



SUBMISSION TO ASIC

CP 327 Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty

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

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INTRODUCTION

It's time to make mortgage brokers act in the best interests of their customers. As the Banking Royal Commission revealed, simply telling a financial services institution or intermediary to prioritise the best interests of a consumer has often failed.¹ What's more, harmful conflicts of interest such as upfront and trail commissions, that skew the quality of advice, remain in the industry. The continued existence of commissions means there will be an ever-present temptation for brokers to prioritise their own interests and break the law. In order for these laws to be effective, ASIC must provide clear guidance and be a tough and emboldened regulator that prosecutes breaches of this new law.

We welcome ASIC releasing strong and clear guidance on this landmark law reform. The mortgage broking industry is now on notice. Mortgage brokers will no longer be able to recommend poor quality loans that line their pockets with commissions. Instead, brokers will be legally required to recommend loans that are in the borrower's best interests.

We strongly support ASIC's draft guidance on the best interests duty. In particular, we welcome ASIC clearly stating this duty is a principles-based obligation, free from prescriptive safe harbour provisions or carve-outs. Our submission recommends a number of areas where the guidance can be strengthened to ensure that brokers are acting in the best interests of borrowers. In particular, we recommend ASIC:

- mandate that when a broker recommends a bundled home loan package with other credit products, all individual credit products must satisfy the best interests duty;
- clarify that a broker must always present a person with the lowest cost option on the market; and
- provide an illustrative example of when a broker satisfies the responsible lending obligations but fails to adhere to the best interests duty.

The conflict priority rule will also be an essential safeguard to ensure that brokers recommend high-quality home loans. The broking industry has a poor track record of managing conflicts of interest. This obligation will mean brokers have to prioritise the interests of borrowers ahead of their own interests or face large civil penalties.

The guidance on the conflict priority rule can be strengthened by expanding on three key conflicts of interest endemic to the broking industry. They are:

- the incentive of clawback arrangements to prevent switching;

¹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019 Final Report, p.3

- the conflict inherent in upfront and trail commission that distort the quality of loan advice;
and
- the conflicts that arise through lender-owned aggregators in the industry.

RECOMMENDATIONS

ASIC should amend the draft regulatory guidance to state that:

1. Brokers can only make representations about acting in the best interests of consumers when providing credit assistance. Representations made by a broker to act in a consumer's best interests when the duty does not actually apply should be prohibited as misleading and deceptive obligations.
2. In order to discharge their best interests duty obligations, a broker must always be required to present a consumer with the lowest cost option, along with others where appropriate, even where this option does not meet the consumer's stated requirements or preferences.
3. A failure to meaningfully inform consumers about the range of loan options available to them would be viewed as a breach of the best interests duty.
4. In the unlikely event that a broker assesses that only one option meets the best interests obligation, they should nevertheless be required to present additional options and explain why these options are not in the consumer's best interest.
5. In order to satisfy the best interests duty, brokers must access a broad range of lenders on their panel, who offer both competitive prices and product features. If there are a limited number of lenders on the broker's panel, meaning these requirements are not satisfied, licensees must increase the number of lenders on the panel. This must occur within 3 months of identifying the issue. Any delay would be a breach of the duty.
6. A high volume of loans to a limited range of lenders might suggest a breach of the best interests duty.
7. A package of credit products will not be compliant with the best interests duty if a single credit component, for example, a credit card or personal loan, fails the best interests duty.
8. Brokers must provide consumers with fair and appropriate insurance products. This guidance should extend to add-on insurance and lender's mortgage insurance.
9. Brokers should be knowledgeable about reverse mortgages and their implications for Centrelink payments.

10. ASIC must provide clear guidance on the intersection between the conflict priority rule and the following conflicts of interests in the mortgage broking industry:
 - clawback requirements;
 - the payment of commissions; and
 - ownership structures.
11. A failure to keep adequate records should be treated as evidence that a broker or licensee is not acting in the best interests of clients.
12. Brokers must provide clients with a written copy of relevant records as evidence that the broker acted in the best interests of the consumer.
13. A principles-based approach to record keeping obligations be maintained, with the recommendation that records should be kept for a minimum of ten years.
14. Brokers must maintain records of a point-in-time assessment of other loans on the market at the time a loan was arranged.
15. If ASIC investigates alleged misconduct by a broker, they must also investigate whether the licensee was complicit in the behaviour.

Proposed guidance on the best interests duty

- **B1Q1: Do you agree with our approach to structuring our guidance around the mortgage broking process?**

We support ASIC's approach to structuring guidance around the mortgage broking process. We agree with ASIC's guidance that brokers have to meet three best interests obligations when:

- (a) gathering information about the consumer;
- (b) making an individual assessment of what is in the consumer's best interests; and
- (c) presenting information and recommendations.²

In particular, we support ASIC's guidance that the best interests duty is a principles based obligation with no "safe harbour".³ We welcome this unequivocal and clear guidance from ASIC.

- **B1Q2: Are there any steps or processes not covered in the draft guidance which are of particular relevance to the best interests duty?**

ASIC should provide guidance around the additional step of any future communications or marketing that brokers have with clients after the loan is arranged. Consumers expect that brokers are acting in their best interests in all interactions. This expectation cannot be switched on and off. A brief online review of advertising found that brokers regularly advertise that they will be acting in a borrower's best interest over the life of the loan. For example:

"With an outstanding Customer For Life program, I partner with you for the life of your loan, and with any future lending requirements you may have. I want to become YOUR Broker, contact me today for a free appointment!"⁴

"At Mint Money, our customers mean the world to us and part of our service is ongoing and dedicated support through the life of your loan. We'll help you put the pieces together with our trusted and experienced loan advice and we deal with lenders on your behalf."⁵

It is no surprise with this advertising, borrowers expect brokers are acting in their best interests during every interaction or engagement. Consumers are regularly contacted by brokers as part of advertised 'health checks' or 'annual reviews'. They expect that brokers are acting in their best interests when these check-ins occur. However the best interests duty only applies only in

² ASIC 2020, CONSULTATION PAPER 327 / REGULATORY GUIDE 000: Mortgage brokers: Best interests duty, p.10

³ RG 000.27-28

⁴ Aussie Home Loans, 2020, "Julie Levy", accessed 19 March 2020, <https://www.aussie.com.au/find-broker/julie-chengo.html>

⁵ Mint Money, "Ongoing support", accessed 19 March 2020 <https://www.mintmoney.com.au/solutions/ongoing-support/>

relation to credit assistance.⁶ A serious loophole will be created if the broker engages with a customer but does not provide credit assistance. Any representations made by brokers about acting in the best interests of the consumers when they are not providing credit assistance should be subject to misleading and deceptive conduct provisions of the ASIC Act.⁷

Recommendation 1

ASIC should amend the guidance to state that brokers can only make representations about acting in the best interests of consumers when providing credit assistance. Representations made by a broker to act in a consumer's best interests when the duty does not actually apply should be prohibited as misleading and deceptive obligations

⁶ Financial Sector Reform (Hayne Royal Commission Response— Protecting Consumers (2019 Measures)) Bill 2020, s158LA and s158LE

⁷ *Australian Securities and Investment Commission Act 2001*, s12DA

Gathering information about the consumer

- **B3Q1: If you are a mortgage broker, what information do you typically gather from a consumer before considering products? What steps do you take to verify this information?**

Brokers should understand their client's financial situation. This must involve more than listening to what a client says but asking questions to understand their financial position and goal and gathering evidence. At minimum, in line with expectations under ASIC RG 209, brokers should gather information about:

- income sources and level, including;
 - amount (including whether that amount is fixed or variable);
 - frequency of payment;
 - security (permanent, contract, casual employment).
 - actual expenditure, including;
 - individual and total amounts for key expenditures;
 - frequency of payments
 - existing debts and liabilities, including:
 - total amount of debt outstanding;
 - frequency of repayments;
 - liabilities taken directly from income such as Centrelink.
 - any savings or assets;
 - potential changes to income and expenditure in the future;
 - dependents;
 - short-term financial goals (what kind of property they'd like to purchase and budget)
 - long-term financial goals (whether the property is a long-term investment and will have rental income); and
 - financial habits.
- **B3Q2: When should mortgage brokers make further inquiries into a consumer's circumstances to act in their best interests?**

In line with RG209.25 mortgage brokers should be making further inquiries where there are red flags. These can include:

- where there is a deficit or a small surplus between the money the consumer is likely to have remaining after their ongoing expenses have been deducted from their after-tax income and the proposed additional repayment;
- the consumer has not demonstrated savings history;

- the consumer already has frequently overdraws or has payments dishonoured on their account;
- the consumer's net debt position is deteriorating over time with no corresponding increase in assets (consumer has refinanced/consolidated debt at least once previously and now has additional unsecured debt);
- the majority source of the consumer's income is from social security;
- the consumer's income is inconsistent and/or unreliable;
- there consumer's expenses are likely to be significantly higher than average (e.g. because they live in a remote area);
- there are significant existing debt repayment obligations e.g. child support;
- the consumer is likely to have to sell their assets, such as a car, to meet their payment obligations;
- signs of financial vulnerability or addiction.

The above do not exclude consumers from qualifying for a loan but should mean that extra care is taken to ensure the loan is suitable.

However, the inquiries set out in RG209 should be considered a bare minimum. In order to meet the best interests duty, we would expect brokers to be asking additional questions to ensure that the products recommended are the best options for their customers. Guidance should aim to be as consistent as possible with RG175 and RG244 in relation to the best interests duty for personal financial advice. For example, asking the consumer to set prioritised, specific and measurable goals and objectives, and the subject matter of the advice they are seeking and the product features the customer values.

Assessing what is in the consumer's best interests

- **B4Q1: Do you agree that mortgage brokers should consider products holistically in assessing whether they are in the consumer's best interests?**

We strongly agree that brokers should consider products holistically when assessing whether they are in the consumer's best interests. Each borrower has individual requirements and objectives as to why they are purchasing a mortgage. Mortgage brokers must not adopt a cookie-cutter approach to recommending loans. Brokers must approach each applicant with a unique individual assessment and a tailored approach to their borrowing needs.

We also recommend consistency as far as possible with RG175 and RG244. In particular, ASIC should make it clear that customers should be in a better position if the customer follows the advice, which should include advice not to take out a loan if that is in the customer's best interests. Simply owning a house at the end of the process doesn't necessarily mean the customer is in a better position due to following the advice, especially if they have an expensive or inappropriate mortgage product.

- **B5Q2: Do you agree with our expectations about how cost and non-cost factors should be considered by brokers when making a product assessment?**

We strongly agree with ASIC's guidance on their expectations for cost and non-cost factors when making a product assessment.⁸ A typical borrower's priority is to find the cheapest priced mortgage on the market. This is supported by ASIC's REP628, which found consumers expect brokers to find them the cheapest rate or the lowest interest rate.⁹ However we acknowledge there will be limited circumstances where people have other non-cost factors they want prioritised. This may include a quicker time to settle loans or a unique loan structure that caters for personal circumstances.

However, we suggest additional guidance in relation to 'time-sensitive' transactions. For people experiencing financial difficulty, they might be refinancing in circumstances that could be described as 'time sensitive'. However, these customers should still be offered good value products – the time sensitive nature of the transaction should not mean that brokers are permitted to only suggest expensive and potential exploitative loans.

We support ASIC's guidance that a failure to investigate the lowest cost options available may be suggestive of non-compliance.¹⁰ Even if a consumer prioritises a non-cost factor, a broker

⁸ RG 000.49 - RG 000.45

⁹ ASIC 2019, REP628: Looking for a mortgage. Consumer experiences and expectations in getting a home loan

¹⁰ RG 000.52

must be required to present the lowest-cost mortgage option on the market to consumers. This will be valuable in showing the trade-off between prioritising a non-cost option over the cheapest option. It will also mitigate the risk of a broker recommending a loan that isn't the lowest cost to benefit the broker financially. Brokers should present this comparison using the total cost over the life of the loan as a dollar figure where possible, as required in Key Fact Sheets for mortgage products.

An additional factor that needs to be taken into account when assessing a consumer's best interest and undertaking a product assessment is whether the consumer fits into the target market of a product as identified under the design and distribution obligations. There must be an assumption that if a consumer does not fit into the target market of a product, then it is not in their best interests to obtain that product, unless exceptional circumstances can be demonstrated (arising out of a thorough consideration of non-cost factors). A consumer just wanting to have a certain product, such as frequent flyer points or brand loyalty, cannot be a factor that overrides any determination of best interests.

Importantly, in these circumstances there must be an obligation on the mortgage broker to explain to a consumer that they do not meet the target market for a product and why it may not be in their best interests to choose the product against their advice. These conversations must be recorded or minuted for mortgage brokers to be able to fulfil their duty.

Recommendation 2

In order to discharge their best interests duty obligations, a broker must always be required to present a consumer with the lowest cost option, along with others where appropriate, even where this option does not meet the consumer's stated requirements or preferences.

Presenting information and recommendations

- **B6Q3: Do you agree that mortgage brokers should educate consumers and help them to understand potential implications of different choices (e.g. the nature of credit products and their features)?**

We agree with the draft guidance that mortgage brokers should be required to ensure that consumers meaningfully understand the range of loan options and the implications of each choice.¹¹ People go to mortgage brokers for expert and trusted advice to navigate the sometimes confusing process of arranging a home loan. Brokers must not inform consumers about different loans in a tokenistic way. ASIC's REP628 found that consumers who took out a home loan through a broker compared with going direct to a lender were more likely to:

- be a first home buyer;
- have less knowledge about the loan they would like; and
- have done less research.¹²

Brokers must make a conscientious effort to ensure that people understand the loan options. They must pay particular attention to customers from different linguistic and cultural backgrounds, or customers who are experiencing vulnerability or disadvantage. A failure to meaningfully inform consumers about the range of loan options should be a breach of the best interests duty.

In line with the incoming design and distribution obligations, mortgage brokers must inform the consumer of a product's target market, particularly where they do not fall within the scope.

- **B6Q4: If you are a mortgage broker, in what circumstances would you only provide one product option/recommendation? Do you agree with our view that consumers should generally be presented with more than one option?**

Mortgage brokers must be required to present a range of options to borrowers. However, ASIC research has found that brokers routinely recommend only one option, with a third of all brokers presenting a single loan option to their customers¹³.

Given the vast array of lenders and loans on the market, we remain deeply concerned if a broker determines that only one loan option is suitable to a consumer. We recommend that ASIC include in the regulatory guidance that in the unlikely event that a broker assesses that only one option meets the best interests obligation, brokers should be required to present

¹¹ RG 000.92

¹² ASIC 2019, REP628: Looking for a mortgage. Consumer experiences and expectations in getting a home loan, p.8

¹³ ASIC 2019, REP628: Looking for a mortgage. Consumer experiences and expectations in getting a home loan, p.50

additional options and explain why they do not satisfy the best interests duty. However, if there is only one loan on the market that the broker deems satisfies the best interests duty, we would hold deep concerns about the lending suitability of the borrower.

- **B6Q65: How can a mortgage broker act in the consumer's best interests when assisting them to apply for one credit product when the broker recommended another?**

There will be rare circumstances where a consumer has a preference for a mortgage that the broker does not recommend. In this situation, brokers must clearly convey to the consumer there are better options on the market and outline reasons why other options may be preferred. In order to discharge their best interests duty obligations, a broker must clearly document these conversations and maintain records of other options they presented to the customer. Consistent with responsible lending obligations, brokers cannot assist a consumers to apply for an unsuitable loan (as opposed to a loan that is not unsuitable according to the NCCP but not the best loan according to the broker's assessment of the consumer's circumstances)

Recommendations 3 and 4

A failure to meaningfully inform consumers about the range of loan options should be viewed as a breach of the best interests duty.

In the unlikely event that a broker assesses that only one option meets the best interests obligation, they should nevertheless be required to present additional options and explain why these options are not in the consumer's best interest.

Guidance on specific issues relating to the best interests duty

- **B7Q1: Do you require further guidance on the distinction between your obligations under the new best interests duty and the existing responsible lending obligations?**

We strongly support ASIC's assessment that:

“there are situations where you may satisfy the responsible lending obligations but fall short of complying with the best interests duty. Where a credit product is deemed ‘not unsuitable’ for the consumer, it is possible that suggesting that the consumer take out that product may not be in the consumer’s best interests.”¹⁴

The best interests duty and responsible lending obligations, although related, are distinct tests. It would be helpful therefore for ASIC to provide further guidance about the distinction.

A simple example would be in comparing two loans, both of which a borrower could afford and that met their requirements and objectives. Both loans are therefore “not unsuitable” under the responsible lending laws. However one loan may have more desirable features for the borrower that means it is in the best interests of the borrower, such as the interest rate.

- **B8Q1 : Should mortgage brokers be required to consider products provided by parties outside their panel of credit providers?**

We agree with the draft guidance that mortgage brokers must be required to consider products provided by lenders outside their panel of credit providers.¹⁵

Brokers must regularly scan the market to ensure that loans included on their panel are competitive both in terms of price and product features. Individuals have unique needs which may extend beyond the limited range of loans on a broker's panel. ASIC's research found that consumers expect that brokers are experts who scan the market and will find them the “best loan”.¹⁶ A failure to regularly scan the market and ensure that their loans on their panel are competitive when offered to the borrower should be a breach of the best interests duty.

In order to discharge their obligations to act in the best interests of their client, some licensees will be required to increase the number of lenders on their panel. The Productivity Commission

¹⁴ RG 000.98

¹⁵ RG 000.102

¹⁶ ASIC 2019, REP628: Looking for a mortgage. Consumer experiences and expectations in getting a home loan, p.6

found that one aggregator, Citiwide, only had 9 lenders on their panel.¹⁷ This is too limited a number of lenders for the licensee to satisfy the best interests duty. Many licensees and aggregators must either expand the number of lenders on their panel or not offer credit assistance. Some licensees must be required to loosen restrictions that prevent brokers selecting banks and products that are off-panel.

We recommend that the regulatory guidance be amended to explicitly state that:

In order to satisfy the best interests duty, there must be a broad range of lenders on the broker's panel that offer both competitive prices and product features. If there are a limited number of lenders on the panel, meaning these requirements are not satisfied, licensees must increase the number of lenders on the panel. This must occur within 3 months of identifying the issue. Any delay should be as a breach of the best interests duty.

Importantly, it is not simply about the number of lenders on the panel. ASIC research found that despite claims of scanning the market, brokers send 80% of loans to only four lenders.¹⁸ It is concerning that brokers are not selecting loans from a wide range of lenders. The industry's claims of scanning the market and selecting from a wide range of loans becomes disingenuous and misleading. We recommend that ASIC amend the guidance to say that ongoing review of loan flow is expected, and high patterns of loan flows to a limited range of lenders may be suggestive of a breach of the best interests duty.

- **B10Q1: If you are a mortgage broker, on what basis do you typically recommend a package to a consumer?**

We have serious concerns about the packaging of credit and financial products with a home loan.

People go to a mortgage broker for advice in purchasing a mortgage. They do not expect to acquire a new credit card or personal loan in the process. Despite this, brokers regularly sell people into bundled packages and trap people into further cycles of harmful debt. People need time and sufficient information to assess their need for an additional credit product. They must make their own decision free from the emotional intensity of purchasing a mortgage.

We are particularly concerned about the bundling of credit cards and home loans. Credit cards are high-interest, high-fee and risky financial products. ASIC has found that almost a million Australians have been trapped by banks in a cycle of persistent debt, unable to pay down their debt.¹⁹ This is no surprise. Credit cards are complex products. The interaction of balance transfer deals, annual fees, different interest rates for purchases and cash advances, interest-free periods and minimum repayment amounts means that it requires a high degree of

¹⁷ Productivity Commission, 2018, Competition in the Australian Financial System, p.305

¹⁸ ASIC 2015, REP 516: Review of mortgage broker remuneration, p.16

¹⁹ ASIC 2018, REP 580, Credit card lending in Australia

financial literacy to understand how to use a credit card. Credit cards are often offered in a bundle with home loans with a 'discounted' rate, but this often masks the true cost of the products and doesn't consider whether the products individually are suitable for the borrower.

In order to discharge their best interests duty obligations, a broker must ensure that each individual credit product of the bundled package satisfies the best interests duty. We strongly recommend that ASIC amend the guidance to state that a package will not be compliant with the best interests duty if a single credit component, such as a credit card or personal loan, fails the best interests duty. Where a credit card or personal loan is considered an appropriate product (possibly because it is replacing a higher interest facility), then brokers should actively assist the borrower to close down any facility the new product may be replacing.

We acknowledge that the best interests duty only applies to the sale of credit products by mortgage brokers. However, brokers regularly sell insurance products as part of a home loan package. Brokers are subject to separate obligations relating to the sale of insurance under the *Corporations Act* (2001) and the *Insurance Contracts Act* (1984). It would be helpful for ASIC to provide guidance and an example on how this new regime interacts with brokers existing obligations.

ASIC must play a proactive role in ensuring that brokers are providing consumers with fair and appropriate insurance products. We are concerned about the sale of add-on insurance products by brokers such as mortgage protection insurance. Insurance is a complex and sometimes worthless product. It cannot be safely sold when added on the tail end of purchasing a mortgage. ASIC must provide guidance that brokers should provide people with insurance products that are appropriately targeted to their needs and clearly articulate the conditions of the contract. If a broker believes they are unable to undertake this process, then they should consider not selling insurance products to people.

Lender's mortgage insurance (LMI) is a clear example of the failure of the industry to explain complex insurance products. Consumers regularly have to pay for lender's mortgage insurance (LMI) when arranging a home loan. LMI masquerades as a consumer-facing product, yet it exists to benefit the banks while providing no real protection to consumers.

ASIC must provide guidance stating that brokers ensure that people clearly understand the product characteristics of lender's mortgage insurance. A 2014 survey of 26,000 borrowers found that a majority of respondents thought that LMI either protected them or were unsure who it protected.²⁰ The confusion is even worse for first-time borrowers. The survey found that over 50% of first-time borrowers incorrectly believed that in the event of a default, LMI protected them, rather than the bank. If there is a downturn in the economy, with a resultant drop in house prices or an increase in interest rates, there will be a number of borrowers, particularly first-time

²⁰ Martin North, 2014, 'DFA Household Survey 2013', <http://digitalfinanceanalytics.com/blog/is-lenders-mortgage-insurance-a-good-thing/>

borrowers, who are likely to find themselves in serious trouble and without the protection they assume that LMI provides them.

Consumers must be clearly informed:

- that the lender will claim on this insurance if the borrower cannot pay and then the insurer will pursue the borrower for the debt;
- of the full cost of getting LMI (including any interest paid on the premium over the life of the loan);
- any alternative to getting LMI (saving up a larger deposit, another lender); and
- any rights to a partial refund on refinancing.

We believe that Example 4 in the draft regulatory guidance would benefit from also including guidance on how brokers should approach LMI.

- **B9Q1: Do you agree that the best interests duty should apply at the time of the assessment?**

We strongly support the best interests duty applying at the time of assessment and whenever a mortgage broker provides credit assistance. This is the critical period of time when brokers determine whether an individual is suitable for a mortgage.

- **B9Q2: Do you agree that when making subsequent assessments brokers cannot necessarily rely on the initial assessment?**

We strongly support ASIC's view that brokers must not rely on an initial assessment, when conducting subsequent assessments. The financial circumstances of people can change considerably over a brief period of time. Further, as we have seen with both the Global Financial Crisis and the ongoing COVID-19 crisis, financial markets can change considerably overnight. Consumers expect there is an additional assessment that the broker is taking into consideration their objectives and priorities at that current point in time.

- **B9Q3: Do you agree that changes which occurred after the recommendation, which were reasonably foreseeable when the recommendation was made, should be relevant in considering whether the best interests duty has been complied with?**

We strongly agree with ASIC's view that reasonably foreseeable changes should be factored into mortgage broker recommendations. A mortgage broker must make a concerted effort to inquire into the future financial circumstances and commitments of a borrower. This aligns with ASIC's guidance on responsible lending obligations which includes an obligation on credit providers to have regard for future changes in financial circumstances.²¹ A failure to undertake

²¹ ASIC 2019, RG 209: Credit licensing: Responsible lending conduct, 209.179

this consideration must be considered a breach of the best interests duty. Brokers should also be upfront with customers during pre-approval processes that lenders are able to withdraw pre-approval on a range of grounds, including changes in financial circumstances.

- **B11Q1: If you are a mortgage broker, what do you generally do if a consumer seeks tax advice from you? What other matters outside your expertise do consumers seek guidance on?**

In certain circumstances, consumers will need assistance from their mortgage brokers in relation to Centrelink payment and tax issues. This especially applies to reverse mortgages. Reverse mortgages can affect an individual's ability to receive welfare payments, such as the aged pension. Brokers should have a baseline level of knowledge about reverse mortgages and its implications for Centrelink. If they do not believe they have adequate knowledge, then they should refrain from selling these products.

We have deep concerns about 'one stop shops', where there's often real estate advice, mortgage broking, financial advice and tax advice in one building. Our experience is that these firms typically offer poor quality advice to people.

Recommendations 5 - 9

In order to satisfy the best interests duty, there must be a broad range of lenders on a broker's panel, who offer both competitive prices and product features. If there are a limited number of lenders on the panel, meaning these requirements are not satisfied, licensees must increase the number of lenders on the panel. This must occur within 3 months of identifying the issue. Any delay should be a breach of the duty.

A high volume of loans to a limited range of lenders might suggest a breach of the best interests duty.

A package of credit products will not be compliant with the best interests duty if a single credit component, for example, a credit card or personal loan, fails the best interests duty.

Brokers must provide consumers with fair and appropriate insurance products. This guidance should extend to add-on insurance and lender's mortgage insurance.

Brokers should be knowledgeable about reverse mortgages and their implications for Centrelink payments.

Proposed guidance on other obligations

- **C1Q1: Do you agree with our general approach to administering the conflict priority rule?**

We support ASIC's general approach to administering the conflict priority rule.

This rule will be an important safeguard in ensuring brokers recommend high quality loans to people. The Banking Royal Commission identified the failure of industry to manage conflicts of interests:

"Experience shows that conflicts between duty and interest can seldom be managed; self-interest will almost trump duty. The evidence given to the Commission showed how those who were acting for a client too often resolved conflicts between duty to the client, and the interests of the entity, adviser or intermediary, in favour of the interests of the entity, adviser or intermediary and against the interests of the client... A 'good enough' outcome was pursued instead of the best interests of the relevant clients or members."²²

ASIC has a critical role in enforcing this conflict priority rule. History has shown us that simply instructing an intermediary to manage conflicts of interests in favour of the consumer has largely failed.

- **C1Q2: Are there any other factors relevant to the prioritisation of consumers' interests that we should consider including in our guidance?**

We recommend that regulatory guidance be strengthened around three key conflicts of interest that the industry has a poor record of managing.

1. Clawback arrangements

ASIC should provide guidance on the interaction between clawback requirements and the conflict priority rule. Under the new Regulations, brokers are required to clawback any commissions if a borrower changes lenders or repays their loan within two years.²³ Brokers are incentivised to keep people in the same mortgage within the first two years, irrespective of whether there are better performing loans on the market. The ACCC found that regularly shopping around for the best available loan can have real financial pay-offs.²⁴ Given recent

²²Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p.3

²³s28VF, *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers) (Mortgage Brokers) Regulations* 2020

²⁴ACCC, 2018, Residential mortgage price inquiry, Final Report

movements in the cash rate, switching mortgages to more competitive loans can save borrowers tens of thousands of dollars over the life of their loan.”²⁵

We suggest ASIC include the following example in the Regulatory Guidance to clarify guidance around the conflict priority rule:

Example:

Wendy, a mortgage broker, arranged a home loan for Hilary. Eighteen months passed since the loan was arranged and the official cash rate dropped 1.5%. Hilary has noticed lenders advertising rates significantly below what she is paying on her current mortgage. Hilary approaches Wendy for advice about whether she should switch lenders to find a more competitive rate.

Wendy knows that if Hilary switches lenders, they will clawback upfront and trail commissions earned on arranging the existing loan. Wendy scans the market and finds there are cheaper loans on the market. She advises Hilary to stay in the loan for the next 6 months to assess any movements in the market.

Commentary

In this scenario, Wendy contravened the conflict priority rule. Hilary sought credit assistance from Wendy. The broker was aware that there were mortgages in the market that offered a more competitive rate. However, Wendy chose not to recommend these cheaper loans to prevent her commission from being clawbacked.

2. Commissions

We also strongly recommend ASIC provide more detailed guidance on the interaction between the payment of commissions and the conflict priority rule. The Banking Royal Commission, Productivity Commission and ASIC REP516 established that commissions in the broking industry are conflicted and distort the quality of broker advice.²⁶ 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.

ASIC only briefly mentioned this interaction in RG 000.136. The guidance would be strengthened with greater clarification and the inclusion of an example. ASIC’s Report 516 into mortgage broker remuneration found that, “*this standard model of upfront and trail commissions creates conflicts of interest.*”²⁷ The report found that broker commissions create two different kinds of conflicts:

²⁵ ACCC, 2018, Residential mortgage price inquiry, Final Report

²⁶ ASIC 2015, REP 516: Review of mortgage broker remuneration

²⁷ ASIC 2015, REP 516: Review of mortgage broker remuneration, p.10

- a. 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.”²⁸
- b. Lender-choice conflict where a “broker could be incentivised to recommend a loan from a particular lender because the broker will receive a higher commission, even though the loan may not be the best loan for the consumer”.²⁹

The guidance should specifically address these two conflicts and state that if a broker offers conflicted advice, then they are in breach of the conflict priority rule. Brokers must ensure that they do not recommend loans that offer them a higher commission but are not in the best interests of the consumer.

3. Ownership structures

We strongly encourage ASIC to strengthen the regulatory guidance by expanding on the interaction between ownership structures and the conflict priority rule.

Almost seven out of ten loans arranged by brokers come from lender-owned aggregators.³⁰ The ownership of aggregators allows lenders to have a strong influence over the quality and range of loans selected by brokers. Brokers face a conflict of interest where they are incentivised to send loans back to parent-owned banks. This is best exemplified by Aussie Home Loans. Aussie Home Loans directs two in five loans straight back to their owner, the Commonwealth Bank.³¹

Consumers expect independent and expert advice from a mortgage broker who will scan the market for them. They do not expect to be sold into a loan owned by the aggregator. There needs to be additional safeguards for people to prevent them being funneled into lender-owned aggregator loans.

The regulatory guidance should be strengthened to state that when a broker recommends a loan from a bank that owns the business, they must ensure that consumers understand the aggregator is owned by the bank. This obligation must apply also to white-label loans. A failure to inform consumers and record this conflict of interest should be viewed as a breach of the conflict priority rule.

Further, there should be a greater onus on brokers recommending the products of their owners to demonstrate that their recommendations are in the best interests of the particular borrower

²⁸ ASIC 2015, REP 516: Review of mortgage broker remuneration, p.10

²⁹ ASIC 2015, REP 516: Review of mortgage broker remuneration, p.10

³⁰ Productivity Commission, 2018, Competition in the Australian Financial System, p.307

³¹ ASIC 2015, REP 516: Review of mortgage broker remuneration, p.18

each time. Percentage of volume being directed to the owner lender should also be a performance metric tracked for both internal quality control and regulator supervision.

4. No suitable loan available.

Perhaps the biggest conflict of interest is where a consumer cannot afford a loan that would meet their requirements and objectives. By telling a consumer that this is the case, and recommending they do not proceed, or change their objectives, rather than massaging the consumer's circumstances to qualify for the loan, a broker on a commission model forgoes any remuneration at all. This is very important strategic advice and essential to compliance with the NCCP Act. Brokers should be able to demonstrate that this occurs when appropriate.

- **C2Q1: Do you agree with our expectations about record keeping?**

We support ASIC's expectations about record keeping.

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. Written evidence of how the broker formed their best interest view, such as suitability assessments, can play an important role in dispute resolution and in assessing compliance.

Robust record keeping obligations will ensure that brokers who sell inappropriate mortgages will be held to account. It will make it easier for ASIC to oversee the quality of mortgage advice and take enforcement action.

We recommend that ASIC state in their regulatory guidance that a failure to keep adequate records is evidence that a broker or licensee is not acting in the best interests of borrowers.

If requested, brokers must be required to provide clients with a written copy of records to show the broker acted in the best interests of the consumer. These documents must be provided promptly and free of charge. At a minimum, brokers must have on record to provide people with:

- a copy of the responsible lending assessment;
- a copy of the credit guide which was provided to the consumer;
- information provided to the credit provider as part of the application process;
- outcomes of credit applications;
- relevant conversations with the consumer;
- information showing how the broker acted in the best interests of the consumer (including records of efforts made to educate the consumer);
- the options and ultimate recommendation you gave and the reasons why (including a detailed description of your decision-making process); and

- any potential conflict of interest which the broker identified, and the actions the broker took to prioritise the interests of the consumer over their own or those of a related party.

³²

This aligns with obligations for credit providers to provide customers with a written copy of a lending assessment.³³ It also aligns with obligations in financial advice where a client may request a record of the advice up to seven years after the advice was given.³⁴

- **C2Q2: Are there any other examples of types of records that could be referred to in our regulatory guidance?**

Brokers must also be required to maintain records of a point-in-time assessment of other loans on the market at the time a loan was arranged. At a minimum, this can be a screenshot of equivalent loans with relative prices and products. Brokers must be required to maintain records of loans on a broker's panel as well as loans on the market. This will make oversight and enforcement of the best interests duty and the conflict priority rule simpler for ASIC.

- **C2Q3: How long should records be kept for?**

We acknowledge that ASIC has proposed a principles-based approach to record keeping, and has not specified a set period of time for when records must be kept.³⁵ This differs from ASIC's regulatory guidance for financial advice, which states that records must be kept for at least seven years from when the advice was given.³⁶

Mortgages can exceed 30 years in term length, and it can take many years before inappropriate conduct is uncovered. The financial services industry has a terrible track record of identifying, investigating and remediating breaches of the law. A recent ASIC investigation found that on average, it took over four years from when a breach first occurred by an Australian Financial Services Licence holder before the incident was identified. We support ASIC retaining a principles-based approach to retaining records but including as a guide that records should be kept for at least ten years.

- **C3Q1: Do you agree with our general expectations about the practical steps credit licensees should take to comply with this obligation? Are there any other relevant factors?**

Licensees regularly set the culture and behaviour of mortgage brokers. They must be accountable for compliance with the best interests duty and conflict priority rule. For example, licensees control the range of loans that a broker can offer. ASIC should consider stating that if

³² RG 000.140

³³ ASIC, Regulatory Guide 209: Credit licensing: responsible lending

³⁴ *Corporations Regulations* 2001 - REG 7.7.05 and ASIC, Regulatory Guide 175: Licensing: Financial product advisers—Conduct and disclosure, RG 175.171

³⁵ RG.000.143

³⁶ ASIC, Regulatory Guide 175: Licensing: Financial product advisers—Conduct and disclosure.

a licensee restricts the number of loans on the panel that a broker can offer, they may be in contravention of the best interests duty.

Licensees must take a proactive role in investigating and stamping out misconduct. If ASIC investigates alleged misconduct by a broker, they must also investigate whether the licensee was complicit in the behaviour and consider prosecuting them. This will be effective in reforming conduct in the industry and improving standards across the board.

Recommendations 10 - 15

ASIC must provide clear guidance on the intersection between the conflict priority rule and the following conflicts of interests in the mortgage broking industry:

- clawback requirements;
- the payment of commissions; and
- ownership structures.

A failure to keep adequate records should be evidence that a broker or licensee is not acting in the best interests of borrowers.

Brokers must be required to provide clients with a written copy of records as evidence that the broker acted in the best interests of the consumer

A principles-based approach to record keeping obligations be maintained, with the recommendation that records should be kept for a minimum of ten years.

Brokers must maintain records of a point-in-time assessment of other loans on the market at the time a loan was arranged.

If ASIC investigates alleged misconduct by a broker, they must also investigate whether the licensee was complicit in the behaviour.