



Australian Finance Industry Association Limited  
ABN 13 000 493 907

L11 130 Pitt Street Sydney NSW 2000  
02 9231 5877 www.afia.asn.au

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

4 October 2019

By email: [ConsumerCredit@treasury.gov.au](mailto:ConsumerCredit@treasury.gov.au)

Dear Sir/Madam

### **MORTGAGE BROKER BEST INTERESTS DUTY AND REMUNERATION REFORMS**

The Australian Finance Industry Association [AFIA] welcomes the opportunity to inform the Government's consultation on implementing the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's recommendations regarding mortgage brokering sector via the Government's exposure draft package.

### **AFIA KEY POSITION SUMMARY**

- AFIA is broadly supportive of the Government's proposed design of the enabling legislation (the Exposure Draft Bill [the Bill]) to implement a best interest duty for mortgage brokers together with other changes to mortgage broker remuneration structures as recommended by Commissioner Hayne.
- AFIA notes that these changes are likely to have a significant impact on all entities including customers, brokers and credit providers in the home loan market.
- AFIA requests further clarity on particular sections of the Bill. In particular, we note that there is limited clarity on;
  - how the duty is to be discharged; and
  - the interactions between the best interest duty and responsible lending. These issues are discussed in more detail below.

- In the interests of compliance certainty and in line with the commitment given by the Government<sup>1</sup>, AFIA recommends specific clarification that trail commissions are not conflicted remuneration and will not be impacted by the Bill as currently drafted.
- AFIA encourages the Government to provide further guidance on the issues raised in this submission to ensure that the consumer-protection objectives underpinning the reforms are better together with enhanced compliance certainty reducing with the flow on to compliance cost savings for the industry that can be passed on to customers.
- AFIA, as a member of the Combined Industry Forum [CIF], provided input to inform the CIF submission and supports the recommendations proffered to inform and shape the final design of the implementation framework.

More detail i on specific clauses of the Bill is set out below.

#### **AFIA'S BACKGROUND – CONTEXT OF FEEDBACK**

By way of background, AFIA is the voice of a diverse Australian finance industry. AFIA supports our Members to ensure a fair, equitable and competitive market for customers through representation, insights and connectivity.

AFIA is uniquely placed to respond given our broad and diverse Membership of over 100 financiers operating in the consumer and commercial markets. Many of our members assist customers with home ownership or wealth creation through acquisition of residential investment properties through providing the finance needed. These include both bank and non-bank members, some large participants in the market, others niche players. Mortgage brokers play an important role for customers, particularly in regional Australia, as a distribution channel to enable access to a panel of home-finance providers with the benefits that flow from competition and customer choice. Further background on AFIA is available from [www.afia.asn.au](http://www.afia.asn.au) and below.

#### **AFIA'S INSIGHTS -PROCESS TO SOLICIT OPERATIONAL FEEDBACK TO INFORM SUBMISSION**

AFIA has engaged with our Members to ensure the Government's proposed implementation design would be able to be applied by industry participants in an effective and efficient manner while achieving the underlying consumer protection benefits. Our submission focuses on sections in the Consultation Paper where members had some commentary or were seeking greater clarification.

---

<sup>1</sup> <http://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/040-2019>

A large number of members have contributed to our feedback. We note, however, that while members have contributed to inform this response, from an organisational view, the positions being put by AFIA may not reflect every Member's specific position on all the issues. Their individual member viewpoint will get captured through the relevant member's organisationally-targeted submission.

## **FEEDBACK ON SPECIFIC PROVISIONS OF THE BILL**

By way of more detailed commentary on the summary of key positions provided earlier:

- ***Best Interests Duty – section 158LE of the Draft Bill***

AFIA notes that the best interest duty is broadly defined and is principles based. While supporting the consumer protection objective underpinning this reform, such a broad definition could lead to unnecessary and costly compliance uncertainty.

The Bill does not define the term '**best**' presumably in recognition that the assessment can be subjective. To provide compliance certainty with the reduction in costs that flows through to product-pricing benefitting customers, AFIA recommends that further clarity is warranted. More specifically, the definition should be clarified to mean more than the lowest price or rate.

As a proposed alternate, AFIA suggests that the term should be defined in a way that appropriately takes into account the responsible lending compliance obligations detailed in the National Consumer Credit Protection Act [the NCCPA]. In short, a mortgage broker is acting in the best interests of the customer when the recommended loan is not unsuitable. This requires the broker to take into account the customer's requirements and objectives and to obtain and verify financial circumstance information.

AFIA members also raise concerns in relation to the flow-on impacts on a lender if a broker has been found to have contravened the best interests duty. For example, the obligation to meet the best interest duty is imposed on the broker. However, should a broker be found not to have met this requirement and not acted in the best interest of the customer, would the loan provided remain enforceable by a lender that has met all its NCCPA obligations (including responsible lending). We request further guidance on this issue, including on the level of comfort a lender needs that a broker has met their best interest requirements.

**AFIA Recommendations:**

1. Further guidance should be given on how entities can meet the best interest duty including that the loan meets the customer's requirements and objectives.
2. AFIA supports the inclusion of the Combined Industry Forum's examples in the Explanatory Memorandum as part of that guidance.
3. AFIA requests further guidance on the interaction between a broker's best interest duty and a lenders obligations (including the NCCPA responsible lending compliance obligations).

- ***Scope of Best Interest Duty***

AFIA seeks clarification on whether the best interests duty extends to mortgage managers.

More specifically, AFIA requests that it be specifically acknowledged in the legislation that the best interests duty does not apply to securitisation entities.

Mortgage managers perform a different role to a mortgage broker. Mortgage managers do just that, they manage or process your loan application through to approval and settlement, and then manage the outcome of the contract once entered until such time as the loan is repaid in full. Often a mortgage manager will only have one product and are subject to the NCCPA. AFIA recommends that the scope of the legislation is clarified to make clear that mortgage managers are not subject to the best interest duty.

Further, the legislation should be amended to make clear that the best Interest duty does not extend to credit providers where they provide credit assistance in relation to their own credit products.

For the avoidance of doubt, the legislation should be amended to extend the operation of this exclusion to securitisation entities (typically non-bank lenders), which operate under Regulations 23B or 23C of the NCCP Regulations, where the credit provider is not itself a credit licensee, being exempt from the requirements to hold an Australian Credit Licence, and a separate servicer entity is the credit licensee which provides credit assistance in relation to the credit provider's products.

If the Government intended to capture securitisation vehicles within the scope of the Bill we request further consultation. Securitisation is a very complex area and integral to a competitive market enabling customer choice with the flow on benefits to pricing. further consultation.

**AFIA Recommendations:**

4. mortgage managers and securitisation entities should be excluded from the best interest duty.

- ***Prioritisation of Interests – 158LB and 158LF***

Further guidance is needed on how a broker should consider conflicts when applying the best interest duty.

For example, how should a white-labelled product and the brand product (that has the same product features and rate) be assessed if the outcome of one model is that more commission would be payable than for the other. Such a case could occur where the customer receives more support from one channel with services provided by the broker; the additional service brings cost resulting in a higher commission being paid.

Would this scenario need to be disclosed to the customer (apart from already existing commission disclosure laws)?

**AFIA Recommendations:**

5. the prioritisation of interests should be clarified to enable clear understanding of how it would operate under current arrangements (eg white-labelled product offerings vs. own brand) to also ensure the implementation design is future-proofed and can be operationalised for emerging new models going forwards.

- ***Ban on Conflicted Remuneration – Division 4 – trail commissions***

The Bill together with the Exposure Draft Regulations ban certain types of conflicted remuneration.

A key issue AFIA has identified is that the treatment of trail commissions needs to be clarified. Our view is that as currently drafted, the outcome may prevent the payment of trail commissions because:

- regulation 28VA(3) and (4) do not explicitly make clear trail commission is not conflicted remuneration; and
- clause 3 of schedule 1 of the draft Bill will apply to payments of commission from 1 July 2020 where the arrangement was entered into before 1 July 2020.

This will mean:

- trail payments, both as existing trail arrangements entered into before 1 July 2020 or future trail arrangements entered into on 1 July 2020, could be considered conflicted remuneration unless those arrangements meet the requirements of regulations 28VA and 28VB. In practice, it would be almost impossible for industry to determine whether existing loans meet all of these requirements. For example, there will be loans which are NCCPA-regulated because they were to “renovate or improve residential property”, where trail is currently being paid, but these would seemingly fall into the definition of “conflicted remuneration” from 1 July 2020. Lenders and brokers may not readily have information available to determine which loans are, or are not, subject to the ban on “conflicted remuneration” from 1 July 2020 across the thousands of loans in their portfolios.
- It is also unclear why trail commission arrangements for existing loans should be disturbed at all, particularly given the Government’s statements in relation to trail commission. The policy intention of the legislation is to improve customer outcomes by banning “*benefits which could reasonably be expected to influence the credit assistance provided to consumers*”, but in the case of existing loans there is no further credit assistance to be provided. If there is a new loan application this will, of course, be covered by the ban.
- trail commission on further advances or extensions (e.g. customer requests further finance to invest in investment property or to renovate their home) will be considered conflicted remuneration as it will not relate to either the purpose of purchasing residential property or refinancing credit that was used for the purchase of residential property (section 28VB of the draft regulations). It is unclear from either the draft Bill and Regulations, or from the explanatory materials, why loans with this purpose are excluded from regulations 28VA and 28VB.
- Additionally, section 28VB may also prevent commission payments as the new amount will be drawn down 90 days after the initial credit contract is entered into (although the customer sought additional credit at a later date).

The Government in its response to Commissioner Hayne’s recommendation clearly articulated a policy position that it would “*not prohibit trail commissions on new loans, but rather review their operation in*

*three years' time*<sup>2</sup>. AFIA would appreciate clarification of whether the apparent outcome when interpreting the draft Bill and draft Regulations is intended or is a drafting error.

If the draft materials represent a shift in Government policy, AFIA as a priority urgently further consultation on this issue. Such a change represents a substantial shift in Government policy that would have substantial impact on all industry players; customers, brokers and lenders alike. It would undermine existing arrangements between lenders and brokers and lead to significant compliance costs being incurred by lenders as they move to ensure their business is compliant.

If this is a drafting issue, AFIA recommends revision of the Bill and draft Regulations to ensure they reflect the Government's clearly articulated policy that trail commission arrangements are not to be disturbed. An important component of that commitment was that the consumer risk potential (if any) arising from trail commissions should be reviewed in three years' time; an outcome supported by AFIA.

**AFIA Recommendations:**

6. that the draft Bill and regulations be amended to reflect the Government's clearly articulated policy that trail commission arrangements are not to be disturbed, rather the issue should be reviewed as part of the Government's commitment to review commission arrangements in 2022.

- ***Ban on Conflicted Remuneration – Division 4 – other issues for consideration***

AFIA seeks clarity on the following issues and situations our members have identified:

- the Bill should not apply to fees and payments made as part of a securitisation arrangement, for the same reason as set out above (regarding scope of the best interest duty). These fees and payments should be excluded as they are commercial in nature.
- Members have questioned how the ban on conflicted remuneration will work for credit that is not related to a mortgage (as defined in 28VA(3) of the draft Regulations? For example, if a broker uses credit provider 1 for the home loan/mortgage and credit provider 2 for a credit card at the same time, it would be very difficult for credit provider 2 to comply with the Bill compliance requirements as currently drafted as it would not know about the home

---

<sup>2</sup> <http://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/040-2019>

loan/mortgage with the credit provider 1. Such a requirement places a significant compliance burden on credit providers to comply with 158NE of the Bill with flow-ons in the attendant product pricing generally borne by all customers.

- The draw down requirement in section 28VB may act in an arbitrary fashion. For example, if a builder delays the start of construction causing the delay of a draw down, this will affect the amount of commission that can be paid. In situations such as this the Bill should allow for a longer draw down period to not unjustly impact any party.
- The two year clawback requirement (section 28VE(2) of the draft Regulations may act to inadvertently create tension between any annual review a customer may have with their broker and considerations of whether it is in the customer's 'best interest' to move. Additionally, after the two-year period, any customer movement to a different loan should not be seen simply as 'churn' as it is more likely customers are seeking a better deal with another lender.

**AFIA Recommendations:**

- 7. AFIA seeks further clarification on how this section of the draft Regulations relates to the best interest duty as defined in the Bill.
- ***Non-Monetary and Not Conflicted Remuneration – Section 28VF of the Draft Regulations***

AFIA also seeks clarification on the intended operation of this section. Further clarification is sought on the definition of 'infrequent benefits valued at less than \$300' (section 28VF(1) of the draft Regulations). AFIA submits clarity on the following points would be beneficial:

- is the \$300 limit per benefit or the total of benefits provided over a certain time (e.g. a year)?
- what is 'infrequent' – would quarterly catch-ups with business development managers be seen as infrequent?
- is the \$300 amount GST inclusive or exclusive?

**AFIA Recommendations:**

8. AFIA recommends that further guidance should be developed (possibly by ASIC) to provide a clear answer to the matters raised above. We note this was done previously in respect of the financial advice reforms.



## NEXT STEPS

Should you wish to discuss our feedback further, or require additional information, please contact me at [helen@afia.asn.au](mailto:helen@afia.asn.au) or Alex Thrift, Associate Director, Policy & Technology at [alex@afia.asn.au](mailto:alex@afia.asn.au) or both via 02 9231 5877.

Kind regards



Helen Gordon  
Chief Executive Officer

\*\*\* \*\*

## AFIA'S BACKGROUND

AFIA is the voice of a diverse Australian finance industry. AFIA supports our Members to ensure a fair, equitable and competitive market for customers through representation, insights and connectivity.

AFIA Members:

- include banks (major, regional and mutual/community-owned) and non-banks;
- range from ASX-listed public companies through to small businesses providing finance;
- operate via a range of distribution channels including bricks and mortar premises, intermediaries (finance brokers, dealerships, suppliers) through to online / digital access
- collectively operate across all states and territories in Australia in capital cities through to regional and remote areas: the majority operating across at least one border;
- have customers from all demographics, all age groups (legally able to borrow) in support of Australia's diverse and multi-cultural community with:
  - consumers ranging from high to low-income earners (including some whose main income source may be government welfare); many with substantial assets, others with few; single borrowers through to blended families; covering the whole range of employment scenarios, full-time, part-time, seasonal or casual employment.
  - commercial entities ranging from sole traders and partnerships through to the more complex corporates (e.g. trusts, corporate group) and government-entities some with no employees through to others with hundreds (if not thousands) of employees.

- provide a broad range of products:
  - consumer: from personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), loans secured by land or personal property; consumer leases of assets (including household/electrical/IT or cars) and buy-now, pay later solutions;
  - commercial: asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); working capital solutions (online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards) together with more sophisticated and complex finance solutions.

Further detail on AFIA is set-out below and available from: [www.afia.asn.au](http://www.afia.asn.au).