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

Maurice Blackburn Pty Limited
ABN 21 105 657 949

Level 21
380 Latrobe Street
Melbourne VIC 3000

DX 466 Melbourne
T (03) 9605 2700
F (03) 9258 9600

By email: ConsumerCredit@treasury.gov.au

Dear Sir/Madam,

We welcome the opportunity to provide feedback in relation to the National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 (the Bill).

Maurice Blackburn Pty Ltd is a plaintiff law firm with 32 permanent offices and 31 visiting offices throughout all mainland States and Territories. The firm specialises in personal injuries, medical negligence, employment and industrial law, dust diseases, superannuation (particularly total and permanent disability claims), negligent financial and other advice, and consumer and commercial class actions. The firm also has a substantial social justice practice.

Importantly, our submissions in response to matters raised by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) are drawn from the direct experience of our clients who have suffered significant financial and personal hardship as a result of the actions of major financial service providers.

In this regard, the findings of the Royal Commission clearly reflect the day to day experience of our staff - that a combination of banks' relaxed lending standards and brokers' involvement in loan sales has resulted in widespread debt over-commitment. We are pleased that this Bill seeks to address the second of these concerns.

Our experience in working with clients who are facing difficulty servicing mortgage debt indicates that, until recently (save for the west coast and some rural communities) this problem has been largely contained. That is, investors who defaulted on their mortgages were often fortunate enough to sell the investment property at a gain or at least break even, clearing the mortgage without too much pain.

However, we have seen greater property market volatility in recent years despite record low interest rates. Whilst some consider the Sydney and Melbourne property markets to have 'bottomed out', the following factors are major causes for concern:

- the imminent maturation of interest only loans which tend to be for larger sums and take longer to repay¹; and
- the growing levels of household mortgage stress amid stagnant wage growth.

As to the first noted factor, it was reported in 2018 that about \$360 billion worth of interest-only loans are due to mature over the next three years². Interest only loans have been strongly preferred by mortgage brokers who stand to receive a longer and higher commissions.

It has also been reported that up to one-third of borrowers with interest-only loans may not realise they have them³ which raises serious concerns regarding the extent to which brokers/intermediaries are communicating effectively with consumers.

As to the second noted factor, it has been reported that if/when interest rates begin to rise, a 1% increase would put more than 40% of households in mortgage stress (for context, a 4% increase above current rates would bring interest rates roughly in line with the average over the past two decades)⁴.

It is also noted that recent ASIC research found that consumers who obtained their loan through a broker⁵:

- borrow more;
- have higher loan to valuation ratios;
- spend more of their wage on a mortgage;
- take out more interest-only loans; and
- get the same rate as customers that go directly to a lender.

All of these findings demonstrate the propensity of mortgage brokers/intermediaries to expose consumers to excessive mortgage debt against their best interests whilst failing to source a better interest rate.

These factors have the potential to further drive up distress sales and may leave thousands in financial ruin, staring at the prospect of bankruptcy.

The causes of these problems relating to credit over-commitment facing consumers are multidimensional, and therefore require a multidimensional solution.

Maurice Blackburn has long argued that this must include addressing, among other things, the culture of self-interest and skewed financial incentives that tempt bankers/brokers to get large loans approved even where they are unaffordable.

To this end, Maurice Blackburn is pleased to support the principles underpinning this Bill.

¹ ASIC Report 445 – Review of interest-only home loans (August 2015)

² R [Pupazzoni](https://www.abc.net.au/news/2018-08-01/interest-only-mortgage-borrowers-flock-to-principal-and-interest/10059960), Interest-only mortgage borrowers flock to principal and interest loan discounts, *ABC News* (online), 1 August 2018, <https://www.abc.net.au/news/2018-08-01/interest-only-mortgage-borrowers-flock-to-principal-and-interest/10059960>

³ M Janda, 'Interest-only home loans a ticking time-bomb, warns UBS', *ABC News* (online), 4 October 2017, <https://www.abc.net.au/news/2017-10-04/consumers-unaware-they-have-interest-only-home-loans/9014448>

⁴ See for example <http://www.abc.net.au/news/2017-08-21/how-interest-rate-rises-could-see-affect-home-loanstress/8798274>

⁵ ASIC REP 628 Looking for a mortgage: Consumer experiences and expectations in getting a home loan, released 29 August 2019: <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-628-looking-for-a-mortgage-consumer-experiences-and-expectations-in-getting-a-home-loan/>

Maurice Blackburn notes paragraph 1.3 of the draft Explanatory Memorandum⁶, which provides context for the proposed amendments. That paragraph reads:

The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry considered mortgage broking in Australia and made recommendations relating to mortgage brokers, including recommendation 1.2 (the best interests duty) and recommendation 1.3 (mortgage broker remuneration). In response to the Royal Commission, the Government committed to a number of reforms in relation to the regulation of mortgage brokers including to:

- *introduce a duty for mortgage brokers to act in the best interests of consumers; and*
- *address conflicted remuneration for mortgage brokers.*

We address these two matters below.

A duty for mortgage brokers to act in the best interests of consumers:

Recommendation 1.2 of the Royal Commission reads as follows⁷:

The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision.

Maurice Blackburn supports the provisions contained in Schedule 1 to the Bill, which amends the *National Consumer Credit Protection Act 2009* (the NCCP) to require mortgage brokers and intermediaries to act in the best interests of consumers.

In particular, Maurice Blackburn supports the introduction of civil penalties for breaches of the provisions detailed in Schedule 1 of the Bill. In our experience, the absence of consequences for corporate misconduct will perpetuate those behaviours. Unless financial service providers face hefty fines for breach of best interests duties, there is a real chance that brokers/intermediaries will continue to prioritise other interests over those of the consumer.

Maurice Blackburn notes that this recommendation also enjoys the support of the Federal Government. In its February 2019 statement⁸, the Government noted, in relation to Recommendation 1.2:

The Government agrees to introduce a best interests duty for mortgage brokers to act in the best interests of borrowers.

The best interests duty will not change the responsible lending obligations for broker originated loans, consistent with the Government's response to Recommendation 1.1 above.

The Government also agrees that a breach of the best interests duty should be subject to a civil penalty.

⁶ https://treasury.gov.au/sites/default/files/2019-08/exposure_draft_explanatory_memorandum.pdf, p.3

⁷ <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>, p.20

⁸ <https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf>, p.6

The Government agrees, following the implementation of the best interests duty, to further align the regulatory frameworks for mortgage brokers and financial advisers.

*This also responds to the Productivity Commission's report *Competition in the Australian Financial System*, which also recommended imposing a best interests duty on mortgage brokers and a review of the feasibility of enabling financial advisers to also act as mortgage brokers.*

We note that the implementation of Recommendation 1.2, including the imposition of civil penalties, enjoys bipartisan support.

We encourage Treasury to consider the development of specific regulatory obligations on brokers/intermediaries to identify and appropriately assist consumers who have a particular vulnerability or bargaining power imbalance, which affects the consumer's ability to make a judgment as to their own best interests. Examples of such vulnerabilities include:

- Consumers from non-English speaking / cultural and linguistically diverse backgrounds,
- Inexperience with financial matters,
- Illiteracy or lack of education,
- Poverty or need of any kind on the part of the consumer,
- The consumer's age,
- Consumers with mental health issues, or other physical illness,
- Age or emotional dependency, and/or
- Other groups that may experience disadvantage in the current systems.

These important principles are perhaps most notably enshrined in the High Court decision of *Commercial Bank of Australia v Amadio*⁹ which found an elderly couple who acted as guarantor for their son's mortgage were at a special disadvantage which seriously affected their ability to make a judgement as to their own best interests.

We also note the case of *Elkofairi v Permanent Trustee Co Ltd*¹⁰ where the court, in considering the terms of the contract and the circumstances in which the contract was made, took into account Mrs Elkofairi's lack of education, poor health and difficult domestic situation, even though the lender had no knowledge of these circumstances, suggesting a failure on the part of the lender to make appropriate enquiries.

The Royal Commission shone a spotlight on the need to ensure that financial service providers have appropriate culture, systems and processes in place to:

- Recognise and respond to the needs of these cohorts, and
- Protect against the exploitation of vulnerable people.

Maurice Blackburn have acted for individuals with special disadvantages such as psychological illness and limited English language skills. We have been surprised and disappointed at the lack of rigour in lending practices around identifying and addressing such vulnerabilities and consider this to be an integral aspect of a functional best interests duty.

⁹ (1983) 151 CLR 447; [1983] HCA 14

¹⁰ (2003) 11 BPR 20,841

Conflicted remuneration for mortgage brokers:

Recommendation 1.3 of the Royal Commission reads as follows¹¹:

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.

We note that the Government's response to this recommendation has varied since their initial support for it was announced and it is disappointing to see that the reforms continue to allow commissions given by a credit provider to a mortgage broker/intermediary provided that the commission is based on the actual amount drawn down (not the approved loan amount).

That plainly fails to adhere to Recommendation 1.3.

Maurice Blackburn believes that the payment by lenders of commissions to mortgage brokers/intermediaries embeds an unacceptable risk of conflicted decision making by the broker/intermediary. An expedited retreat from this damaging practice, as was initially proposed by the Government¹², is essential.

Other Matters:

Firstly, the Royal Commission helped expose the conflicts of interest ingrained in the credit broking industry generally, not limited to the mortgage market. Maurice Blackburn sees no reason why these reforms should be limited to *mortgage* brokers/intermediaries and we therefore call for their application to all credit assistance providers whose customers are no less vulnerable to analogous undesirable practices in other credit transactions.

Secondly, Maurice Blackburn is concerned that a number of significant elements related to the implementation of consumer best interests and the reduction of conflicted remuneration are to be documented in regulations, rather than being articulated in the Bill. The Exposure Draft Explanatory Statement says¹⁴:

The Bill allows regulations to be made that prescribe circumstances, in addition to those set out in the Bill, under which a benefit is and is not conflicted remuneration.

The Bill also allows regulations to be made that prescribe circumstances in which conflicted remuneration must not be accepted and circumstances in which conflicted remuneration must not be given.

Maurice Blackburn encourages Treasury to ensure that the processes for developing and implementing regulations are sufficiently robust to withstand pressure from industry groups that may seek to water down what is and what is not considered to be part of the consumer interests duty.

We submit that an embedded requirement for consultation and transparency would go some way to ensuring the development of regulations is not compromised.

¹¹ <https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf>, p.20

¹² <https://treasury.gov.au/sites/default/files/2019-03/FSRC-Government-Response-1.pdf>, p.7

¹⁴ https://treasury.gov.au/sites/default/files/2019-08/exposure_draft_explanatory_statement.pdf, p.1

Please do not hesitate to contact me and my colleagues on 07 3014 5051 or at JMennen@mauriceblackburn.com.au if we can further assist with Treasury's important work.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'JMennen', written in a cursive style.

Josh Mennen
Principal Lawyer
Maurice Blackburn