ASIC Consultation Paper 327 – Mortgage Brokers and the Best Interests Duty

Submission by Legal Aid Queensland

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Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to make a submission to the Australian Security and Investment Commission Consultation on CP 327 Mortgage Broker and the Best Interests Duty.

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 in relation to banking, insurance, mortgage stress, housing repossession, debt, contracts, loans, telecommunications, credit reporting and unsolicited consumer agreements. Legal Aid Queensland's Farm and Rural Legal Service (FRLS) 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.

Proposals and Questions

Proposal

B1 We propose to provide high-level guidance on our expectations for what mortgage brokers may need to do to meet the best interests duty 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.

Questions

B1Q2 Do you agree with our approach to structuring our guidance around the mortgage broking process?

LAQ supports a principle-based approach to structuring guidance.

B1Q2 Are there any steps or processes not covered in the draft guidance which are of particular relevance to the best interests duty

No comment.

Proposal

We also propose to address specific issues, including:

(a) the interaction of the best interests duty and the responsible lending obligations;

(b) the implications of the best interests duty for the range of credit providers and products mortgage brokers deal with;

(c) when the best interests duty applies; and

(d) other circumstances including packaged products or matters outside the mortgage broker's expertise.

Questions

B2Q1 What additional specific issues (if any) do you consider should be addressed in the draft guidance? Why is guidance on these issues needed?

- *Guidance is necessary as LAQ has seen 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 they were seeking;*
- *misrepresenting a consumer's income and expenses;*
- *recommending a consumer take out an inappropriate financial product that was not suited to their needs;*
- *directing clients to products that pay the mortgage broker the largest commission;*
- *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.*

Proposal

B3 We propose to provide guidance that mortgage brokers should gather relevant information to ensure they can provide recommendations that will be in the consumer's best interests. The draft guidance indicates that this may involve an iterative process of receiving instructions and making inquiries.

See draft RG 000.29–RG 000.42.

Questions

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?

No comment

B3Q2 When should mortgage brokers make further inquiries into a consumer's circumstances to act in their best interests?

ASIC should give some guidance as to what documentary information a broker should collect when gathering information about the consumer. Best practice requires that at a minimum when a broker is verifying income, expenses and assessing what is in the consumer's best interest that the broker obtain three months of bank statements for all bank accounts held solely in the consumer's name or jointly with others. These bank statements can then be used to assess anomalies in income or expenses and whether the proposed product is in the consumers best interest. If there are anomalies in this information the broker must then make further inquiries.

For example, bank accounts can indicate:

- the individual expenses and lifestyle;
- The amount of income from all sources and whether the income is paid weekly, fortnightly monthly etc;
- Whether the consumer is employed casually or earns overtime if payments are irregular;
- The sources of income;
- Whether the consumer has a gambling problem;
- Whether the consumer has financial commitments that are not discretionary and not included on a credit report such as school fees, child care, child support and or the repayment of fines;
- What a consumer's regular expenses are through direct debits;
- Whether the consumer is financially responsible for someone else;
- Whether the consumer has accessed unregulated credit such as "after pay" or private loans;
- What other persons maybe contributing to the household expenses of person who are not parties to the proposed loan; and or
- Whether the consumer is already making payments for insurance products such as life or consumer credit.

There may also be other documents that could be used to interrogate the information that the broker has collected from the consumer such as payslips, rates notices, credit reports, tax returns loan agreements, penalties and enforcement registry statements, employment contracts, cash flow projections and asset and liability statements in particular for farmers.

Proposal

B4 We propose that mortgage brokers should consider products holistically to assess whether they are in the consumer's best interests. The draft guidance describes factors which may be relevant to this assessment, although the factors and their relative importance will depend on the consumer's circumstances

Questions

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

Mortgage brokers should consider products holistically in assessing whether they are in the consumer's best interests. Some of the factors are well set out in the draft guide at RG0000.46. If, for example, only cost considerations were used to assess consumers best interest then matters such as foreseeable changes in a consumer's personal and financial circumstances would not be taken into account and failure to take that into account may cause the consumer significant detriment.

Proposal

B5 We propose to provide guidance that:

(a) the cost of a product—such as interest rate, fees and charges and repayment size—is a factor that should be prioritised during this assessment; and

(b) where other non-cost considerations affect what is in the consumer's best interests, brokers should assess whether those considerations or loan features have a realistic possibility of offering the consumer good value or a net benefit relative to other options.

See draft RG 000.43–RG 000.76.

Questions

B5Q1 What factors and product features do you consider are most relevant to assessing whether home loan products are in an individual consumer's best interests?

The features most relevant to assessing whether the home loan products are in the individual's best interest include:

- The cost of the product including the interest, whether mortgage insurance is payable, and ongoing monthly fees and charges;
- The capacity of the borrower to pay without substantial hardship;
- The other financial or non-financial obligations of the borrower, for example in relation to reverse mortgages whether the borrower will need some of the equity in the property to fund their aged care requirements or if the borrower has children who may need future support;
- Flexibility of payments options;
- In light of mandating the reporting of repayment history information and defaults on credit reports, the way in which offset accounts are structured. Some consumers may want to have the flexibility of not making regular repayments to a loan, because they may be seasonal workers, having a break from work or to travel. If they have an offset account from which payments are drawn, then they will not be late in any particular payment (as the payment is made from the offset) so will not have RHI recorded or if they do not pay for an extended period (more than 60 days) will not have a default recorded;
- Term of the loan;
- Taking into account expected changes in a person's life, for example moving into retirement, the sources of income after retirement, access to lump sum payments or moving into other types of accommodation; and
- Whether the person would need detailed other advice to assess whether the product is suitable for them and the likelihood of the person accessing the advice. For example, for reverse mortgage products it may be necessary to obtain Centrelink, tax advice and/or financial and investment advice.

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

LAQ supports ASIC's expectations about how cost and non-cost factors should be considered by a broker when making an assessment.

B5Q3 Are there any other factors or circumstances relevant to determining whether a product is in the consumer's best interests that our guidance should discuss? If so, what are they and why is guidance needed?

There are no further factors or circumstances outside those identified by ASIC that LAQ can identify.as relevant to determining whether a product is in the consumer's best interests.

Proposal

B6 We propose to provide guidance to encourage mortgage brokers to, where necessary, tailor how they present product options and recommendations to account for the consumer's expectations and circumstances. We also propose to emphasise the educative role of mortgage brokers and the importance of presenting a range of options.

See draft RG 000.77–RG 000.92

Questions

B6Q1 Are there any other factors relevant to the presentation of information that we should consider including in our guidance?

We emphasise the importance of mortgage brokers being able to present information in different ways that are suitable for the individual client to understand.

B6Q2 If you are a mortgage broker, how do you typically present information to consumers? Does this information take a particular form?

No comment

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)?

It is critical that the mortgage broker is able to explain to the consumer why one product is preferable to another based on the consumer's circumstances. In addition the mortgage broker should be able to explain the features of products that they are recommending. This will involve an element of educating the consumer.

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?

It is difficult to see with the myriad of products and providers available, that only one option is suitable for the consumer. In our view making just one offer should be viewed as prima facie not in the consumer's best interest. In those circumstances the mortgage broker would have to provide additional information as to why the product offering was in the consumer's best interest.

B6Q5 How can a mortgage broker act in a consumer's best interests when assisting them to apply for one credit product when the broker recommended another?

Once the mortgage broker has provided a recommended option and the consumer has chosen not to proceed with the recommended option but chosen another option, the mortgage broker should assist the consumer to apply for the other credit product. The mortgage broker would need to record a detailed statement of the advice that they provided to the consumer before assisting the consumer to apply for a loan that is not the recommended option.

Proposal

B7 We propose to avoid duplicating the content of other regulatory guides in our guidance on the best interests obligations. We propose to distinguish the requirements of the best interests duty and responsible lending obligations.

See draft RG 000.93–RG 000.99

Questions

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

B7Q2 Are there any other requirements of the National Credit Act that interact with the new obligations and require further guidance?

The guideline makes it clear that the best interests' duty is separate and different to responsible lending obligations. We agree that a particular loan may be responsible but may, nevertheless, not be in the consumers best interest.

Proposal

B8 We propose to provide guidance that mortgage brokers must be satisfied that the range of products they can access and recommend is sufficient to allow them to act in consumers' best interests. Additionally, we would generally expect brokers to maintain an awareness of products and features that may be available on the market.

See draft RG 000.100–RG 000.104.

Questions

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

Mortgage brokers should be required to consider products provided by parties outside their panel of credit providers.

This is particularly so if the individual circumstances of the borrower are unique because they have, for example, a higher risk profile which limits the options the broker maybe able to present or the broker has a very narrow panel of lenders which may similarly limit the options available to the consumer.

Where either of these circumstances exist, then it may mean that the broker is not acting in the consumer's best interest if they recommend a product they have access to, without considering other products. If after considering other products, the mortgage broker may still have an appropriate product that meets the best interest duty or if not must then refer the consumer to another broker who may be able to assist them in obtaining an appropriate product.

We are aware of brokers recommending products to consumers, who have a higher risk profile, that were entirely inappropriate because the terms of the loans were very short (for example 12 months or less), the interest rates were very high (for example up to 48%) and were structured in such a way to avoid regulation by the National Credit Code. If the broker was required to also consider products provided by providers outside their panel of credit providers, the loan that was negotiated may not have eventuated. However, there is a possibility that there may be no appropriate loans and in those circumstance the broker would not meet the best interest duty if they suggest an inappropriate option.

B8Q2 If you are a mortgage broker, does the software you currently use present you with options that you are not accredited to recommend?

No comment.

Proposal

B9 We propose to provide guidance to clarify that the best interests duty generally applies at the time of the assessment and whenever a mortgage broker provides credit assistance.

See draft RG 000.105–RG 000.109.

Questions

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

It is critical that it applies at the date of assessment whenever credit assistance is provided. If the best interest duty applied at another time, it might mean that information that only became available at a later time but before the time of assessment would not be taken into consideration by the broker.

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

Yes, particularly as the consumer's circumstances may have changed as well as the product offerings.

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?

Yes, particularly if the mortgage broker was aware of impending changes in the consumer's life such as, the impending birth of a child and the effect on expenses and income as a consequence of having a child , a contract of employment ending or a new contract of employment or impending retirement

Proposal

B10 We propose to provide guidance that recommendations by mortgage brokers on packages are to be based on a holistic assessment of the package and involve a process of comparison with other available products, such as other packages or standalone home loan products.

See draft RG 000.110–RG 000.117

Questions

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

B10Q2 If you are a mortgage broker, do you typically compare a range of packages that are available to you? Do you currently compare packages available to standalone home loan products? If so, how

Credit cards recommended as part of a home loan package have been particularly problematic for consumers. Generally, the consumer never asks for the credit card and are not necessarily cheaper than the credit cards the consumer already has. Recommending such additional credit may also breach responsible lending obligations as extra credit is provided.

Sometimes the consumer already has a credit card and the recommendation by the broker is that extra funds are obtained in the home loan and used to pay out the existing third party credit card. However, the third party credit card is not paid out on settlement of the new packaged home loan resulting in the consumer having extra credit that they did not ask for.

Even where the third party credit card is paid out on settlement there is no action to ensure that the third party credit card was cancelled resulting in the risk that the consumer may use that card again in the future.

In addition, it is not enough to say that paying out a credit card using home loan funds is in the best interest of consumers as the interest rate is cheaper. The lower interest rate is only advantageous to the consumer if they make extra repayments to the home loan that matched their required payments under the credit card account. Otherwise the consumer, may end up paying more in interest payments than had they maintained their third party credit card and paid it off in accordance with their minimum payment obligations. This is because the home loan is repayable over 25 to 30 years.

This leads to significant detriment for consumers. The mortgage broker should take these factors into account when recommending packaged products to a consumer.

The same issue exists if a broker recommends insurance products in conjunction with a home loan product. In a recent case, a consumer paying an insurance policy with one provider and when he received his home loan was also provided with another similar insurance product from the home loan provider. The consumer was paying for a number of insurance policies for the same risk for a number of years without realising he had taken out the additional.

Proposal

B11 We propose that mortgage brokers should be able to give guidance about the suitability and value of product features for each consumer, including a basic understanding of tax implications. However, we do not expect mortgage brokers to advise on matters outside their expertise.

See draft RG 000.118–RG 000.120.

Questions

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?

Sometimes consumers will need some guidance in relation to Centrelink issues. Mortgage brokers should have some understanding of Centrelink issues if they are recommending reverse mortgage products. For detailed advice as to the individual consequences a consumer should be directed to Centrelink. However, mortgage brokers should not be able to shield themselves from liability by making blanket referrals where they ought to know that the product is likely to have some negative consequences for the consumer. For example, if a consumer is on an aged pension and takes out a reverse mortgage it may affect their rate of payment of the aged pension. That information should be provided to the consumer with the recommendation that that they seek advice from Centrelink as to the specific effect on their payment rate, if any.

Proposal

C1 We propose to provide guidance that complying with the conflict priority rule requires mortgage brokers to:

(a) identify what interests they or their related parties have, and prioritise the consumer's interests; and

(b) not provide credit assistance where it would not be possible to prioritise the consumer's interests.

See draft RG 000.121–RG 000.138

Questions

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

Yes.

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

No

C1Q3 Are there other types of activities or conduct that would contravene the conflict priority rule where ASIC should provide guidance.

No.

Proposal

We propose to provide guidance that:

(a) what constitutes reasonable steps may vary depending on the nature and scale of the mortgage broker's operations and their relationship with the credit licensee; and

(b) in determining whether steps taken are reasonable, we would consider factors such as the likelihood of the mortgage broker not complying and the harm that would result from that non-compliance.

See draft RG 000.145–RG 000.149

Questions

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?

No comment.

C3Q2 If you are a credit licensee, how do you currently monitor your authorised mortgage brokers? How do you intend to monitor compliance with the best interests' obligations?

Not applicable

Future Reviews and resourcing of the community sector

LAQ supports a mandatory review being conducted of the regulatory guide in conjunction with a review of the legislation implementing a mortgage brokers best interest duty. Given that there is in our view a need to extend the best interest duty to other brokers, three years would be a reasonable period of time within which a review should be conducted. However there must be provision made for the resourcing of the community sector so that they can contribute meaningfully to reviews