REPORT 662

Response to submissions on CP 327 on mortgage brokers and the best interests duty

June 2020

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 327 *Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty* (CP 327) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC may exercise specific powers under legislation
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the credit legislation and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 273 *Mortgage brokers: Best interests duty* (RG 273).

Contents

A Overview/consultation process

1 The best interests duty and related obligations for mortgage brokers were legislated by the Parliament in response to Recommendation 1.2 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).

Note: See Royal Commission, Final report, 4 February 2019.

2 The obligations will require mortgage brokers to act in the best interests of consumers and to prioritise consumers' interests when providing credit assistance.

Note: ASIC Credit (Deferral of Mortgage Broker Obligations) Instrument 2020/487 means that mortgage brokers and Australian credit licensees do not need to comply with the obligations until 1 January 2021. See Media Release (20-109MR) *ASIC defers commencement of mortgage broker reforms and design and distribution obligations* (8 May 2020).

3 The best interests duty is a statement of principle which seeks to align the interests of the mortgage broker with the interests and expectations of the consumer.

4 In Consultation Paper 327 *Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty* (CP 327), we consulted on our proposed guidance on the best interests duty and related obligations.

5 This report highlights the key issues that arose out of the submissions received on CP 327 and our responses to those issues.

6 This report is not meant to be a comprehensive summary of all submissions received. It is also not meant to be a detailed report on every question from CP 327. We have limited this report to the key issues.

Responses to consultation

7 We received six confidential and 15 non-confidential submissions to CP 327, including from industry groups and associations, consumer groups and legal firms. The submissions informed our final guidance in Regulatory Guide 273 *Mortgage brokers: Best interests duty* (RG 273) and we are grateful to respondents for taking the time to send us their comments.

8 The main issues raised by respondents were:

(a) the importance that mortgage brokers should place on cost as a factor in determining whether recommending a product will be in a consumer's best interests;

(b) the range of credit providers and products offered (i.e. panel composition) and the extent to which brokers should need to look beyond their panels;

(c) how brokers can determine if a package of products might be in a consumer's best interests;

(d) who the duty applies to and when; and

(e) what information should be recorded.

These issues are discussed in Section B of this report, with other issues covered in Section C.

9 Respondents also commented on the design of the new law, including the definition of 'mortgage broker' and the application of the reforms to products other than home loans. ASIC guidance explains how we interpret the law and describes the principles underlying our approach. Our guidance must be consistent with the law and cannot change policy decisions made by the Government.

10 We also received feedback on the Government's reforms to mortgage broker remuneration. We are not providing guidance on these reforms at this time. The Government has not yet made regulations to finalise the details of the mortgage broker remuneration reforms.

11 For a list of the non-confidential respondents to CP 327, see the appendix. Copies of these submissions are currently on the ASIC website at www.asic.gov.au/cp under CP 327.

B Key issues raised in submissions on CP 327

Key points

This section outlines the feedback we received on the following key aspects of our proposed guidance in CP 327, and our responses to these issues:

- whether cost is a factor that should generally be prioritised when determining whether recommending a product is in the consumer's best interests;
- the range of credit providers and products offered (i.e. panel composition) and the extent to which brokers should need to look beyond their panel;
- how brokers can determine if a package of products is in a consumer's best interests;
- who the duty applies to and when; and
- the keeping of records.

Weighing up factors

12 In CP 327, we proposed to give high-level guidance on factors that may be relevant to the assessment of whether a product is in the consumer's best interests and to the weighting of cost and non-cost considerations.

13 We also proposed to give guidance that:

(a) the cost of a product—such as interest rate, fees, charges and repayment size—is a factor that should generally be prioritised during the assessment of whether products are in the consumer's best interests; 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.

14 We sought feedback on:

(a) whether mortgage brokers should consider products holistically in assessing whether they are in the consumer's best interests; and

(b) the factors and product features brokers might consider to be most relevant to that assessment.

15 Many respondents expressed the view that cost sometimes does not outweigh all other considerations, and that in some circumstances the consumer's objectives may mean that other factors are more important.

16 Conversely, some other submissions supported our proposals about the importance of cost.

17 Consumer advocates suggested that to meet the best interests duty, a broker should always be required to present a consumer with the lowest cost option, along with other options where appropriate, even in situations where this option does not meet the consumer's stated requirements or preferences.

ASIC's response

In Report 516 *Review of mortgage broker remuneration* (REP 516), we acknowledged that consumer outcomes are multifaceted and comprise a series of factors, such as price, product accessibility, product features and loan performance.

We continue to consider that cost is a factor that should generally be prioritised.

This does not necessarily mean that recommending the lowest cost option will always be in a consumer's best interests. Some consumers' circumstances will mean that the benefits provided by other features or factors will outweigh the importance of cost.

To better reflect this, we have provided greater clarity in our guidance on how mortgage brokers might weigh up factors and product features to determine which products may be in the consumer's best interests.

We have done this by:

- further describing our expectations of brokers when they are weighing up factors and features; and
- adding guidance and new examples on promotional offers and government schemes.

We recognise that factors and features vary in importance from consumer to consumer, and the weight that should be attributed to such factors when deciding upon recommendations may also vary.

This is consistent with our findings in REP 516.

Range of credit providers and products

18 In CP 327, we proposed 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.

19 Additionally, we indicated that we would generally expect brokers to maintain an awareness of products and features that may be available on the market. The draft guidance suggested that this could be achieved by informally benchmarking the options the broker could access against the wider market.

20 We sought feedback on whether mortgage brokers should be required to consider products provided by parties outside their panel of credit providers. We also asked whether brokers have software which presents them with options they are not accredited to recommend.

21 Many respondents suggested that the approach taken in the guidance could be interpreted to mean that brokers should look at the whole market for each consumer and not provide credit assistance if they are not accredited for the best product on the market. Some submissions identified practical difficulties that might arise as a result of this interpretation.

22 For example:

(a) time constraints may mean that obtaining accreditation with a new credit provider before settlement may not be possible; and

(b) some credit providers may choose not to deal with brokers at all, limiting brokers' ability to assist some consumers.

23 In this context, some respondents raised issues with the guidance on informal benchmarking and brokers maintaining awareness of the most price-competitive products on the market. Additionally, some respondents queried whether there should be a minimum number of credit providers on an aggregator's panel, and whether mortgage brokers should be accredited for a specific number of credit providers.

ASIC's response

We acknowledge the concerns raised that the guidance relating to our expectations for panel composition could be unclear.

In response, we have clarified our guidance as follows:

- Brokers need to ensure that their panel and accreditations are sufficient to allow them to act in their consumers' best interests.
- Having an awareness of the products and features that are available on the market is important for these purposes; brokers can achieve this by periodically comparing the products and credit providers they can access to those available on the market.
- The number of credit providers on a broker's panel may vary and we expect brokers to use their judgement to determine whether their panel composition is sufficient to meet their consumers' best interests.
- If a broker is not satisfied that the products and credit providers they can access and recommend will allow them to act in a consumer's best interests, the broker must not provide credit assistance to that consumer. In these situations, it may be helpful for the broker to refer the consumer to another broker who may be better placed to assist them.

We have not specified a minimum panel size, as this is not consistent with the legislative design of the best interests duty. However, brokers should be accredited with a reasonably representative panel of credit providers and products, reflecting the market they operate in.

We have also added an example to demonstrate how a broker's awareness of the broader market may assist them in a situation where the consumer is seeking a certain type of credit product or credit provider which the broker does not have access to.

Packages

24 In CP 327, we proposed to provide guidance that recommendations by mortgage brokers on packages are to be based on a holistic assessment of the package. This assessment would involve a process of comparison with other available products, such as other packages or standalone home loan products.

25 We sought feedback on:

(a) the basis on which mortgage brokers typically recommend packages to consumers;

(b) whether brokers typically compare a range of available packages; and

(c) whether brokers compare packages to standalone home loan products and, if so, the basis for this.

26 Some respondents noted that the arrangements that underpin mortgage brokers assisting consumers to apply for home loans do not generally extend to credit cards. This can affect brokers' ability to access a wide range of credit card options. These respondents submitted that for the guidance to have a practical application, it should clarify that packages are to be compared with packages. This would mean that brokers would not need to compare credit cards within packages to other credit cards, for example.

27 Consumer advocates suggested that our guidance clarify that each component of a package needs to meet the best interests of the consumer, and highlighted that credit cards, in particular, can be risky products for consumers.

28 Some respondents submitted that mortgage brokers cannot provide specific advice on the terms and conditions of credit cards, and that brokers should be able to disclose that providing such advice does not form part of their service to the consumer.

29 Some respondents supported a holistic approach. These respondents submitted that considering the loan package as a whole and comparing it to other available loans (standalone or packaged) to determine whether the package might be in the consumer's best interests would lead to favourable consumer outcomes.

ASIC's response

The design of the new laws means that the best interests duty applies to all credit assistance provided by brokers. This includes the recommendation of each credit product in a package.

As a result, our view is that a product's inclusion, as part of a package, must be in the best interests of the consumer in order for that package to be recommended. A range of factors may be relevant to what is in the consumer's best interests, including their objectives and other products held. It may also sometimes be helpful to assess packages holistically.

ASIC's response (cont.)

To clarify this, we have provided additional examples which demonstrate how a broker may compare packages to other packages and standalone home loan products available to the consumer.

The examples also provide guidance on the extent to which brokers may need to compare a packaged credit card with other products. At a minimum, brokers should be able to compare a potential packaged credit card to cards the consumer currently holds, as well as other cards that are packaged. However, as the law is principles-based, further inquiries may be warranted in certain circumstances.

Who the duty applies to and when

30 In CP 327, we proposed 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.

31 We sought feedback on:

(a) whether the best interests duty should apply at the time of the assessment;

(b) whether, when making subsequent assessments, brokers should rely on the initial assessment; and

(c) whether 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.

32 Many respondents noted that our draft guidance did not specify whether the best interests duty would apply to mortgage managers, and if so, the circumstances in which this would occur. Some respondents suggested that mortgage managers should be subject to the best interests duty when acting as a broker but not when acting as a credit provider.

33 Some respondents asked when the obligations would apply and what our expectations were for reasonable foreseeability. Respondents also sought further guidance on what is expected of brokers when the credit assistance process is delayed and may need to be restarted.

34 Several respondents asked whether the best interests duty and related obligations would apply to credit for business or commercial purposes. Some also requested that we provide guidance on when a person may 'carry on a business' as a mortgage broker.

35 Some respondents asked whether brokers will be subject to the best interests duty in relation to standalone non-mortgage-related credit products and requested that the guidance address this scenario.

ASIC's response

We acknowledge the concerns raised about whether mortgage managers would fall within the 'mortgage broker' definition. After considering this feedback, we have decided to provide more detailed guidance on the application of the best interests duty.

Whether mortgage managers will be captured under the definition of 'mortgage broker' will depend on the business model of individual mortgage managers. Therefore, individual mortgage managers should determine whether they will be captured by the 'mortgage broker' definition in s15B of the *National Consumer Credit Protection Act 2009*. ASIC guidance cannot change the effect of s15B, or reflect every possible business model.

However, to assist with this determination, we have provided additional guidance on our view of when a person may not be a mortgage broker. The additional guidance clarifies that exercising some of the rights, or performing some of the obligations of a credit provider in relation to the majority of loans will mean the person is not within the 'mortgage broker' definition.

Our guidance states that the assessment of what product(s) would be in the consumer's best interests is a point-in-time assessment.

We have provided further guidance to outline circumstances where it may be appropriate for brokers to start a new assessment or make new inquiries before making a recommendation or assisting the consumer to acquire a product.

In accordance with the consumer credit regime, the best interests duty applies only in relation to credit products which are provided to consumers for personal, domestic or household purposes or for the purchase or improvement of residential investment property. This also reflects the guidance provided in Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209).

The guidance refers to Regulatory Guide 203 *Do I need a credit licence?* (RG 203) and Regulatory Guide 121 *Doing financial services business in Australia* (RG 121) for the meaning of 'carrying on a business'. RG 121 refers to instances where courts have considered the meaning of this phrase.

Record keeping

36 In CP 327, we proposed to provide guidance on the types of records mortgage brokers may keep to help them demonstrate that they have acted in the consumer's best interests.

37 This guidance:

(a) specifically outlined the type and nature of documents that might be kept, including documents that make clear how the credit assistance provided was in the consumer's best interests;

(b) suggested that the types of records kept will vary depending on the scope of the recommendations and assistance provided to the consumer; and

(c) suggested that the period of time documents should be kept may vary and brokers should use their judgement.

38 We sought feedback on:

(a) our expectations for record keeping;

(b) whether there are other examples of types of records that could be referred to;

(c) how long records should be kept for; and

(d) whether credit licensees already require mortgage brokers to keep standardised records, and if so, what form this takes.

39 We received several requests to clarify whether there are any circumstances where brokers should document the reasons why a product was not recommended. Some respondents were of the view that, in some instances, mortgage brokers should document such reasoning, but that it would be onerous for a broker to document the reasons for not considering every other product on the market.

40 Several respondents, including consumer advocates, suggested that the guidance should stipulate the minimum amount of time that records should be kept for. Some suggested that the time period should be at least 10 years. Other respondents suggested keeping records for a minimum of seven years to provide consistency with our record-keeping guidance for the responsible lending obligations in RG 209.

41 Some respondents queried whether the steps taken by a mortgage broker to educate a consumer can be measured and recorded and how this might occur.

ASIC's response

We appreciate that evidence of compliance with the best interests duty and related obligations is likely to come predominantly from a mortgage broker's records. To that end, we think it is important that the suggestions we make in relation to record keeping are practicable.

We have clarified that brokers are unlikely to need to provide reasons for not considering or recommending every alternative product on the market. Distinguishing the type of product or feature, as opposed to exhaustively excluding individual products, may be sufficient.

We also recognise that, in some situations, recording the reasons why a certain product or type of product was not recommended might assist in demonstrating compliance with the best interests duty. We have provided examples to illustrate the types of situations where this may be relevant.

While we acknowledge the concerns raised about not prescribing a minimum timeframe for keeping records, we consider that this timeframe may vary and brokers are well placed to use their judgement to determine how long their records should be kept.

We have also noted that brokers may be subject to legal requirements to keep information for other obligations, such as the responsible lending obligations and the product design and distribution obligations.

We suggest that drafting notes and creating records throughout the credit assistance process may be an effective way for brokers to keep accurate records. We also suggest that keeping a narrative summary can be an effective way of outlining why products were recommended and the steps taken throughout the process.

We expect these suggestions will help brokers to demonstrate compliance with the best interests duty, including the steps taken to educate the consumer. We have added a new example to illustrate how these practical suggestions could be adopted.

C Other issues

Key points

This section outlines the feedback we received on other aspects of our proposed guidance in CP 327, and our response to these issues:

- the application of the conflict priority rule;
- our expectations relating to monitoring of mortgage brokers by licensees;
- how brokers should consider promotional offers and incentives offered by credit providers;
- our expectations for presenting information and recommendations, including the number of recommendations brokers should provide to consumers; and
- whether brokers are prohibited from misleading or deceiving consumers about when the duty applies.

The conflict priority rule

42 In CP 327, we set out our expectations that complying with the conflict priority rule will require 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.

43 We sought feedback on our general approach to administering the conflict priority rule and asked whether there are other factors relevant to the prioritisation of consumers' interests that we should consider including in our guidance.

44 We also sought feedback on whether there are types of activities or conduct, in addition to those addressed in the draft guidance, that would contravene the conflict priority rule.

45 While many submissions did not comment on this aspect of the draft guidance, a number did:

(a) Several respondents asked whether the conflict priority rule extends to non-credit products such as insurance.

(b) Some respondents requested clarification of how the conflict priority rule might apply in relation to related and third parties when receiving payments.

(c) One respondent asked about the relationship between the conflict priority rule and clawback of commissions.

> *ASIC's response*
>
> The guidance states that the conflict priority rule means that a broker must not recommend a product or service of a related party that would create extra revenue for the broker, their credit licensee or any other related party, unless doing so would also be in the consumer's best interests.
>
> The guidance also states that to comply with the conflict priority rule, mortgage brokers must first identify what interests they and their related parties have. We expect that brokers will then consider what a mortgage broker in the same position, but without a conflict of interest, would do in the circumstances.
>
> We believe this approach is consistent with the legislative purpose of the conflict priority rule and will reduce the potential for conflicts of interest to affect the advice consumers receive from brokers.

Monitoring of mortgage brokers by licensees

46 In CP 327, we proposed to provide guidance on credit licensees' obligation to take reasonable steps to ensure that their representatives who are mortgage brokers comply with the best interests duty and related obligations.

47 We proposed that:

(a) what constitutes reasonable steps may vary depending on the nature and scale of the 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.

48 We sought feedback on our expectations of the practical steps credit licensees should take to comply with this obligation, and the methods licensees currently use to monitor their brokers.

49 Several respondents asked whether proactive monitoring was required and, if so, what measures ASIC would expect. Some respondents also asked whether the obligation would require licensees to use automated monitoring systems to track the operations of the representatives. One respondent considered that the technology that is available may not be able to fulfil this requirement.

> *ASIC's response*
>
> In response to this feedback, we have adjusted our guidance on this obligation to:
>
> - clarify that the obligation requires proactive steps for licensees to be compliant; and
> - provide an example of proactive steps that a licensee can take after it becomes aware of a breach.

> *ASIC's response (cont.)*
>
> Our guidance on these issues reflects the explanatory materials supporting the changes to the law, as well as judicial interpretation of similar obligations in the *Corporations Act 2001*.
>
> We consider that the obligation does not impose the use of a particular technology. Although credit licensees are required to take proactive steps, we note that the requirement to take 'reasonable steps' would not extend to using technology which does not exist.

Promotional offers and Government schemes

50 Some respondents requested additional guidance about how mortgage brokers should consider promotional offers and incentives offered by credit providers when complying with the best interests duty. Examples of these offers and incentives include 'cash back' or time-limited 'discounted interest rate' offers.

51 Guidance was also sought in relation to Government schemes, such as the First Home Loan Deposit Scheme, the First Home Super Saver Scheme and first home owner grants.

> *ASIC's response*
>
> We have added guidance about promotional offers, including how they may be relevant to a broker's assessment of what recommendations would be in a consumer's best interests.
>
> We have also added guidance and a new example to outline our expectations in relation to Government schemes that may be available to some consumers, such as first home buyers.
>
> Our general expectation is that, when relevant, brokers should educate consumers about the availability and eligibility requirements of these schemes.

Presenting information and recommendations

52 In CP 327, we proposed to provide guidance to encourage brokers to tailor how they present product options and recommendations to account for the consumer's expectations and circumstances, where necessary. We also proposed to emphasise the educative role of mortgage brokers and the importance of presenting a range of options when acting in a consumer's best interests.

53 Consumer advocates asked whether it should be implied that mortgage brokers are to only provide one recommendation from a shortlist of options. The submission raising this issue suggested that limiting brokers to providing only one recommendation may not achieve the legislative

intention of the best interests duty and that there are situations where consumers would benefit from receiving multiple recommendations.

Note: Although the submission concerned question B6Q2 in CP 327, it was made in response to question B2Q1 (feedback on additional specific issues that should be covered).

ASIC's response

We consider that, in some situations, it might be necessary for a broker to make multiple recommendations, particularly when there are products that are largely similar and would equally meet the consumer's best interests. We have amended our guidance accordingly.

Misleading or deceiving consumers

54 Consumer advocates suggested that we should clarify that mortgage brokers are prohibited from misleading or deceiving consumers about when the best interests duty applies and whether it applies to non-credit products.

ASIC's response

We have clarified that the best interests duty does not apply in relation to non-credit products or services. When communicating with consumers, brokers should be aware of their obligations under the *Australian Securities and Investments Commission Act 2001* not to mislead or deceive.

Appendix: List of non-confidential respondents

- AHL Investments Pty Ltd
- Australian Banking Association
- Australian Finance Group Ltd
- Australian Finance Industry Association
- CHOICE, Consumer Action Law Centre, Consumer Credit Legal Service (WA), Financial Counselling Australia and Financial Rights Legal Centre (joint submission)
- Combined Industry Forum
- Connective Credit Services Pty Ltd
- Finance Brokers Association of Australia Ltd
- Financial Planning Association of Australia
- Hatch Financial Services
- Legal Aid Queensland
- Mortgage and Finance Association of Australia
- Mortgage Choice Ltd
- Prospa Advance Pty Ltd
- Purple Circle Financial Services Pty Ltd