



NATIONAL AUSTRALIA BANK SUBMISSION

Mortgage broker best interests duty
and remuneration reforms

4 October 2019

Introduction

National Australia Bank (NAB) welcomes the opportunity to provide feedback on the exposure draft Bill and exposure draft Regulations. These changes implement a broker best interests duty and remuneration reforms in response to recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

About NAB

NAB participates in the mortgage broking market as a lender distributing NAB branded loans and also as a provider of 'white-label' branded loans through Advantedge subsidiary entities which are fully-owned by the NAB Group. NAB also has full-ownership of three aggregators, PLAN Australia (PLAN), Choice Aggregation Services (Choice) and Finance and Systems Technology Group (FAST). PLAN, Choice and FAST provide aggregation services to approximately 30 per cent (circa 4,600) of brokers in the market and provide access to approximately 40 lenders and over 1,200 products.

Finally, BLSSA Pty Ltd (BLSSA), another fully-owned NAB Group entity, is holder of an Australian Credit Licence that authorises brokers contracted with PLAN, Choice and FAST to act as credit representatives in the provision of credit assistance services. BLSSA is currently the largest provider of licence and compliance services to brokers in Australia. Brokers under PLAN, Choice, FAST and credit representatives of BLSSA are not employees of NAB¹ and operate through businesses which are owned independently of NAB.

NAB's submission on the reforms

NAB believes that a vibrant, competitive mortgage sector market is essential to maintain competition in the mortgage market in Australia. NAB supports mortgage broking as a channel of choice for home buyers. Mortgage brokers play an essential role in enhancing competition in the home loan market and enabling access to credit for home buyers.

Recognising the need to ensure better customer outcomes and improved standards of conduct and culture, NAB has played an active role in the Combined Industry Forum. NAB supports measures to strengthen protections for consumers who use mortgage brokers including through the introduction of a best interest duty, consistent with Recommendation 1.2 of the Royal Commission. NAB also supports reforms to broker remuneration and has already implemented numerous changes in both its lending and aggregation businesses.

Best interests' duty and priority rule

NAB supports the introduction of a best interest duty, which is an important step towards better protecting consumers who use mortgage brokers when seeking a home loan.

Best interests duty - Regulatory guidance should provide clarity on: how the duty will interact with responsible lending: for a broker and lender;² ensuring the timing of the duty is at the time credit assistance is provided; confirming the duty does not apply on an ongoing basis (that is, after loan settlement); and that it is not considered with the benefit of hindsight.

Regulatory guidance should also assist in providing clarity on documentation, including simplification by proposing one 'statement of mortgage advice', that could fulfill the regulatory requirements for both the credit assistance provider (broker) and the credit provider (lender). Mandated documentation standards could lead to simplification of customer disclosure

¹ With the exception of a small number of brokers under PLAN who are NAB employees.

² For example, the lender is only responsible for undertaking responsible lending inquiries under Chapter 3 of the *National Consumer Credit Protection Act 2009*.

documents, to assist customer understanding and broker compliance. The mandating of standardised expense categories (e.g. per LIXI, which sets industry data standards), may be beneficial.

Priority rule - We understand that regulatory guidance will provide relevant detail to ensure a broker can 'resolve' a conflict.³ In particular, where there are comparable products that meet a customer's requirements with identical interest rates but one product containing higher commission than the other, the broker should ensure the customer is aware of the details of the product, rates, remuneration and how these meet requirements of the customer.

Design and Distribution Obligations (DDO) – We note the recent enactment of the *Treasury Laws Amendment (Design and Distribution Obligations (DDO) and Product Intervention Powers) Act 2019* (Cth) which imposes obligations upon credit providers to determine and manage appropriate target markets, distribution channels and product suitability. We seek clarification from Treasury on the overlap between the DDO and best interest duty.

Application of the laws

NAB's submits the proposed laws should apply to a range of participants, but only with respect to 'mortgage broking' and consumer lending activity. The credit advice activities of commercial brokers acting on behalf of commercial clients for commercial lending facilities should be excluded. The laws should not apply where the credit assistance provider accesses products from only one lender, given such instances do not give rise to lender choice conflict.

Commercial credit assistance providers - The proposed laws apply to 'mortgage brokers' that are licensees or representatives 'carrying on a business' of residential home lending.⁴ Commercial brokers arranging debt solutions which fall outside National Consumer Credit Protection Act (NCCP) regulation commonly hold or operate under an ACL to cover instances where they may assist in residential home lending, as an adjunct to commercial lending, where a commercial customer also requires a home loan. In order to enhance outcomes for all customers NAB proposes that any licensee or credit representative, including commercial brokers, who provide credit assistance in relation to credit contracts secured by mortgages over residential property, must also comply with the best interests and priority duties. Conversely, the best interest and priority duties should not apply to credit assistance provided by brokers in relation to commercial lending for commercial clients which falls outside credit types to which the NCCP applies.⁵

Best interests applying to package residential mortgage lending - The Explanatory Materials⁶ explain that brokers act in the best interests of the customer 'in relation to any other contract for which they provide credit assistance' and refers to the example of credit cards and personal loans 'that are packaged with the mortgage'. Lenders make available 'packaged products' which are loans that may include a credit card and a transaction account with the main home loan. We consider that it will be not be possible for brokers to determine whether the particular credit card packaged with a home loan is comparable to other credit cards. However, we agree that a broker should consider the whole of the lending requested by a customer.

Credit assistance providers offering products from only one credit provider - An Advantaged entity, fully owned by the NAB Group, makes available white-label mortgage lending products to UBank, which is a division of NAB operating on a 'trading as' basis. Under these commercial

³ *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019*, ss 158LB, 158LF and para 1.22 in *Explanatory Materials*.

⁴ *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019* s 15B.

⁵ *National Credit Code*, Schedule 1 to *NCCP 2009* (Cth), ss4-5 definitions 'credit contract' and 'provision of credit to which this code applies'.

⁶ at 1.19.

arrangements, UBank undertakes the role as credit assistance provider, whilst Advantedge fulfils the obligations of a credit provider. UBank does not offer residential mortgage lending products from any other credit provider, including NAB.⁷ The proposed laws appear to require structures like these to act in the best interests of the customer.⁸ We agree that where a credit assistance provider undertakes credit assistance for more than one credit provider, the credit assistance provider should be subject to best interest and priority duties. We submit structures such as UBank's are analogous to a retail branch – a customer is aware there is only one product supplier on sale and UBank will make product recommendations only from this sole supplier, rather than between different credit providers. On that basis, we propose the best interest duty and priority rule should not apply to structures where the credit assistance provider is acting with respect to *only one* credit provider.

White-label products to aggregators and mortgage managers - It is unclear whether circumstances under which an aggregator or mortgage manager retains profit from a white-label product is considered 'conflicted remuneration' under regulation 28VB.⁹ An aggregator may include branded home loans on their lender panels which are funded by one or more wholesale loan manufacturers. Similarly, mortgage managers are distributors of mortgage lending products which are funded and manufactured by one or more wholesale funders. Aggregators, and in many instances mortgage managers, do not deal directly with end-consumers given loans are introduced by third-party brokers. In the case of aggregator white-label loans, wholesale lenders pay the aggregator a royalty. In the case of mortgage managers a margin is earned, being the interest rate differential between cost of funds from the wholesale funder and the consumer rate. These income amounts represent consideration for the aggregator or mortgage manager providing services in marketing, distributing, packaging and, for mortgage managers, providing ongoing services to customers during the loan term. Regulatory guidance should provide that intermediary profits derived from this form of commercial arrangement should not be considered as conflicted, given that intermediaries do not deal directly with consumers and do not make product recommendations to consumers.

Conflicted remuneration

NAB supports reforms to broker remuneration and has already implemented numerous changes in both its lending and aggregation businesses. NAB has been supportive of the Combined Industry Forum, implementing many of the reforms recommended by that body, including not paying or receiving volume based incentives on regulated credit and removal of conflicted soft-dollar benefits. Importantly, NAB and Advantedge have changed the calculation of upfront commissions to be based on the drawdown amount (as opposed to the approved facility limit), net of offset. This reform is important because it aligns to the objective of removing broker commission payments from lending that might potentially be in excess of a consumer's requirements.

In our view, the proposed changes to the broker remuneration model, as currently drafted, are disconnected from the underlying best interest and priority duties. Current drafting of the legislation and regulations would lead to fundamental changes in the broker remuneration model, removing commissions from lending for which there are legitimate consumer needs, which do not give rise to any conflict with the interests of brokers. We believe the proposed broker remuneration changes would give rise to unintended adverse consequences for consumers and brokers. The scope and impact of proposed changes to broker remuneration appear to conflict with policy announcements made by the Government.¹⁰

⁷ UBank can refer a customer to NAB, but cannot assist a customer to apply for a NAB loan.

⁸ UBank will be a mortgage broker under section 15B because it provides credit assistance, but does not perform the obligations of a credit provider.

⁹ Regulation 28VB prohibiting a licensee accepting 'conflicted remuneration' relating to, among others things, 'whether or how' the licensee acts as an intermediary.

¹⁰ Treasurer, the Hon Josh Frydenberg MP, *'Media Release: Review of mortgage broking trail commissions'*, 12 March 2019, available at: <http://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/040-2019>

Conflicted remuneration definitions - The draft legislation and regulations define eligibility for broker upfront and trail commissions on residential mortgage loans. Essentially, only credit that relates to loans ‘wholly or predominantly’ for the purchase of residential property would be eligible for payment and receipt of a commission.¹¹ A consequence of this definition is that commission will not apply to lending for other purposes such as: (i) home improvements, renovations and upgrades, (ii) debt consolidation to achieve a lower interest rate, (iii) major expenditure for personal wellbeing purposes, such as payment of school fees or deposits for retirement care made by adult children for their parents.

NAB believes it is not necessary to define criteria for remuneration eligibility / ineligibility, because brokers recommending loans will be subject to tests of consumer interest on the loans themselves. That is, under the proposed best interest and priority tests which are backed by the weight of substantial civil penalties, along with the existing ‘not unsuitable’ test, brokers will be obliged to act in consumers’ best interests. If credit recommended by a broker: (i) is not unsuitable, (ii) is in the customer’s best interest and (iii) the customer’s interest has been given priority over the broker’s interest, then it should be lawful for the credit provider to pay a commission and for the broker to receive it. In our submission, the further definition of *conflicted remuneration* contained within the draft legislation¹² is unnecessary and not aligned with the policy objective.

Upfront commissions on initial loans to purchase a property – A consequence of the above is that calculation of broker upfront commissions will fundamentally change. Brokers will be remunerated only for loans used to purchase a residential property, not for any other purpose. This means

- Consumers would likely lose access to broker advice for credit obtained for any purpose other than purchasing a property (or refinancing such debt), because brokers will not be remunerated for these services. This may in turn create an adverse impact on the competitive benefits of the broking sector.
- Lenders would need to update commission systems to differentiate between funds used to purchase the property (eligible for commission) versus funds for other purposes (ineligible for commission). The technology used to calculate and pay NAB’s commission to mortgage brokers is complex and we estimate that it would take more than 12 months to implement changes required to comply with the legislation.

Upfront commissions – Timeframe for drawdown on commission eligibility – It is common practice for customers purchasing a property to seek additional funds to undertake home renovations / improvements soon after acquisition. The lead time between property settlement and renovating can include matters such as obtaining council approvals, drafting plans and arranging tradespeople. We submit the timing of the calculation for drawdown in regulation 28VB should be extended from 90 days to 365 days, to allow commissions to be paid on funds drawn-down within timeframes that accommodate the above lead times.

In 2018, in implementing the Combined Industry Forum recommendations, NAB and Advantedge implemented a calculation over a one year period, which was considered appropriate to align with customer drawdown activity. Consumers intending to undertake property renovations and improvements may be required to undergo the credit application and approval process two or more times, rather than submitting one application which provides funds for both the home purchase and improvements.

In addition, the date from which the 90 day period applies is currently drafted against the date of entering the credit contract. We propose the calculation should be based on the date of initial loan drawdown.

¹¹ Regulations, R28VA(3)(d).

¹² National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019 s158NA and Regulations r28VA.

- It is common for the elapsed time between contracts being entered into and initial loan drawdown delay to be 60 or more days. Therefore in practice, a 90 day timeframe would result in an available timeframe for commission eligible subsequent drawdown to be 30 days or less.

Upfront commissions on subsequent lending ('top-ups') – Approximately 20-30 percent of NAB and Advantedge's volume of new residential mortgage lending arises from customers seeking additional funds against their existing lending facility. Such 'top-up' increases involve submission of a new loan application and a full re-assessment by the lender. The eligibility definitions as discussed above, which exclude commissions on funds drawn down for purposes other than property purchases, would result in brokers being ineligible for upfront remuneration on top-ups. A likely consequence is that many brokers may cease to provide services to customers for top-up lending. Consumer choice and convenience in seeking the assistance of a broker would be adversely impacted which may in turn lessen competition in the sector.

Trail commissions – The proposed changes to the calculation of trailing commission will significantly reduce broker income. The effect of the proposed legislation is to apply a retrospective impact upon broker trail remuneration, based on legal tests (best interests and priority duty) that did not exist in law when the loans were originated. Furthermore, there is no clear and objective connection between the tests (best interests and priority duty) and the reason for excluding trail commissions (i.e. lending was for a purpose other than purchasing residential property).

- Customers do not receive any benefit from removal of commissions on existing debt, given commissions are paid by lenders direct to brokers.
- Brokers would suffer income loss, arising from legislation which applies a retrospective effect.
- By complying with the legislation, lenders might breach their obligations to pay commissions in accordance with contractual arrangements.

Trail commission is currently calculated as a percentage of an outstanding loan balance. In some instances, a loan facility may include top-ups that have been requested by the customer at different points of time. For example, a customer may have originally arranged a loan through a broker for \$500,000 to purchase a house. Some years later based on changing family circumstances, the customer may have obtained the broker's assistance to apply for an additional loan amount of (say) \$100,000 to undertake home extensions. During the course of the loan term, the customer may have made additional voluntary repayments, reducing their loan balance. The customer may also have utilised redraw facilities on the account, drawing down a component of their previous additional repayments.

The balance of any given loan account, upon which trail commissions are calculated, can therefore comprise a mixture of initial lending, subsequent lending, additional customer initiated repayments and re-drawings. Lenders do not and cannot track individual sub-components for borrowings made within a single account. Therefore, it would not be possible for NAB lenders to calculate trail commission based only on the portion of the loan used to purchase a property. It would also not be possible to base the calculation only on the original loan (which may have included sub-components for the house purchase and 'other' purposes), ignoring or stripping out subsequent account activities and transactions.

NAB proposes that the retrospective impact on trail commission be removed¹³ and that trail commission calculations be based on loan account current balance, net of offset.

Aggregator commercial arrangements - Aggregators provide commercial services to brokers including:

- A broad panel of lenders and products
- White label (aggregator branded) home loan products on that panel

¹³ This change can be effected by simply removing the word 'before' in *National Consumer Credit Protection Amendment (Mortgage Brokers) Bill 2019*, Schedule 1, s3(1) quote '... benefit is given under an arrangement entered into ~~before~~, on or after 1 July 2020'.

- Systems and technology including application platforms
- Marketing services
- Support with professional and business development, and
- Assistance with licensing and compliance.

Brokers pay for those services by fee or by arrangement with the aggregator to retain commission earned by the broker.

Conflicted and un-conflicted soft-dollar benefits provided to brokers - We support a ban on any soft-dollar benefit which promotes particular lenders, products or loans and is likely to influence a broker in a manner that is conflicted. However, PLAN, Choice or FAST (as opposed to a lender) may offer benefits to brokers based on factors which are not conflicted, such as loan application quality, or number of units originated. Such benefits relate to the services that an aggregator provides as a service provider to the broker, which are not potentially conflicted, in comparison to lenders who might seek to influence the sales behavior of brokers to consumers. Regulatory guidance should delineate commercial or service functions with those that are intended to influence broker choice of a particular product or lender.

Miscellaneous benefits - Regulatory guidance should clarify the scope of conflicted remuneration under proposed Division 4 of the Bill and Division 2 of Part 3.8 of the Regulations including commercial benefits, benefits to staff, small value benefits, IT systems.

Construction and lines of credit - Products such as construction loans and lines of credit are designed to be drawn over time. We propose that the benefit be calculated on the limit (excluded from the drawdown calculation) for loans for the purpose of construction and lines of credit.

Conclusion

NAB believes mortgage brokers play an essential role in enhancing competition in the home loan market and enabling access to credit for home buyers and supports industry reform to improve customer outcomes. We appreciate the opportunity to provide any further feedback or information you may require.