

11 March 2020

Product Regulation
Strategic Policy
Australian Securities and Investments Commission
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Submission on Consultation Paper 325: Product design and distribution obligations (DADO)

The Mortgage & Finance Association of Australia (**MFAA**) is pleased to have the opportunity to comment on Consultation Paper 325 'product design and distribution obligations' and the Draft Regulatory Guide.

We have taken this opportunity to comment on the Draft Regulatory Guide and Consultation Paper at a high level, rather than responding to the specific questions in the Consultation Paper. We are not addressing the requirements on lenders in any detail.

We do agree with feedback from other industry bodies of the difficulties in formulating a Target Market Determination (**TMD**) for generic products like home loans and personal loans.

Part 1: About the MFAA

With more than 13,500 members, the MFAA is Australia's leading professional association for the mortgage broking industry, with membership covering mortgage and finance brokers, aggregators, lenders, mortgage managers, mortgage insurers and other suppliers to the mortgage broking industry. The stated purpose of the MFAA is to advance the interests of our members through leadership in advocacy, education and promotion. To achieve this aim, the MFAA promotes and advances the broker proposition to a range of external stakeholders, including governments, regulators and consumers, and continues to demonstrate the commitment of MFAA professionals to the maintenance of the highest standards of education and development.

Part 2: The MFAA's feedback

The MFAA agrees that industry should strive to achieve better customer outcomes in the provision of financial services. Mortgage brokers play an important role in assisting consumers to navigate a dense credit market, equipping them with the information and support that they need to make good financial decisions in relation to what, for many, will be the biggest investment of their lives.

This submission outlines a range of proposals in relation to the implementation of DADO which support the achievement of good consumer outcomes whilst ensuring that the additional compliance burden of DADO does not lead to a decrease in competition for consumers and lenders, a contraction of the mortgage broking industry and a reduction in available mortgage credit products.

By way of summary, the MFAA's submissions focus on five key issues:

1. The interplay between the incoming Broker Best interests Duty and DADO;
2. The obligation to prepare TMDs – it should be made clear that mortgage brokers (as credit representatives or licensees in their own right), intermediaries (including aggregators), and referrers do not need to prepare TMDs;
3. Practical impacts of DADO for choice and competition in credit – it is important that mortgage brokers (as credit representatives or licensees in their own right), intermediaries (including aggregators), and referrers need not be monitored by lenders nor be subject to the reporting regime;
4. Referrers and intermediaries;
5. Aggregators; and
6. Subsidiary or 'bundled' credit products.

2.1 The interplay between the Broker Best Interests Duty and DADO

Mortgage brokers act for the consumer, not the lender, to facilitate applications for credit.

Whilst mortgage brokers commonly have access to a panel of lenders, this does not mean that they distribute products on behalf of the lenders on that panel.

Rather, mortgage brokers are simply accredited by lenders to submit applications for credit on a consumer's behalf.

The *Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures) Act 2019* (Cth) (**Broker Best Interests Duty**) commencing on 1 July 2020 enshrines an obligation for brokers to act in the best interests of the consumer. This obligation imposes a higher standard on brokers than the new Design and Distribution Obligations (DADO).

The Broker Best Interests Duty recognises the role that mortgage brokers play as an agent of the consumer (as distinct from the lender) and confirms that their primary obligation is to serve the best interests of the consumer.

An important factor in achieving good consumer outcomes is maintaining the independence of mortgage brokers. Treating mortgage brokers as a distributor for the purposes of DADO threatens this independence.

Similar to financial advisors, mortgage brokers are required to investigate and understand the consumer's objectives, financial situation and needs before recommending a product which meets those objectives, financial situation and needs under current law (NCCP Act). ASIC's commentary in RG 000.180 regarding the role of a financial advisor also encapsulates the role that mortgage brokers play in credit:

Interaction with personal advice obligations

Financial advisers

RG 000.180 If a distributor provides compliant personal advice to a consumer in relation to a financial product, its advice, and implementation of that advice, will be tailored to the consumer's personal circumstances. In these

circumstances, the distributor is not required to take reasonable steps that will, or are reasonably likely to, result in distribution of a financial product being consistent with the target market determination: see 994E(3) and the definition of 'excluded conduct' in s994A. Financial advisers providing personal advice are under legal obligations to take into account the consumer's personal circumstances and provide advice in their best interests.

The law should be clarified to exempt mortgage brokers from DADO in the same way financial advisers are exempted. In addition, because mortgage brokers and financial advisors are required to consider products through the lens of the consumers' objectives, financial situation and needs, neither should be required to review the content of any TMD.

Because the Broker Best Interest Duty imposes a higher standard than DADO, requiring mortgage brokers to comply with DADO adds an additional compliance burden on industry without achieving any additional consumer benefit. We also reject feedback received from ASIC during the formal consultations on CP325 that the BID will not have been in operation for long enough when DADO comes into operation for ASIC to assess its effectiveness. This statement ignores the fact that the mortgage broker BID (particularly when coupled with responsible lending obligations) is a much stronger duty than that which is operating in financial planning, and that planners have been exempted from the DADO regime.

The mortgage broker Best Interests Duty is a principles based duty that is in fact considered to be more onerous than the financial advice "safe harbour" duty, in effect providing an even higher level of consumer protection than available in the financial advice sector which has been exempted from DADO. Mortgage brokers also provide credit assistance on products that are less complex, carry lower risk (advising on credit versus investing life savings) and accordingly carry lower levels of potential consumer detriment to those available in the financial advice sector which we again feel is supportive of a mortgage broker exemption in a similar manner to that afforded to financial advisers.

The MFAA also considers that a conflict of interest may arise with respect to duties under DADO and the Broker Best Interest Duty.

Under the Broker Best Interest Duty, mortgage brokers have a duty to act in the best interest of the consumer when providing credit assistance. However, if brokers are treated as distributors for the purposes of DADO, they will also have a duty to lenders to distribute products in accordance with that product's TMD.

Despite both duties being introduced from a customer-centric and community standards perspective, we think that it is likely they could each lead to different customer outcomes. There may well be circumstances where the product offered by a particular lender is the best on offer for the relevant consumer, notwithstanding that the customer falls outside of the issuer's TMD. Requiring a mortgage broker to simultaneously comply with the Broker Best Interests Duty and DADO is likely to lead to conflicts of interest.

We think that this conflict of interest can be avoided altogether if the higher mortgage broker Best Interests Duty is relied upon and brokers are clearly exempt from additional obligations under DADO.

Mortgage brokers could easily be exempted from DADO by exempting those who must comply with the Broker Best Interest Duty.

2.3. The obligation to prepare TMDs

If mortgage brokers are not exempted from DADO, the Regulatory Guide should make it clear that there is no obligation on a distributor to make their own TMD.

The ambiguity arises because an 'issuer' has an obligation to prepare a TMD and 'issue' is defined in section 9 of the Corporations Act to mean '*circulate, distribute, and disseminate*'. There is a risk that mortgage brokers (as credit representatives or licensees in their own right) and aggregators could fall within this definition because they 'circulate, distribute, and disseminate' credit products.

In contrast, the meaning of *issued, issuer, acquire* and *provide* in relation to financial products is defined in S761E(4) of the Corporations Act to mean "the person responsible for the obligations owed, under the terms of the facility that is the product".

The Act does not contain a definition of distribute or disseminate. However, because mortgage brokers are not responsible for the obligations owed to the consumer under the terms of the facility the better view is that they are not an issuer and therefore are not required to prepare a TMD.

We request that ASIC amend the Regulatory Guide to make it clear that mortgage brokers, intermediaries (including aggregators), and referrers (who are not lenders) are not required to prepare TMDs.

2.3. Practical impacts of DADO for choice and competition in credit

The purpose of DADO is to ensure that consumers are offered products which are appropriate for them. As noted above, mortgage brokers are already required by the Broker Best Interest Duty to go beyond ensuring that the consumer forms part of the target market for a credit product; they must ensure that their recommendations are in the consumer's best interests.

Imposing an additional layer of regulation leads an additional compliance burden for mortgage brokers and lenders, without achieving any additional consumer benefit.

Treating mortgage brokers as distributors and not applying a similar exemption to that provided for financial advisors will inevitably lead to mortgage brokers (the majority of which are small businesses):

- a) exiting the industry because the compliance costs make it unprofitable to operate;
- b) narrowing their panel of lenders to fewer providers to minimise the burden of being familiar with a significant number of different TMDs; or
- c) restricting their panel of lenders to the major Banks, whose product offerings and credit policies are largely similar, to the detriment of smaller lenders.

Each of these impacts, or a combination of them, will lead to a reduction of competition and consumer choice in credit, to the detriment of consumers.

The burden on lenders to monitor tens of thousands of mortgage brokers is also likely to lead to a contraction of lender distribution channels, further impacting on choice and competition.

We support the recent comments by COBA in a media release that additional regulation will reduce competition and place new entrants and smaller lenders at an unfair disadvantage. DADO's obligation on lenders to prepare DADOs for vanilla products, and (more importantly) lenders' obligation to monitor brokers is a key example of unnecessary and inappropriate regulatory burden.

2.4. Referrers and intermediaries

We use the term 'referrers' to refer to licensed and unlicensed persons who refer consumers to brokers or lenders without providing credit assistance. Licensed referrers act as 'intermediaries' as defined in section 9 of the NCCP Act.

We note that referrers do not fall within the definition of an issuer for the same reason mortgage brokers do not – as stated in 2.3. However, an express statement to this effect would be useful in the Regulatory Guide, for the avoidance of doubt.

It is equally important that lenders do not have to monitor the conduct of licensed and unlicensed referrers and that these referrers are not subject to the reporting regime. Referrers do not provide credit assistance to consumers. Apart from the impracticality and huge cost of doing so, such monitoring is likely to have the same anti-competitive result and poor consumer outcomes as monitoring mortgage brokers will have.

2.5. Aggregators

Aggregators usually have several roles including:

- acting as an 'intermediary' in respect of credit arranged by their licensed brokers should the broker hold their own ACL; and
- acting as an 'intermediary' in respect of credit arranged by their credit representatives should the aggregator also act as a credit licensee.

Aggregators provide a service which has become essential for mortgage brokers and for the promotion of competition.

Without aggregators to provide a platform to host lenders, provide systems, and monitor members, many lenders would lose an essential distribution channel and consumers would lose choice. There would be no option but for lenders to deal directly with brokers and reduce the number of brokers they deal with. Brokers would no longer be able to offer the broad range of solutions now provided.

Among other things, aggregators assess lenders and members before admission to their panel, provide valuable training, and monitor the performance of their members.

The income of aggregators has reduced over recent years as a result of competition, while legal obligations and lender/member demands have increased. The imposition of additional costs if subject to DADO may make some businesses unviable, or result in extra costs being passed onto consumers. The mass of small businesses that are mortgage brokers will be faced with additional costs which may make some businesses unviable.

Aggregators do not have direct contact with the consumer during the application process and it is imperative when conducting the credit activities described above that aggregators are exempted from DADO (i.e. exempted from each of the preparation of TMDs, monitoring the compliance of mortgage brokers with TMDs, being subject to monitoring by lenders, and having a reporting obligation).

In the event that brokers are not exempted from DADO, aggregators should not be required to monitor mortgage brokers except to the extent that a mortgage broker is a credit representative of the particular aggregator. Non-credit representative mortgage brokers would report directly to the lender without the involvement of the aggregator.


2.6. Subsidiary or ‘bundled’ credit products

It is unclear how mortgage brokers are expected to comply with DADO in the context of ‘bundled’ or subsidiary credit products such as mortgage protection, home and contents insurance, personal loans and credit cards.

It is important to recognise that that these items when arranged by mortgage brokers are incidental to the activity of arranging the mortgage loan. They often result from a simple ‘tick and flick’ on application forms where consumers express an interest in acquiring these products. The sale of these products is then separately handled by the issuer.

Mortgage brokers are acting more like referrers in respect of these products. It is patently obvious that the imposition of DADO in respect of these products is impractical, and so must be excluded in the same way and for the same reasons specified above.

Part 3: Conclusion

Should you have any questions or require any further information, please do not hesitate to contact Mike Felton .

Yours sincerely



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