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# **MORTGAGE BROKERS - YOU COULD BE UP FOR \$1.05M IN FINES FROM 1 JULY 2020**

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## I. Introduction

On 6 February 2020, the *Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2019 Measures) Bill 2019 (Bill)* passed in Parliament. The Bill gives effect to recommendations 4.7 and 4.2 of the Hayne Royal Commission by amending the *National Consumer Credit Protection Act 2009 (Cth) (NCCP)* and the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 (Cth)* to mandate that mortgage brokers and credit representatives must act in the ‘best interests’ of consumers and also prohibits them from receiving ‘conflicted remuneration’.

Meanwhile, The Treasury is currently consulting on a new and onerous breach reporting regime that will apply to financial services *and* credit licence holders. There are also new obligations which will be placed on credit licence holders to check and provide references in relation to mortgage brokers, which are designed to limit (using the language of the Hong Kong and United Kingdom’s regulators) ‘rolling bad apples’ in the industry. The consultations for those reforms will end on 28 February 2020.

All of these changes will come into effect by 1 July 2020. Before then, credit providers, intermediaries and mortgage brokers need to ensure they have established appropriate systems and processes, as there will be civil penalties of up to \$1.05M for breaches of the law.



## II. Best Interests Duty

The Bill imposes an obligation on mortgage broker licence holders and their credit representatives to act in the ‘best interests’ of consumers when giving credit assistance in relation to credit contracts; ss. 158LA and 158LE of the Bill.

If the mortgage broker licensee knows, or reasonably ought to know, that there is a conflict between the interests of the consumer and the interests of the mortgage broker licensee, their associate or a representative or an associate of a representative of the licensee, then the licensee must give priority to the consumer’s interests when giving the credit assistance; s. 158LB of the Bill. A similar broad conflicts of interest provision is placed on the credit representatives; s.158LF of the Bill.

Each of these provisions come with penalties of up to \$1.05M if they are breached. In addition, mortgage broker licensees must take ‘reasonable steps’ to ensure that their credit representatives comply with their obligations; s. 158LE(2) of the Bill. That will require an appropriate risk framework to be put in place by licence holders.

The duty is a principles-based standard of conduct. As stated in part 3.24 of the Amended Explanatory Memorandum to the Bill:

*what conduct satisfies the duty will depend on the individual circumstances in which credit assistance is provided to a consumer in relation to a credit contract... It is the responsibility of mortgage brokers to ensure that their conduct meets the standard of ‘acting in the best interests of consumers’ in the relevant circumstances*



### III. Conflicted Remuneration

The Bill prohibits mortgage broker licensees, credit intermediaries, and credit representatives of those entities from accepting 'conflicted remuneration'; ss. 158NB and 158NC of the Bill. Again, there is a duty placed on licensees to ensure that their credit representatives comply with their duties and penalties of up to \$1.05M apply for breaches. There are also bans on employers, credit providers and intermediaries from giving conflicted remuneration to mortgage broker and mortgage intermediary licensees and their representatives; s 158ND – NF of the Bill. Identical civil penalties apply to this conduct.

S. 158N of the Bill sets out that 'conflicted remuneration' means any benefit, whether monetary or non-monetary, that is given to a licensee, or a representative of a licensee, who provides credit assistance to consumers or acts as an intermediary and because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the credit assistance provided to consumers or whether / how the licensee or representative acts as an intermediary. This will require credit licensees to conduct a detailed audit of their incentives framework to ensure they comply.

The circumstances in which these bans on conflicted remuneration apply are to be set out in the regulations, which may further define conflicted remuneration beyond the above definition; s158NA. In December 2019, the Senate's Scrutiny of Bill Committee called for more guidance to be provided in the legislation as to what constitutes conflicted remuneration and the

circumstances in which it should be banned, as, while noting the Bill's intention to provide flexibility to identify and ban conflicted remuneration, its view was that:

*...the need for flexibility does not, of itself, provide an adequate justification for leaving significant matters to delegation legislation. In this instance, it is unclear why these matters cannot be included on the face of the primary legislation. The committee's scrutiny concerns are further heightened by the high civil penalties that can be imposed*  
(Emphasis added)

The Senate Committee's concerns, which are set out in the Scrutiny Digest 10 of 2019 dated 5 December 2019, appear to have been dismissed by The Treasury.

It is worth noting that, as with other recent legislation, there is a broad anti-avoidance provision in the Bill (s. 158T) which applies to any scheme carried out for the purpose of avoiding the best interests and conflicted remuneration obligations.

### IV. Breach reporting

On 31 January 2020, The Treasury released the exposure draft legislation and explanatory memorandum designed to implement recommendations 1.6, 2.7, 2.8, 2.9 and 7.2 of the Hayne Royal Commission including those with respect to more expansive breach reporting and mortgage broker reference checks (**Exposure Draft**).

There is a significant amount of detail in the Exposure Draft. For the purpose of this briefing prepared for mortgage brokers, it is important to note two key aspects.



*Firstly*, the Exposure Draft will implement a breach reporting regime for credit licence holders. Matters that may need to be reported to ASIC are to be referred to as 'reportable situations' and split between core and non-core reportable situations. A core reportable situation will arise where the credit licensee or its representative has breached or is likely to breach a 'core obligation' or the credit licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation and, in either case, the breach or likely breach is 'significant'. The primary core obligations are to be the general conduct obligations imposed on credit licensees under s. 47 of the NCCP, which include the obligation to do all things necessary to ensure that the credit activities authorised by the licence are engaged in '*efficiently, honestly and fairly*'.

Relevantly, the exposure draft is much more prescriptive than the existing breach reporting regime for financial services licensees. For example, it states that a breach or likely breach of a core obligation needs to be taken as 'significant' where the breach constitutes a contravention of civil penalty provision. There are a vast number of civil penalty provisions in the NCCP, for example failure by a mortgage broker licensee to provide a compliant credit proposal disclosure document under s. 121 of the NCCP. This will mean a lot more breach reports will be received by ASIC if the Exposure Draft stays in its current form. Another example is with respect to when the reporting actually needs to occur; as set out under 2.133 of the Explanatory Memorandum, there will be an obligation to lodge a report with ASIC upon the commencement of an investigation and at the end

of an investigation. A report must be lodged within 30 calendar days after the credit licensee first reasonably knows there are reasonable grounds to believe the reportable situation has arisen.

*Secondly*, the Exposure Draft imposes new reference checking and information sharing obligations on credit licensees in relation to mortgage brokers in s. 47 of the NCCP. In effect, the goal is to weed out those in the mortgage broking industry who engage in misconduct, as '*employment information will be available about all financial advisers and mortgage brokers*' as stated in 1.41 of the Explanatory Memorandum. A licensee must undertake reference checking and information sharing in relation to qualifying mortgage brokers, either by requesting information about the individual or providing information about the individual. The specifics of the obligations on the licensee will be included in a legislative instrument - the Reference Checking and Information Sharing Protocol (**Protocol**).

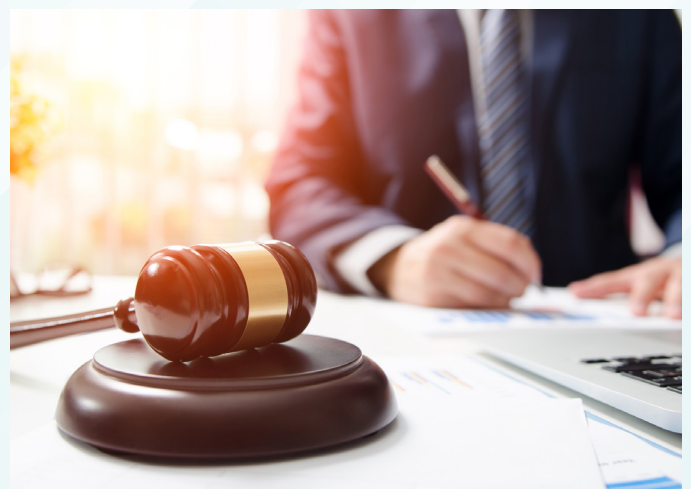
ASIC will design the Protocol, which is likely to include details on information that should be sought and provided when checking a reference and sharing information, steps a licensee should take to contact referees, methods by which information is to be requested and provided, and particular record-keeping requirements. A civil penalty will apply to a contravention of the credit licensee's obligation to comply with the Protocol. It is relevant that, because credit licensees are sharing information which may be detrimental to an individual's career, they will be able to rely on a defence of qualified privilege.

## V. What practically to do now?

The new laws will come into effect by 1 July 2020.

This leaves very little time for all mortgage brokers, intermediaries and credit providers to implement risk management frameworks and policies to ensure that they are:

- conducting themselves in accordance with their consumers' 'best interests';
- taking 'reasonable steps' to ensure that their credit representatives are conducting themselves in accordance with their consumers' 'best interests';
- not receiving or giving 'conflict remuneration';





- prepared to investigate, respond to and report breaches under the new onerous breach reporting framework; and
- compliant with the new mortgage broker reference checking framework.

Given the interpretational aspect of these laws – for example what may constitute ‘conflicted remuneration’

and the appreciable penalties for falling foul of them (as noted by the Senate) – we encourage affected mortgage brokers, intermediaries and credit providers to start their preparations in response to these requirements now.

Our Banking & Finance and regulatory teams have deep experience in this space and would be happy to assist you. Please reach out to your usual Gadens’ contact if you would like any further information.

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## Contact Us



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Susan has more than 20 years’ experience and is one of Queensland’s leading litigation and insolvency lawyers.

Her areas of expertise include banking and debt recovery, enforcement of mortgage and other securities, insolvency, secured and unsecured asset recovery and loss minimisation, including farm debt mediation.

Using her extensive advisory and legal risk management experience, Susan advises a number of Australia’s largest retail, commercial and agribusiness banking and financial institutions. She acts on the enforcement and collection of secured and unsecured debts and investigates fraud allegations, as well as assisting in responses to AFCA/COSL complaints. Susan also advises on bankruptcies, receiverships, and winding up proceedings.



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Craig heads the Banking & Finance Team in Brisbane. With more than 30 years’ experience in finance and property transactions, Craig acts primarily for banks and other financial institutions on a range of mainstream commercial, residential and business transactions. In his role he oversees thousands of transactions every month.

With significant experience in the National Consumer Protection Act and the National Credit Code, Craig is regularly invited to deliver seminars on mortgage lending and self-managed super fund lending. He has also previously lectured on mortgage lending law at the Securities Institute of Australia and TAFE.

As Craig acts for a large variety of banks, building societies and other funders as well as major commercial borrowers; he has unrivalled understanding of both sides of large financial transactions.

Craig is a Life Member and Fellow of the Mortgage and Finance Association of Australia, Member of the AICD, and a Notary Public.

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Victor is a Partner in Gadens' Banking & Finance Team with excellent experience in banking and property law.

Victor acts for a variety of private lenders, traditional banking and mid-tier lending clients in the banking sector as well as ASX 100 listed companies providing sound advice across a broad range of financial transactions.

He has advised on client loans in areas touching on property development, construction, pharmacy and other related healthcare services, invoice financing, self-managed super fund lending arrangements and Personal Property Security Act securities and the registration on the Personal Property Security Register.

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Liam is a Financial Services specialist at Gadens. He is well-versed with both the UK SMCR and the BEAR. Additionally, he has significant experience in financial services compliance / risk matters, regulatory inquiries and disputes, and has practised in Brisbane, Sydney, Melbourne and London. He is also the primary author of the Australian regulators weekly wrap.



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