serve consumer interests, upfront commissions should be removed and replaced with fixed fees for advice, either lump sum payments or rates based on hours of work required to arrange a loan.
5. Trail commissions should be removed as they offer no benefit to consumers.
6. Bonus commissions, bonus payments and soft dollar payments are removed within the year.
7. Brokers are required to disclose ownership relationships and the lender behind any white-label loan recommended to a consumer.
    a. Disclosure should be visual (through branding) and written.
    b. Specific forms of disclosure should be consumer-tested by ASIC to ensure that they're as effective as possible.
8. Lenders should remove any internal performance targets or remuneration metrics relating to volume of loans from affiliate aggregators or broker businesses.
9. In addition to the metrics proposed by ASIC, we recommend that there is also reporting on:
    a. The average value of remuneration received by brokers within aggregator networks.
    b. If trail commissions are retained, the average value of trail for brokers within aggregator networks as well as the total amount of trail paid by each lender to aggregators and brokers.
    c. The total amount of commissions, upfront and trail, paid by each lender.
    d. If broker clubs continue, lenders disclose how brokers qualify, what perks are provided and how many brokers are participants.
    e. Lenders and aggregators disclose any payments or other benefits provided to brokers who sell other products including insurance and credit cards.
10. Lenders and aggregators should ensure that brokers keep consistent and detailed file notes. File notes should demonstrate that a broker has complied with the NCCP Act and ASIC's Regulatory Guide 209 by completing a preliminary assessment that details:
    a. The outcomes of the reasonable inquiries into the consumer's financial situation.
    b. The outcomes of the reasonable inquiries about the consumer's requirements and objectives.
    c. The reasonable steps the broker has taken verify the consumer's financial situation.
11. Amend the law so the mortgage brokers have to act in the best interests of their clients. This would require:
    a. Ensuring that mortgage brokers need to meet the existing requirements under the NCCP Act, including the requirement to arrange a not unsuitable loan.
    b. Ensuring that mortgage brokers have to act in the best interests of their clients. This could mirror obligations that financial advisers have under the Corproations Act. Additional requirements should be legislated and ASIC should prepare regulatory guidance on its application.

12. ASIC conducts a large shadow shopping exercise to determine the scope of discussions that brokers have with clients as well as the quality of information and recommendations provided.
13. ASIC pursues monitoring and enforcement action against brokers misusing Business Purpose Declarations.
14. Governance arrangements include measures to identify misuse of Business Purposes Declarations.
15. ASIC investigate referral networks for home loans to determine the impact of these networks on consumer outcomes and if consumers are aware that there's financial payments being made for the introduction.
16. The Federal Government, in consultation with the states and territories, brings the regulation of the property investment industry into line with regulations applicable to the financial investment industry by:
    a. making the regulation of property investment advice a Commonwealth responsibility (recognising that services provided by licensed real estate agents would remain under state and territory regulation);
    b. inserting a definition of property investment advice into the Corporations Act and the Australian Securities and Investments Commission Act; and
    c. requiring that anyone providing property investment advice should hold an Australian Financial Services Licence.

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COMMENT ON THE PROCESS FOR REFORM

Consumer groups must be included in reform process

Reform must be focused on what's best for consumers, not what works for brokers, aggregators or lenders. Several recommendations from the review leave solutions to widespread industry problems in the hands of industry. This is not good enough.

Industry have already progressed changes without including consumer representatives.[1] Any solution achieved through negotiation between major commercial interests will work well for those commercial interests. The best option to deliver strong consumer outcomes would be for the regulator or Federal Government to take responsibility for defining and delivering reform. Consumer representatives must be part of discussions about mortgage broker remuneration from the beginning to make sure consumer outcomes rather than commercial interests are front and centre.

Solutions must apply to all of industry and be properly enforced

For solutions to properly work they need to apply to all members of the industry and be enforced, with sanctions if they are not complied with. There are two ways to achieve this: an industry-wide enforceable code that is registered with ASIC or legislative change.

The solutions put forward by ASIC in the review are highly unlikely to fully cover all mortgage brokers, aggregators and lenders. It is also unlikely that there will be any enforceable element to the changes.

Of primary concern is that the Australian Bankers' Association (the ABA) is being directed by ASIC to deliver or negotiate solutions to remuneration issues with mortgage brokers, specifically for proposals one-three. While the ABA represents the largest home loan lenders in Australia, its membership does not cover all lenders. As noted in the review, 8% of lenders are not Australian Deposit Taking Institutions (ADIs).[2] In addition to this, not all ADIs, brokers or aggregators are ABA members. While the review left many proposals to be dealt with by the ABA's Retail Banking Remuneration Review, the recommendations from that report only apply to ABA members and focus on the actions banks should take as opposed to aggregators and brokers.[3] As the ABA does not have full coverage of the markets needed to deliver solutions, it's unclear how solutions would be enforced.

It is not clear how many of ASIC's proposals will be implemented, monitored and enforced. The review does not specify how proposal four (disclosure of ownership structures) or five (public reporting) should be implemented. For proposal six (improved governance and oversight), the review implies that individual lenders, aggregators and broker businesses will be responsible for implementing changes and that ASIC will request data from aggregators and lenders to review some outcomes. It's unclear if there will be monitoring across all of industry, especially broker businesses. These proposals must be clearer and specify what body is responsible for making sure change is implemented and then reporting on ongoing compliance. Again, the best way to achieve this would

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[1] See https://www.theadviser.com.au/breaking-news/36198-banks-and-brokers-in-remuneration-talks#!/ccomment-comment=12947

[2] ASIC (2017), *Report 516: Review of mortgage broker remuneration*, paragraph 237.

[3] Sedgwick, Stephen (2017), *Retail banking remuneration review*, http://retailbankingremreview.com.au/wp-content/uploads/2017/04/FINAL_Rem-Review-Report.pdf See recommendations 16-21 on pages 10-11.

be through legislative reform although a well-developed and enforced industry code could also achieve these outcomes.

Recommendations:

1. Consumer representatives must be included in any discussions to address problems raised by ASIC.
2. To ensure that all problems identified in the report are dealt with in a consistent way, an industry code that applies to all lenders, aggregators and brokers should be developed. The code must be approved by ASIC and include clear monitoring and enforcement provisions. If this doesn't occur within a reasonable period then the Federal Government should pursue legislative reform.

COMMENTS ON SPECIFIC PROPOSALS IN THE REVIEW

Proposal one: changing the standard commission model to reduce the risk of poor consumer outcomes

ASIC proposes that the standard commission model of upfront and trail commissions is amended so that mortgage brokers are not incentivised to recommend poor loan options. The proposal to adjust standard commissions has potential to lessen the impact that commission payment models has on consumer outcomes but we believe more should be done. We note that reforms in the United Kingdom and the Netherlands have gone further than what ASIC is proposing for Australia. In the United Kingdom, brokers are required to act in the consumer's best interest and New Zealand is considering similar reforms.[4] In the Netherlands, commissions have been banned completely, with most brokers now charging an upfront flat fee for advice.[5]

As noted in the review, current remuneration arrangements create two different kinds of conflicts:

1. Product-strategy conflict: where "a broker could recommend a loan that is larger than the consumer needs or can afford to maximise their commission payment."[6]
2. Lender-choice conflict: where a broker is incentivised to recommend one specific loan over another because they will get a higher commission when that may not be the best option for the customer.

In our experience, product-strategy conflict is common. While there is limited formal research available about the quality of recommendations that brokers are providing, the available data indicates that some brokers are not recommending good quality loans.

In 2015, CHOICE conducted a shadow shopping exercise where we sent five customers looking for a home loan to three brokers each (15 brokers total).[7] We found:

- Risky borrowing suggestions – one broker advised a home owner who wanted to refinance her home loan and was in an unsecure employment situation to use the equity in her home to invest in new property or go on a holiday. Another broker advised a couple to borrow $1 million against their home when they only needed $600,000 to buy an investment property.
- Recommendations weren't always based on quality – one broker pushed his own company's product even while acknowledging that other lenders offered a cheaper loan.
- Little discussion of long-term risk - no broker had a conversation about capacity to pay should interest rates rise.

Based on cases that financial counsellors and community legal centres see, it appears that some mortgage brokers are so motivated by commissions that they put customers at significant risk and take extreme steps, including likely document fraud and breaches of the responsible lending obligations under the *National Consumer Credit Protection Act 2009* (NCCP Act). Instances where a broker arranges a loan that a customer can't afford cause financial harm as well as personal harm, putting mental health and personal relationships at risk.[8] See, for example, case two in the appendix

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[4] ASIC review, para 215, 230.
[5] Ibid paras 221-223.
[6] ASIC review, p. 10.
[7] CHOICE (2015), *Mortgage broker investigation*, https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop
[8] For further examples see Consumer Action (2017), Submission to Senate Economics Committee, pp.20-21 http://policy.consumeraction.org.au/wp-content/uploads/sites/13/2017/03/FINAL-submission-Banking-Rip-Offs-Inquiry-March-2017.pdf

where a man with PTSD was pushed into a loan for investment properties. The inappropriate lending caused financial stress as well as issues within a marriage and for the wider family.

We also believe that lender-choice conflict is common however a range of factors appear to be driving brokers to recommend one product over others including commissions, bonus payments, approval times, broker clubs, other soft-dollar benefits and familiarity with application processes that reduces the work required to arrange a loan.

These conflicts, particularly product-strategy conflict, will be lessened by changes to the standard commission model. At minimum, change must occur to uncouple remuneration from the amount a consumer borrows to ensure brokers are not motivated to encourage people to borrow more.

With upfront commissions, any percentage based payment has less clarity for consumers simply because it requires the customer to calculate the total fee based on amount borrowed. Flat fees, either calculated as per-hour fees for work or as a single fee for arranging a loan are easier for a customer to understand and completely remove the conflicts ASIC has identified. Fees could be included in the cost of the loan if ASIC testing shows that consumers are able to easily weigh up the costs of the mortgage advice with this format.

With trail commissions, we see no benefit to consumers in retaining current remuneration practices. Trail commission payments offer no clear benefit to consumers but significant benefits to the brokers, aggregators and lenders. For consumers, there is some implication that trail accounts for service delivered by the broker over the life of a loan. It is incredibly unclear what service is being delivered – any assessment about whether other options are better suited to a client during the life of a loan could be covered through one-off fees based on time actually spent assisting the client rather than the opaque high-costs of trail commissions.

As noted in the review, aggregators can be paid over $2,200 per year through a trail commission for a single loan, although the average annual amount is likely closer to $750.[9] The only work required for this payment is to not switch the customer to another product. Trail also offers benefits to the lender as it positively incentivises brokers to keep clients in current loans. Trail commissions introduce competition issues as they discourage brokers from switching clients to other options. Some industry members may argue that trail incentivises brokers to recommend quality loans to lenders where the client won't default, however this is a basic requirement under the NCCP and should be covered by responsible lending obligations.

We see trail at its most perverse in businesses established to buy and sell mortgage loan books (the trail payments).[10] The consumer gets no benefit and the possibility of additional service is likely removed when these sales occur. The buyer gets great benefits: ongoing income for no work and, as implied through industry press, the possibility of making the list more valuable through selling additional products from insurance to SMSFs.[11] The price for these books is exceptional. In a quick online search, we found one book sold for $39,000 for delivering expected trail income of $1630 a month plus GST.[12] This money is coming from just 19 clients on the Northern Beaches in Sydney, meaning each client accounts for an average of over $85 a month in payments or $1,029 a year. While it could be argued that the consumer doesn't directly pay for these trail payments, that it's a payment from the lender for arranging the loan this ignores the fact that trail contributes to overall lender costs which are inevitably passed on to the consumer.

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[9] ASIC review, paras 465-466.

[10] For example http://www.trailbookbuyers.com.au/

[11] See http://www.afr.com/real-estate/residential/vic/mortgage-broker-billiondollar-windfall--as-loan-book-prices-soar-20150415-1mlfu7

[12] Example sourced from http://www.xcllusive.com.au/Sold-Businesses/222-Mortgage-Loan-Book-For-Sale.html , screenshots available if required.

As noted by ASIC, trail payments are rare in other comparable markets (New Zealand and the United Kingdom), indicating that remuneration models without trail payments are very viable.[13]

Recommendations

3. At minimum, commission payments must be restructured so that payments are not linked to the amount a customer borrows.
4. To best serve consumer interests, upfront commissions should be removed and replaced with fixed fees for advice, either lump sum payments or rates based on hours of work required to arrange a loan.
5. Trail commissions should be removed as they offer no benefit to consumers.

Proposals two and three: moving away from bonus commissions and bonus payments and moving away from soft dollar payments

We strongly agree with ASIC's conclusions that bonus payments and soft dollar payments create a higher risk that brokers will place consumers with lenders for the wrong reasons. ASIC has proposed that the industry move away from these payment types. We agree but change must apply to the whole broking industry, for all loans, and a clear timeline is needed.

We urge quick action on two elements that add greatest risk of a broker recommending poor quality loans: volume-based payments and broker clubs where incentives are tied to volume of loans written. These payments contain the same risk. They mean that consumers are more likely to walk away with a loan from a small number of lenders, even if a broker claims they look at a wider range of loans. This is a poor outcome for individuals who are less likely to get the loan that best fits their needs. It's also a poor outcome for the overall system, as the benefits of competition that brokers should be delivering are substantially lessened.

Recommendation:

6. Bonus commissions, bonus payments and soft dollar payments are removed within the year.

Proposal four: clearer disclosure of ownership structures within the home loan market to improve competition

We agree with ASIC's conclusion that the impact of ownership on loan recommendations creates poor consumer outcomes. Ideally, mortgage brokers should be increasing competition in the banking sector by steering consumers to the best options in the market. This isn't occurring. At present brokers do not get their clients better priced loans and on average send 80% of loans to just four preferred lenders.[14]

It is clear that lender ownership of a broking business influences the recommendations made. NAB has full ownership of three large aggregators: Finance & Systems Technology, Professional Lenders Association Network and Choice Aggregation Services. These aggregators account for approximately 30% of all brokers in Australia. NAB owned-aggregators directed 22% of home loans to NAB-branded or white-labelled loans even though NAB's overall home loan market share is 13.2%. Similarly, CBA has a controlling ownership stake (80%) in Aussie Home Loans. CBA received 37.3% of Aussie Home Loans; its overall market share is 20.9%. Consumers were more likely to walk away with a white-

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[13] ASIC Review, para 211.

[14] Finding six: interest rates are not different between distribution channels, ASIC review, p. 15.

labelled NAB or CBA loan from an affiliated network, which means they can't easily tell that there's a conflict of interest.[15]

Consumers should be clearly informed if a broker or aggregator they are using is owned by a lender. We also recommend that brokers clearly indicate, through written disclosure and branding, which lender is funding a white-label loan. All forms of disclosure should be consumer tested by an independent third-party, ideally ASIC, to ensure that information is conveyed in a manner that is most useful to consumers. However, disclosure is only a small part of the solution to solve these problems.

Disclosure of a conflict does not remove the conflict. Research has shown that mortgage broker disclosure of commissions can actually increase trust in the broker.[16] ASIC's proposal assumes that a consumer is well-placed to weigh up the risks of seeing a broker that is owned-by a larger institution. However, when a consumer is purchasing the expertise of a professional (like mortgage brokers), they are often very poorly placed to assess the quality of the information they are receiving. The consumer is relying on the expertise and ethical behaviour of the professional to guide them through decisions.

This is best seen in ASIC shadow-shopping research for financial advice. In 2012, ASIC shadow shopped retirement advice found that 39% of advice was poor (failed to meet requirements of the law at the time), 58% was adequate (met requirements of the law) and 3% was good (complied with the law, met clients' needs, improved their situation and clearly explained recommendations). Many people had trouble objectively assessing the quality of information they had received – they trusted that the professional they had seen had done the right thing. 86% of participants felt they had received good quality advice, and 81% said they trusted the advice they received from their adviser 'a lot', even though only 3% received objectively good advice.[17]

Consumers cannot be properly protected from the risks of ownership conflicts through disclosure. Instead, professionals must set high ethical standards to actively manage conflicts that harm consumers. Brokers should have obligations to recommend the best loan to fit their client's needs (this is explored in detail below). In addition, lenders should be responsible for the recommendations that affiliated aggregators and brokers make, with any sales or performance targets relating to volume of loans directed back to the parent company removed.

Recommendations:

7. Brokers should be required to disclose ownership relationships and the lender behind any white-label loan recommended to a consumer.
    a. Disclosure should be visual (through branding) and written.
    b. Specific forms of disclosure should be consumer-tested by ASIC to ensure that they're as effective as possible.
8. Lenders should remove any internal performance targets or remuneration metrics relating to volume of loans from affiliate aggregators or broker businesses.

[15] Ibid, para 291, 86.

[16] James Lacko and Janis Pappalardo, 2004, *The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment*, Federal Trade Commission Bureau of Economics Staff Report referenced in Financial Services Authority, 2008, *Financial Capability: A Behavioural Economics Perspective*. We referred to this research in this submission: http://consumeraction.org.au/wp-content/uploads/2017/02/170212-Consumer-Action-Submission-Sedgwick-Review-Issues-Paper-FINAL.pdf

[17] ASIC (2012) Report 279 Shadow shopping study of retirement advice, p 8, 54.

<u>Proposal five:</u> <u>establishing a new public reporting regime of consumer outcomes and competition in the home loan market</u>

We strongly support this proposal. To be useful, data must be provided in a standard manner and collected, verified and published by ASIC. Data should be released regularly, ideally every three months but at minimum once a year.

ASIC has proposed that the following data is collected and published:

(a) The actual value of remuneration received by aggregators and the potential value if all criteria for remuneration are satisfied;
(b) The average pricing of home loans that brokers obtain on behalf of consumers;
(c) The average pricing of home loans provided by lenders according to each distribution channel; and
(d) the distribution of loans by brokers between lenders to give consumers a better indication of the range of loans that brokers within the network offer

We believe that further detail about commissions and other payments is required.

Recommendation:

9. In addition to the metrics proposed by ASIC, we recommend that there is also reporting on
    a) The average value of remuneration received by brokers within aggregator networks.
    b) If trail commissions are retained, the average value of trail for brokers within aggregator networks as well as the total amount of trail paid by each lender to aggregators and brokers.
    c) The total amount of commissions, upfront and trail, paid by each lender.
    d) If broker clubs continue, lenders disclose how brokers qualify, what perks are provided and how many brokers are participants.
    e) Lenders and aggregators disclose any payments or other benefits provided to brokers who sell other products including insurance and credit cards.

<u>Proposal six:</u> <u>improving the oversight of brokers by lenders and aggregators.</u>

We strongly agree with this proposal. In addition to the steps proposed we recommend that lenders and aggregators should ensure that brokers keep consistent and detailed file notes to assist with future monitoring and enforcement activities.[18]

Recommendation:

10. Lenders and aggregators should ensure that brokers keep consistent and detailed file notes. File notes should demonstrate that a broker has complied with the NCCP Act and ASIC's Regulatory Guide 209 by completing a preliminary assessment that details:
    a) The outcomes of the reasonable inquiries into the consumer's financial situation.
    b) The outcomes of the reasonable inquiries about the consumer's requirements and objectives.
    c) The reasonable steps the broker has taken verify the consumer's financial situation.

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[18] While s286 Corps Act requires adequate books and records to be kept and the NCCP Act requires records of assessments the Small Amount Credit Contracts Review acknowledged the obligations aren't very prescriptive http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/SACC%20Final%20Report/Key%20Documents/PDF/SACC-Final-Report.ashx pp 80-83.

OTHER PROBLEMS WITH MORTGAGE BROKERS

Standards for mortgage brokers

Some consumers do not get the service they expect when they visit a mortgage broker. Advertisements for brokers claim that they will find customers the right loan, provide tailored advice or get a great loan for the client. However, their actual obligation to clients is quite low – brokers are only required to provide credit assistance that is 'not unsuitable' for the consumer. We believe this standard must be lifted, especially as mortgage brokers are involved with a growing share of the home lending market. ASIC's research into consumer perceptions of brokers revealed that there's a mismatch between what consumers think they are getting when they see a broker and what they receive.

Consumer perception	Reality
Brokers will arrange a better deal than if a consumer approaches a lender directly: 25% of all consumers and 58% of consumers with experience of or plans to use a broker thought that brokers would offer a better deal than a bank.[19]	Brokers do not get their clients better priced loans.[20]
Brokers look at a wide range of loans to get consumers a better deal The main reasons people said they would use a broker is to access a wider range of home loans (32% overall and 40% with experience or intention to use a broker) and to get a better interest rate or deal (27 overall, 35% with experience or intention to use a broker).	Brokers send 80% of borrowers to four preferred lenders.[21]
A broker puts the customers' needs first 86% of people with experience or intention to use a broker thought that brokers would put customer needs first all (27%) or some of the time (59%).[22]	Legally, a broker is only obliged to arrange a 'not unsuitable' loan. Commissions and other payments means it's highly likely a broker will recommend a loan or investment strategy that does not put customer needs first. Brokers don't have to act in the best interests of the client.
Brokers get paid the same amount regardless of the loan arranged 36% of people with experience or intention to use a broker mistakenly believe that brokers get paid the same regardless of the loan[23]	Most brokers are paid varying commissions for loans arranged in addition to volume-based payments, campaign commissions and soft dollar benefits.

[19] Asic review, para 906.
[20] Finding six: interest rates are not different between distribution channels, Ibid, p. 15.
[21] Ibid, para 86.
[22] Ibid, para 913.
[23] Ibid, para 916

Standards brokers have to meet don't match consumer expectations. They also don't align with the expectations placed on other professionals providing advice on money matters. A comparison of the obligations under the NCCP Act[24] compared to the required behaviour for financial advisers under the Corporations Act shows that brokers are being held to a relatively low standard.

Financial advisers must…	**Mortgage brokers must…**
Be licensed or work for or be an authorised representative of a financial services licensee.	Be licensed or work for or be a credit representative of a credit licensee. [25]
Gather detailed information to understand the financial situation of their client as well as their goals.	Make reasonable inquiries into client's requirements and financial situation, focusing on a client's ability to meet repayments (income and expenditure) and that the loan is not unsuitable for their requirements and objectives.[26]
Act in the client's best interests.	Make a preliminary assessment about whether a loan would be "not unsuitable" (the client can afford to pay the loan without substantial hardship and the loan meets their requirements and objectives) [27]
Disclose how they are paid but there are many restrictions on remuneration models known to cause consumer harm, like commissions.	Disclose how they are paid, although practically this may occur at the end of the loan arrangement process when it is too late to affect the client's decision. [28]
Be members of an external dispute resolution service (such as CIO or FOS).	Be members of an external dispute resolution service (such as CIO or FOS).
Most financial advisers are currently required to have Diploma level qualifications.[29] However, standards are being lifted to require a degree, compliance with a code of ethics, a professional year for new advisers and an industry-wide exam.	Mortgage brokers are only required to have Certificate IV level qualifications.[30]

Some industry associations do place additional requirements on their members but association membership is not compulsory for brokers. The major associations are the Mortgage and Finance Association of Australia (MFAA) and the Finance Brokers Association of Australia (FBAA). The FBAA

[24] Section 8 of the Act defines the process of credit assistance as where a person suggests a consumer apply for, increase or remain in a particular credit contract or assists the consumer with an application or increase. Section 9 defines instances where a person 'acts as an intermediary' between credit providers and consumers. Both terms include the primary roles of a mortgage broker. For clarity, this paper uses the term 'mortgage broker' where the legislation refers to 'credit assistance providers' or 'intermediary'.
[25] S 26 of the NCCP Act and Regulation 22, http://www.comlaw.gov.au/Details/C2014C00411/Html/Text#_Toc393444815
[26] s 117 of the NCCP Act.
[27] s 115, 123, 138 and 146 of the NCCP Act. and ASIC Regulatory Guide 209.91.
[28] s 113, 114, 121, 136, 137 and 144 of the NCCP Act.
[29] ASIC RG146
[30] RG206.8 http://download.asic.gov.au/media/4112044/rg206-published-15-december-2016.pdf

Code includes a requirement for brokers to "Act in the best interest of the Client but in a manner consistent with the Finance Broker's appointment document and this Code".[31] It is unclear how this requirement applies to product recommendations, for example, if it requires brokers to arrange a high quality or the best loan for the client. The MFAA code has no requirement for brokers to act in the best interests of clients. It instead requires that brokers meet the lower standard of acting in good faith and adhering to the reasonable instructions of customers.[32] Both codes rely on complaints to address issues rather than a more comprehensive system of monitoring and enforcement.

Given the trust consumers place in brokers, they should all be held to a higher standard than arranging a "not unsuitable" loan for their customers. They should be required to act in the best interests of their customers. This would require first clearly defining a mortgage broker in the NCCP Act and then articulating new obligations that brokers would need to meet. Alternatively, the proposal the mortgages are reclassified as a financial product so that consumers have protections under the Corporations Act when seeking advice also has some merit and could address these problems; it should be explored further through research and consultation. .[33]

Recommendations:

11. Amend the law so the mortgage brokers have to act in the best interests of their clients. This would require:
    a) Ensuring that mortgage brokers need to meet the existing requirements under the NCCP Act, including the requirement to arrange a not unsuitable loan.
    b) Ensuring that mortgage brokers have to act in the best interests of their clients. This could mirror obligations that financial advisers have under the Corproations Act. Additional requirements should be legislated and ASIC should prepare regulatory guidance on its application.

Brokers may be providing financial advice

CHOICE asked a nationally representative sample of Australians if they had seen a mortgage broker in the last six years. The survey asked those people who had seen a broker about their experience.[34] We note that the sample size of this research is relatively small: 280 people had seen a broker in the last six years, the majority (170) had seen a broker in the last two years. Given this, these findings should be taken as an indication of likely behaviour from brokers but not definitive percentages of the activity.

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[31] https://www.fbaa.com.au/wp-content/uploads/2016/10/Code-of-Conduct-2016-08-11.pdf

[32] https://www.mfaa.com.au/AboutUs/Governance/Documents/MFAA%20Code%20of%20Practice%20160904.pdf

[33] Rice Warner (2017), *Governance of mortgage brokers*, http://www.ricewarner.com/governance-of-mortgage-brokers/

[34] This question was asked as part of CHOICE's Consumer Pulse study. Consumer Pulse is a study conducted by CHOICE among a sample of 1025 respondents aged 18-75 years. The sample is a nationally representative of the Australian population, based on the 2011 ABS Census data. The study was conducted via an online self-complete survey in partnership with The ORU. The ORU is an ISO 20252 / ISO 26362 accredited panel provider and full AMSRO member. Fieldwork was undertaken from 21 to 29 July 2016.

The results are concerning. Many people appear to have been given limited information. About a third of people said a broker did not tell them how they were paid. We are also worried about the nature of the information provided by mortgage brokers to consumers. Some brokers appear to have a financial advice-style relationship with their clients – they were discussing non-property investments (24%), long-term investment strategies (33%) and helping people make financial decisions linked to superannuation (20%) and retirement (30%).

	Yes	**No**	**Don't recall**
The mortgage broker told me how they were paid	48%	35%	17%
The mortgage broker gave me information about how loans work	58%	28%	14%
The mortgage broker explained the risks of different kinds of rate options (e. g. fixed, variable, interest-only)	53%	35%	12%
I trusted that the mortgage broker was acting in my best interests	61%	25%	14%
The mortgage broker gave me advice about finding a property that met my needs	41%	45%	13%
The mortgage broker gave me advice about how much I could afford to borrow	64%	25%	10%
The mortgage broker gave me advice about non-property investments	24%	60%	15%
The mortgage broker helped me create a long-term strategy to buy investment properties	33%	54%	13%
The mortgage broker helped me use my superannuation to buy property	20%	65%	15%
The mortgage broker advised me on how to use investment property to manage my money in retirement	30%	56%	15%

Unless a broker is also a qualified and appropriately licensed financial adviser they should only be providing credit assistance to consumers; they are not able to provide financial advice on other financial products. It is incredibly worrying to see that some consumers are receiving guidance from brokers about non-property investments. It is also worrying, but perhaps less surprising, to find that some mortgage brokers are having conversations with their clients about superannuation, retirement and long-term financial security given the importance of housing to the long-term financial well-being of Australians. At minimum, we need to know much more about the nature of conversations between consumers and mortgage brokers.

Recommendation:

12. That ASIC conducts a shadow shopping exercise covering a wide range of brokers from large firms and small or independent firms to determine the scope of discussions that brokers have with clients as well as the quality of information and recommendations provided.

<u>Classification of consumers borrowing for business purposes</u>

Financial counsellors and community legal centre services hear from vulnerable consumers who have been told to sign a Business Purposes Declaration in order to arrange a loan through a mortgage broker. This is arguably done so the broker avoids regulation under the NCCP Act, which includes responsible lending obligations.

These declarations are sometimes being pushed on vulnerable consumers who would not otherwise be eligible for a loan. We see this in the case studies in Appendix One. For example, the loan that was arranged for the couple with intellectual impairments (case seven) that were cold called by a mortgage broker who then completed documents that falsely claimed that the wife ran her own business. This was only discovered when a financial counsellor investigated loan arrangements after the couple was in financial distress.

We call on ASIC to take action against brokers misusing Business Purpose Declarations and for new public reporting arrangements to identify likely areas of misuse.

Recommendations:

13. ASIC pursues monitoring and enforcement action against brokers misusing Business Purpose Declarations.
14. Governance arrangements include measures to identify misuse of Business Purposes Declarations.

Referral networks and work with property spruikers

Cases from financial counsellors and community legal centres also show use of referral networks, with referrals flowing from third-parties to brokers and from brokers to third-parties. For example, the broker who worked with an accountant to arrange a reference letter for a loan for a consumer with a known gambling problem (case study one). In other cases, consumers are directed to a mortgage broker by a solicitor or another broker who is unable to arrange the loan themselves. There are few obligations on referrers, even though referrers are able to receive sometimes significant financial rewards for linking a consumer with a loan. We encourage ASIC to investigate these arrangements in more detail.

In other examples, two parties seem to work extremely closely. For example, the financial counsellor who provided case two reports that the property salesperson and the mortgage broker appear to work together to target ex-military personnel and arrange high risk investment strategies. Gaps in the law mean that property salespeople can push poor lending strategies which brokers then help implement.

Currently, property investment advice is not considered to be personal financial advice or credit assistance. It is not covered by the Corporations Act or the NCCP Act and consumers don't have any tangible protections against poor behaviour from spruikers beyond the Australian Consumer Law. This issue has been the subject of more than two decades of state, federal and multi-jurisdiction reviews in Australia, most recently summarised in the report from the Scrutiny of Financial Advice Inquiry from the Senate Economics Committee.[35]

Legislative change is needed to treat property investment advice like all other investment advice under the Corporations Act. Property investment advisers should be required to hold a licence, meet basic education and professional standards, belong to an external dispute resolution service, not accept harmful conflicted remuneration and to act in the best interests of their clients when

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[35] Senate Economics Committee (2017), *Scrutiny of Financial Advice, Report 1:* http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Scrutiny_of_Financial_Advice/Report/c08

providing personal financial advice. This will curb property salespeople's ability to work with mortgage brokers to target vulnerable consumers and arrange loans that they cannot afford to pay.

Recommendations:

15. That ASIC investigate referral networks for home loans to determine the impact of these networks on consumer outcomes and if consumers are aware that there's financial payments being made for the recommendation.
16. That the Federal Government, in consultation with the states and territories, brings the regulation of the property investment industry into line with regulations applicable to the financial investment industry by:
    a) making the regulation of property investment advice a Commonwealth responsibility (recognising that services provided by licensed real estate agents would remain under state and territory regulation);
    b) inserting a definition of property investment advice into the Corporations Act and the Australian Securities and Investments Commission Act; and
    c) requiring that anyone providing property investment advice should hold an Australian Financial Services Licence.

APPENDIX ONE: CASE STUDIES

Case one

Demonstrates issues with:

- Compliance with responsible lending obligations
- Referral networks
- Document fraud
- Impact of poor lending on consumers

When the financial counsellor started working with 36-year-old Cindy[36] as part of the Gamblers' Help program in 2014 she disclosed that she had a problem with pokies and has gambled at both TAB and pokies since she was 16 years old. Cindy is a sole parent of three children the youngest diagnosed with autism and the oldest has serious mental health conditions. Cindy has never been employed and completed school in year 11 many years ago. Cindy's husband committed suicide eight years ago and she was left with a house in an affluent suburb in Geelong (valued at $700,000) and $100,000 in the bank. Cindy has been receiving sole parent, family tax A and B and carer pension since.

At Cindy's first financial counselling appointment she stated she had mortgaged the home (small amounts of $10,000 with a prominent building society) up to the value of $70,000 after using the $100,000 inheritance funds. Cindy wanted to increase her mortgage further but the bank refused to lend further monies as she was always late with payments and renegotiating payments. At the same time Cindy had items at pawn brokers, payday loans, was behind in utility bills and the school provided a waiver for school costs for her children (no one knew she was a gambler except our service, her mother and a close girlfriend).

Cindy tried two of the big four banks for a mortgage but was unsuccessful. She then went through a local mortgage broker. The financial counsellor advised against this, stating upon assessment it wasn't in her interest and she shouldn't be given a mortgage due to her current financial situation. Cindy was adamant that this time if she could just catch up on her bills she would stop gambling and would be ok financially.

Cindy continued to pursue a local mortgage broker who 'supported her' through the loan application process. He informed her to stop gambling at venues and using her ATM card at venues (he suggested she take cash out and gamble if she had to, to 'keep her bank statements clean for three months'). The mortgage broker also had a working relationship with an accountant who wrote a support letter for Cindy stating she is a good person and has good intentions of payments. Cindy told the financial counsellor that she had never met the accountant before and was aware that a bottle of scotch was exchanged for this letter.

Cindy was provided with the loan via the mortgage broker in June 2015 for $100 000 and in February 2016 she presented to financial counselling requesting financial hardship as she had missed payments. Cindy continues to see a financial counsellor within the Gamblers Help program. She still receives only Centrelink income and is financially struggling. Cindy obtained a further financial hardship arrangement in February 2017 through the mortgage provider, which has recently ended.

[36] All names and identifying details have been changed.

Case study two

Demonstrates issues with:

- o Compliance with responsible lending obligations
- o Referral networks
- o Document fraud
- o Impact of poor lending on consumers

Bradley is ex-military and is on a pension since being invalided out of the Army in 2004. His wife is his carer and on a Carer's Pension. He and his wife had a mortgage on their residential dwelling. They were approached by a property salesperson who put them in touch with a mortgage broker from a large firm.

Bradley has severe PTSD and has not worked since leaving the military. He spent six months in a mental hospital when initially diagnosed. This was well known to the broker and property salesperson (who even visited Bradley in hospital). In 2010, the broker and salesperson persuaded Bradley and his wife to refinance their existing mortgage, obtain finance to purchase two investment properties and then take out a $75,000 line of credit. This was used in part to pay the property salesperson a large commission. Bradley's financial counsellor subsequently found that the property salesperson was paid a separate commission from the refinancing deal that was not disclosed.

Bradley and his wife went from owing around $150,000 to around $700,000. Bradley's PTSD means that he 'zones-out' when things become complicated. As a result, he relied totally on the advice of the broker. To justify these loans the broker falsified the loan documentation in several ways:

- He claimed that Bradley had $175,000 in superannuation. He had less than $25,000 and had made withdrawals on the grounds of financial hardship.
- He claimed that Bradley and his wife were moving to live with their daughter and would rent out their existing house to increase their income. The lender's procedures required that the broker submit evidence of this additional income but this never occurred.
- The broker used overly generous estimates of rental income. This became an even greater problem as one of the properties they were convinced to buy by the salesman was in a mining town where prices and rental incomes plummeted due to the end of the mining boom. The other property also appeared to be overvalued and rental income fell below expectations.

The application and assessment indicated that the lender made no real attempt to follow-up on the claims in the application, accepting figures provided by the broker at face value. Though one client was on a Military Pension and the other was on a Carer's Pension there was no apparent attempt by the lender to ascertain whether this affected their capacity to make what amounted to a significant financial decision. When the financial counsellor submitted a complaint to the lender, he was informed that the lender was entitled to rely on the information supplied by the broker and did nothing wrong.

Bradley and his wife were in severe financial hardship for almost the whole period they had the loans. Halfway through the financial counsellor's involvement in the case the loans changed from interest only to principal and interest and Bradley and his wife were unable to meet the repayments. They had investigated selling the properties but it was clear they could only be sold at a significant loss.

The issue only advanced when the lender's hardship team was approached. After this, the lender offered to take over the two existing properties and sell these (freeing the clients from the stress

involved in the sales process – a significant issue given Bradley has PTSD), waive the remaining debt related to the properties and waive the line of credit. They also offered another mortgage for the residential property. The amount that was written off was significant. But a greater impact was that the write-off allowed the clients to revert to a residential mortgage that they could afford from their military pension, which was crucial as neither client would ever work again.

The greatest impact of the poor lending was on the personal situation of the clients. They admitted that their relationship was strained as a result of their financial position and that there had been instances of verbal abuse that had come close to physical abuse on several occasions. The financial pressures that the loans had created had also caused them to become estranged from some of the children.

Case three

Demonstrates issues with:

- Referral networks
- Misuse of Business Purpose Declaration

In 2016 Barry lost his job and could not afford to continue making his mortgage repayments. He was unable to get a personal loan through a bank. A friend referred him to a solicitor, who referred him to a mortgage broker who was offering low doc loans.

Barry told a community legal centre service that he met with the broker to obtain a personal loan to help him pay off his arrears on his mortgage while he found another job. The broker said that he could arrange a $20,000 loan for Barry but that it would need to be secured by a mortgage over his home and he would need to sign a business purpose declaration. Barry informed the broker that he wanted to enter into a personal loan not a second mortgage, and the broker told him to either take it or leave it. Desperate to save his home, Barry signed the mortgage documents. The interest rate on the loan was 15% including fees and other charges of approximately $5,500.

The mortgage did not meet Barry's needs and Barry decided not to go ahead with the mortgage. Barry received a bill of costs from the lender in relation to the preparation of the mortgage documents. Barry could not afford to pay the lenders costs, so the lender lodged a caveat over Barry's home. Barry was then pursued for costs totalling $1,300.

Case four

Demonstrates issues with:

- Compliance with responsible lending obligations
- Referral networks
- Document fraud
- Impact on poor lending on consumers

Jacob had a mortgage with his wife and had refinanced it a few times to pay a number of his debts. Jacob runs his own business and engaged the services of an accountancy firm to complete his tax returns. Jacob received demands from the Australian Tax Office of accrued taxation and fines where they were threatening to garnish his wages and commence recovery action. His tax accountant negotiated a lump sum reduction of the debt but Jacob could not afford to make the payment within the required time frame. His accountant indicated that "he knew a broker who could help" get him a loan to refinance his mortgage.

Jacob met with the mortgage broker and recalls being told by the broker that he was going to "put the best picture forward" in order to obtain a loan. The application form was completed by the

mortgage broker. Jacob's gross income was listed was $120,000 as he believed that he did earn that amount as gross income and that he would earn that much in the following 12 months. Jacob's accountant wrote a letter in support of the application where they confirmed that his stated gross income of $120,000 was accurate. Jacob expected to have a contract for service for the following 12 months and expected that he would have a gross income of $120,000 per annum. Jacob's taxable income for the financial year immediately prior to taking out this loan was approximately $28,000. The mortgage broker assessed that a refinance was suitable based on the accountant's letter of support and Jacob's explanation as to his debt issues. There was no evidence that any proper enquiries or verification was made as to Jacob's real financial situation as required by the NCCP.

The mortgage was refinanced into Jacob's name only with a further amount of $50,000 borrowed on top of the existing balance of the mortgage. Jacob lived with his wife (who was a stay at home mum) and their four dependent children. At the time of the application, Jacob advised the mortgage broker that he had four dependent children, a wife who does not work, council rates owing where they had applied for judgment against him and a default on his credit file for a phone bill. Jacob struggled to make the payments because the work contract he had expected did not eventuate with the same level of income he had before. Jacob missed the payments under the loan a number of times and repossession action was commenced against him with judgment obtained; he eventually had to sell his family home.

Case study five

Demonstrates issues with:

- Referral networks
- Document fraud
- Misuse of Business Purpose Declaration

Nina was seeking a consolidation loan as she was having difficulty managing her financial situation. Nina had lost her job and started receiving Centrelink benefits. This put her in further financial stress. One of her big concerns was a mortgage she had on a property that she had inherited.

Nina approached a mortgage broker to discuss her situation and that she was requiring a consolidation loan to pay her personal debts while she was trying to obtain a full time job. She was advised by them that they could not assist her but they could get her in contact with someone who could and arranged a meeting with a smaller mortgage broking business that specialises in small business loans.

Nina was advised by the broker at the small firm that he could organise a loan but the only way he could do that was to give her a business loan. Nina told the broker that she was not running a business and never had. He assured her that he could sort everything out and that the loan would be secured on her house but it was a way to protect her house. The broker knew that the consolidation loan Nina was seeking was to pay for personal debts. Nina was made to sign a Business Purpose Declaration for a loan of $40,000 with a brokerage fee of $25,000 which would be financed by the loan.

Nina did not end up landing the full-time job she was hoping for and could not pay back the loan. The lender commenced proceedings against Nina to take possession of the security property. Proceedings were later changed to recovery of a debt. This matter is currently listed for hearing in the Supreme Court where the issues of a false Business Purpose Declaration and breaches of the responsible lending provisions of the NCCP will be heard.

Case study six

Demonstrates issues with:

- Referral networks
- Document fraud
- Misuse of Business Purpose Declaration
- Impact on poor lending on consumers

Carol is a 66-year-old pensioner who signed up for business loan to support son-in-law's business. Carol saw a financial counselling service, citing being unable to afford her mortgage. She was taking care of three generations of her family as her daughter and son-in-law had a failed business and needed to move back home..

It soon became clear that the mortgage against the house was not an ordinary mortgage, but a business loan that had been obtained through a law firm via a broker who was known to the son-in-law. The son-in-law's business was poorly planned and failed very quickly, leaving the grandmother with the debt.

Initially, the financial counsellor suspected the son-in-law had coerced or taken advantage of the Carol by using her property to secure the loan. However, on interview with the grandmother and the son-in-law, it became clear that they both didn't fully understand the loan arrangement or its implications.

A family friend suggested that the son-in-law open a business and that he could use his grandmother's house as security. This person was a broker worker for a small broking firm. The broker then had extended contact with the son-in-law until he'd effectively 'talked him into' the loan, and the loan documents were presented to the son-in-law and the grandmother in their own home to sign.

At the time, Carol was advised this was a business loan, and that she should sign a 'business use' agreement. She also signed some documents which she was advised would 'open her business'. She didn't really understand the broker, but the broker said, "Don't worry, this is just how it's done these days, otherwise it won't be approved." Carol wanted her son-in-law to get the money he needed, so signed the paper without any real knowledge of what she was doing.

The broker made $15,000 in commission from this loan. There were also a number of other complications with the loan: a portion of it was 'invested', but then 'lost' ($60,000), but no evidence or explanation of this was ever provided.

The financial counsellor sought legal advice prior to complaining to EDR. Because Carol had signed the papers and been advised what they were, even though she didn't understand them, the legal advice was 'this is technically fraud', and although the lawyer advised 'no jury is going to convict a sweet-looking 66 year old grandmother of fraud', when the financial counsellor advised Carol of the risk of legal action, she opted to not pursue the law firm or the broker.

Unfortunately, Carol opted to sell her house to pay out the debt. Her house had been owned outright prior to the involvement of the broker. To the financial counsellor's knowledge, the broker has never been pursued or investigated over this incident.

Case study seven

Demonstrates issues with:

- o Cold calling
- o Referral networks
- o Document fraud
- o Misuse of Business Purpose Declaration
- o Impact on poor lending on consumers

An intellectually impaired couple in their 40s presented to financial counselling citing that they were having a dispute with their lender over some hardship. The husband, Frank*, had an acquired brain injury, and the wife was significantly intellectually impaired since birth. Frank had more function than his wife, Meg, but both presented as visibly disabled and with affected speech.

The first time the financial counsellor spoke to the lender, the hardship clerk asked in an offhand way, “Oh, by the way, what business does Meg run? It’s not noted.” The financial counsellor responded that the Meg had never owned a business and had been on the Disability Support Payment for more than 20 years. Frank and Meg were confused about why the lender would think they ran a business, so the financial counsellor ordered a copy of the documents. The documents clearly stated that Meg operated a business, and Frank’s name was not on the documents at all (which was a surprise to both of them).

Frank can’t remember (both have significant memory problems), but he thinks he was cold-contacted by a broker about extending the mortgage. At the time, the couple had a $80,000 mortgage on their house through a major bank. Frank and Meg were interested in perhaps a further $25,000- $30,000 because the wife wanted a baby and they needed IVF. The broker convinced them to take out a further $160,000, and gave them some good reasons they should—to repair the property, purchase cars for everyone and have some money ‘in the kitty’.

At no point were Frank and Meg advised what was on the mortgage documents, just that they needed to sign them. Meg advised she even gave the broker her pension card, so she was very sure he wouldn’t have thought she was running a business. However, the broker filled out the mortgage documents saying Meg was running a business and fabricating her income. The financial counsellor believes the broker didn’t put the Frank’s name on the documents as he had a credit default.

To prevent legal action as the Frank and Meg were significantly in arrears and the lender was uncooperative, the financial counsellor lodged a complaint with both EDR schemes: ‘COSL’ for the broker, and FOS for the lender. The EDR schemes then argued for 11 months about who should investigate it, before FOS eventually agreed to.

FOS, in their investigation against the lender, found that the couple was significantly intellectually impaired and were in a position of ‘special disadvantage’, determined that the lender should waive approximately $100,000 of interest and fees, reduce the loan to $180,000, and that should be paid off at a low, fixed interest rate for 30 years. To the financial counsellor’s knowledge, the broker disappeared and no action was taken against him.