Mortgage Broker Best Interests Duty and Remuneration Reforms

Submission by Legal Aid Queensland

Legal Aid
QUEENSLAND

Mortgage Broker Best Interests Duty and Remuneration Reforms

Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to make a submission to the Treasury Consultation on the Mortgage Broker Best Interests Duty and Remuneration Reforms.

LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the Legal Aid Queensland Act 1997, LAQ is established for the purpose of "giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way" and is required to give this "legal assistance at a reasonable cost to the community and on an equitable basis throughout the State". Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ's services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ always seeks to offer policy input that is constructive and is based on the extensive experience of LAQ's lawyers in the day to day application of the law in courts and tribunals. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

LAQ's Consumer Protection Unit lawyers provide advice and representation to clients dealing with financial institutions including banks, regulated and unregulated lenders and insurance companies, including regularly representing clients with complaints about credit, banking, debt, broker issues in relation to obtaining credit. Our Farm and Rural Legal Service provides advice and assistance to rural producers and rural small businesses that have severe debt related problems or are in dispute with their lenders, or are otherwise facing financial hardship directly related to their business of primary production.

This submission is informed by the knowledge and experience of LAQ's Consumer Protection Unit and Farm and Rural Legal Service and our previous submission/s to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[1]

The amendments to the *National Consumer Credit Protection Act (2009)* seek to:

- Impose an obligation on mortgage brokers to act in the best interest of the consumer; and

[1] https://financialservices.royalcommission.gov.au/Submissions/Documents/interim-report-submissions/POL.9100.2000.0035.pdf

- Prohibit conflicted remuneration of brokers.

Mortgage Broker Duties

In LAQ's view this is a positive development. We have numerous case examples where brokers do not appear to act in the best interests of consumers.

Examples of where brokers have not acted in the best interests of consumers include:

- selling insurance products that are included in loan contracts without the consumer's knowledge;
- selling insurance products that are inappropriate for the consumer's needs: for example, selling consumer credit insurance for unemployment where the borrower is casually employed and therefore cannot access the benefits under the policy if they were to lose their job;
- encouraging consumers to borrow more money than what they were seeking;
- encouraging consumers to obtain other credit products, for example, encouraging borrowers to take up a credit card when applying for a home loan;
- encouraging consumers to provide false information to lenders to assist in having loans approved; and
- failing to provide advice about the disadvantages of a particular loan product, for example failing to provide the consequences of early termination when fixing the interest rate on a loan.

The Duty should be extended to other brokers

Examples of brokers failing to act in the best interest of consumers are not restricted to assistance provided to consumers regarding credit contracts that are secured over residential land.

In LAQ's experience the most vulnerable and marginalised consumers in the community are often the victims of unscrupulous brokers who organise finance for them, particularly for car loans. LAQ has encountered numerous cases of brokers misrepresenting the nature of the finance being offered and the inclusion of unwanted 'add on insurances" and other insurance products when organising loans for consumers. Besides the fee that consumers pay for a brokerage service, the broker may also receive numerous commissions from selling unwanted or inappropriate add on insurances and products.

Consideration be given to extending the application of the legislation to all regulated brokers not just mortgage brokers

If the legislation will only apply to mortgage brokers, their intermediaries and credit representatives as defined in section15B and 15C in the *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill* 2019 (the Bill) then the definition should be expanded to include an activity test. That is if a "licensee" who does not meet the business test in s15B or S15C will also be required to comply with the proposed legislation when they provide credit assistance to consumers to obtain loans secured against residential property regardless of their business model.

Access to External Dispute Resolution

Whilst it is positive that the law will strengthen the obligations of brokers to act in the best interest of consumers and ban conflicted remuneration, it is also important that that consumers can obtain redress if brokers fail to meet these legislative obligations.

Consumers currently take complaints against finance and mortgage brokers to the Australian Financial Complaints Authority (AFCA). Brokers are often "self-employed one person businesses" who may struggle to pay a compensation award and continue operating if an award is made against them. It's important that AFCA is not swayed to find against the consumer because of the consequences to a "broker" of having a compensation award made against them.

To assess the effectiveness of the new legislative obligations and, in particular, how the new obligations have improved industry conduct or resulted in beneficial outcomes for consumers the legislation should include a reporting regime. AFCA is well placed to implement a reporting regime as they have similar responsibilities in relation to other financial products.

Recommendation

Consideration be given to extending the application of the legislation to all regulated brokers not just mortgage brokers.

The legislation include a reporting regime whereby AFCA provide specific reporting to ASIC regarding the application of the new provisions and ASIC be resourced so that they can respond appropriately to any issues identified in the reporting.

Specific Issues with Draft Legislation

Definition of Mortgage Broker, Mortgage Intermediary and credit representative in S15B and S15C

Section 15B defines mortgage brokers in subsection (1)(a) and (2)(b) *as a licensee or credit representative of a licensee if* the licensee or credit representative of the licensee *carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property.*

Section 15C has similar definitions covering licensees and credit representatives of mortgage intermediaries.

It would appear that the definition is limited to and will only capture brokers who provide credit assistance in relation to credit contracts secured by mortgages over residential property as their principal business.

It would appear that the definition of mortgage broker and mortgage intermediary is not broad enough to cover brokers who are in the business of providing credit assistance in respect of unsecured loans but occasionally provide credit assistance to consumers to obtain loans secured against residential property.

If it is intended that all credit assistance activities relating to credit contracts secured by mortgages over residential property are regulated, the definition of mortgage brokers, their intermediaries and credit representatives as defined in 15B and 15C in the Bill should be expanded to include an activity test. That is if a "licensee" who does not meet the business test in s15B or S15C will be required to comply with the proposed legislation when they provide credit assistance to consumers to obtain loans secured against residential property.

Recommendation

The definition of mortgage broker and mortgage intermediary should include licensee and credit representatives who provides credit assistance where the loan is secured by a mortgage over residential property.

The New Best Interest Obligations

The amendments in Division 2 of the Bill are aimed at ensuring that mortgage brokers and intermediaries, as defined in s15B and s15C, act in the best interest of clients when providing any credit assistance to consumers, not just in relation to credit contracts secured by a mortgage over residential property.

LAQ supports the obligations on mortgage brokers and intermediaries extending to all credit assistance activity so that any other products that are recommended are also in the consumer's best interest.

LAQ's experience has been that borrowers were often provided with credit cards with significant credit limits when they obtained a home loan. This has led to consumers losing or being at risk of losing their homes, not because they are in default of the home loan, but rather as a result of defaulting on their obligations in relation to the credit card account. If a broker is acting in the consumer's best interest they may not in the future recommend obtaining a credit card.

Its critical that the best interest obligations apply to all the activities of a mortgage broker not just those directly associated with the provision of credit secured by a mortgage over residential property.

In those circumstances LAQ supports the Best Interest Obligations where the definition of mortgage broker and, intermediary is expanded to include an activity test.

Conflicted Remuneration

LAQ supports the categories of conflicted remuneration contained in the regulations.

Application of Ban on conflicted remuneration

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) recommended that except for remuneration paid by a consumer all other remuneration to mortgage brokers ought to be banned[2]. The proposed legislation is less onerous than that proposed by the Royal Commission and therefore the lead in time for implementation ought to be very short.

Recommendation

LAQ submits that Royal Commission recommendation 1.3 on conflicted remuneration should be implemented in full. If the recommendation of the Royal Commission is not implemented in full, the lead in time for implementing the legislation should be very short because the changes are not significant.

Future Reviews

LAQ supports a mandatory review being conducted as a part of these proposed changes. Three years would be a reasonable period of time for any issues with the implementation of the mortgage broker best interest duties and remuneration reforms to become apparent.

[2] Recommendation 1.3 – Mortgage broker remuneration *The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending. Changes in brokers' remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers*.