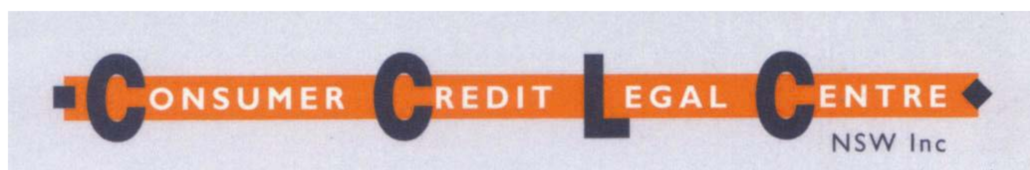

A report to ASIC on the finance and mortgage broker industry

By the Consumer Credit Legal Centre (NSW) Inc.

March 2003

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Executive summary

In August 2002, ASIC, following a recommendation by its Consumer Advisory Panel, commissioned the Consumer Credit Legal Centre (NSW) to produce a report examining the mortgage and finance broker industry. This decision was a response to ASIC taking over Commonwealth level responsibility for consumer protection in the credit marketplace, and the growing importance of mortgage brokers in that market. It was also a response to concerns expressed by community advocates and caseworkers who were experiencing a growing incidence of complaints involving brokers. These experiences led to these groups identifying the industry as lightly and unevenly unregulated, and as containing some high-risk players and unfair practices.

CCLC (NSW) was commissioned to produce a report that:

- analysed the broker industry, both structurally and through a broker survey;
- examined the way in which the broker industry is regulated, both locally and internationally;
- identified the range of problems being experienced by consumers, through case studies and a survey of caseworkers; and
- considered a range of regulatory responses that might address the problems identified from the experiences of consumers and caseworkers.

This report reflects the views of CCLC (NSW), and includes consideration of a number of options for reform. To the extent that these reforms involve legislative changes, it is acknowledged that these are not matters within the discretion of ASIC. However, these options are considered in the context of a continuing debate among industry associations, individual players, financial services commentators in the media and regulators about the nature and future direction of the broker industry. This debate predominantly occurs in the context of what form future regulation of the industry should take, and not whether there should be government intervention. For example, Phil Naylor, chief executive of the Mortgage Industry Association of Australasia (one of the main industry bodies representing brokers), has said:

> *"Brokers in any sector will always have some propensity for fraud and improper practice. Two years ago, we set up a framework for self-regulation of our membership. At that time, our preference was for self-regulation of our membership but things have changed; the mortgage market has heated*

> *up and there has been a lot more scrutiny of brokers. The community's perception is that self-regulation is not enough."*[1]

By way of overview, this report:

- reviews the current state of the Australian broker industry (**Section 1**);
- reviews the ways in which the Australian broker industry is regulated at both the State and Territory and the Commonwealth level (**Section 2**), and identifies a range of barriers impeding attempts by consumers to obtain redress for unfair conduct by brokers (**Section 3**);
- reviews the broker industry internationally, including examination of regulatory models in other jurisdictions (**Section 4**);
- considers various options for national regulation of the Australian broker industry (**Section 5**);
- includes a range of case studies illustrating in a practical way the problems experienced by consumers from transactions with brokers (**Appendix A**); and
- analyses the results of surveys conducted by the Consumer Credit Legal Centre (NSW) of both brokers (**Appendix B**) and caseworkers (**Appendix C**).

The growth of the broker industry in the last five to ten years in Australia has been rapid, with consumers making increasing use of brokers in arranging finance, especially home loans. Many consumers have benefited from using the services of brokers, and saved themselves time and money. This report recognises the important role that many brokers can play in assisting consumers to select and arrange finance. However, the emphasis in the report is on identifying the problematic features of the broker-client relationship, as these are the matters needing to be addressed by regulators, industry bodies and individual participants. The report seeks to identify these problems through assessing the experiences of caseworkers and consumers, in transactions where consumers have been exploited by brokers.

Analysis of the Australian broker industry

Section 1 of the report examines the current nature, structure and operation of the broker industry in Australia. It identifies a number of features that inhibit the development and maintenance of professional standards of conduct by brokers, including:

- minimal or no entry requirements for participants in the industry;

[1] Quoted in "Bridle the Brokers", *Business Review Weekly*, 28 November 2002, pp. 63–4.

- the use of commissions as the dominant method of remuneration for brokers;
- a shift in distribution channels used by lenders from branch networks to brokers, with lenders competing against each other to gain access to broker client bases, through increasing the commission they are prepared to pay to brokers;
- a consequent shift in the preparation of loan applications from lenders to brokers, with some brokers prepared to provide inaccurate information about the financial circumstances of their clients, in order to ensure that loan applications meet the acceptance criteria of the lender;
- difficulties for lenders seeking to discipline brokers, due to the capacity of brokers to switch the lender to whom they direct client applications for finance; and
- a lack of accountability of brokers for poor advice due to the inability of consumers to access alternative dispute resolution (ADR) forums.

These features lead to a number of risks for consumers when using brokers, including:

- the consumer may not receive information about the nature of the services provided by the broker, or their rights in relation to those services;
- the consumer may rely on the recommendation of a broker who is influenced by a conflict of interest and that conflict of interest may not be disclosed to the consumer;
- the consumer may rely on the recommendation where the broker does not have a reasonable basis for that recommendation, due to the failure of the broker to properly consider the consumer's individual needs, objectives and financial circumstances, and/or to properly research a range of loans or credit facilities;
- the consumer may enter into a contract with the broker which is unfair, in that it commits the consumer to paying considerable fees, limits the capacity of the consumer to shop around, and contains few protections for the consumer;
- effective and easily accessible remedies are not available to the consumer where advisers fail in their advisory obligations.

The report then examines in detail the practices of brokers, and discusses, through case studies, the problems that occur in practice. Generally these problems are of two types:

1 problems in relation to fees, including:

(a) excessive fees;

(b) non-disclosure of fees;

(c) charging the full amount of fees where the broker has been unable to arrange suitable finance; and

(d) securing payment of fees through lodging caveats over the client's property.

2 problems in relation to the arranged finance, including:

(a) failing to arrange the finance on time for property settlement deadlines;

(b) failing to arrange the finance for the amount requested by the consumer;

(c) arranging the finance at high interest rates;

(d) maximising the amount borrowed in circumstances where this is not in the consumer's interest; and

(e) arranging finance for borrowers, particularly pensioners, which they are unable to afford.

The report notes that there are a number of fringe players in the broker industry who systematically adopt unfair practices, and pursue their own financial interests over those of their clients.

Regulation of brokers in Australia—and effectiveness of consumer redress

The report analyses current State and Commonwealth legislation, and identifies a number of gaps in the way in which the legislation applies to brokers (Section 2). These limitations arise in part from the fact that the legislation came into effect prior to the recent rapid growth in the number of participants and methods of operation in the broker industry, and therefore do not specifically address the problems currently experienced by consumers. Another contributing factor is the inconsistent nature of regulation at a State/Territory level (where only four jurisdictions have broker-specific legislation). Attempts at self-regulation are also examined (Section 2), but these are still unrefined, reflecting the relatively immature nature of the broker industry.

The report examines the extent to which brokers are made accountable to consumers who have complaints. It concludes that consumers are unable to obtain access to effective, low-cost dispute forums due to the inability to have a complaint heard by an Alternative Dispute Resolution scheme, except in limited circumstances, and that there are considerable barriers inhibiting the capacity of consumers to seek redress through legal action (Section 3). The report concludes

that unless brokers are made accountable through more stringent legislation, and compulsory membership of an ADR scheme, the problems identified in Section 1 will continue.

Limitations in the legislation include:

- limited and inconsistent obligations to disclose commissions received by lenders;
- no limitations on the amount of brokerage fees that can be charged, the circumstances in which they can be charged or how these fees are to be disclosed;
- no obligation to disclose financial benefits received from lenders, apart from commissions;
- no obligation to disclose the range of lenders and products that the broker can arrange, or to disclose whether the broker offers independent advice or merely channels loan applications to one or a few selected lenders;
- absence of any guidelines for distinguishing between the liability of the lender according to the status of the broker/intermediary;
- limited circumstances in which the lender will be held accountable for the actions of the broker;
- no obligation to assess the borrower's capacity to meet repayments under the recommended credit product;
- no minimum statutory standard of quality that advice must meet; and
- no obligation to provide clients with any analysis of the advantages or disadvantages of refinancing an existing credit contract.

The mortgage broker industry and its regulation internationally

Section 4 contrasts the nature of the broker industry and government regulation in Australia with that overseas. Innovative responses adopted by other jurisdictions to the problems created by the conduct of brokers include:

- the licensing of brokers (in the UK, Canada and the State of New York in the USA);
- ensuring that brokers are members of an alternative dispute resolution (ADR) scheme (in the UK); and
- the identification of "high risk" transactions (eg home loans with high interest rates), and the application of stricter rules to brokers advising borrowers in relation to such transactions (in the UK and the State of New York in the USA).

Reform of the broker industry

Having identified a need for greater standards of conduct, Section 5 then analyses a number of options for achieving this goal. These options are:

- national coverage of brokers through uniform State/Territory legislation;
- Commonwealth legislation; and
- enhanced self-regulation.

The report examines the advantages and disadvantages of these three models.

Case studies and surveys

CCLC (NSW) has received numerous case studies from caseworkers, recording the experiences of consumers in their transactions with brokers. Appendix A includes a selection of case studies, providing practical examples of the problems encountered by consumers, and also of the difficulties that arise from advice that is either incompetent or self-interested.

As part of this report, CCLC (NSW) conducted surveys of both finance brokers and caseworkers. Brokers completed and returned 166 surveys, with most of the respondents being members of one of the two main industry bodies, the Mortgage Industry Association of Australasia (MIAA) or the Finance Brokers Association of Australia (FBAA). Caseworkers, such as financial counsellors, community legal centres and Legal Aid solicitors returned 85 surveys. The results of each survey are detailed in Appendix B (brokers) and Appendix C (caseworkers), although they are also referred to elsewhere in this report, where they help explain the way in which brokers operate.

Section 1: Analysis of the Australian broker industry

The broker industry in Australia is relatively new, and has experienced a rapid growth in the last ten years. Its growth reflects the increasing use of brokers by consumers to navigate their way through the vast array of players and products in the competitive home mortgage industry. Industry sources suggest that the use of brokers is as cheap or cheaper than traditional distribution methods. Their assistance can also provide value to consumers by saving them time and money.

However, the proliferation of brokers has also come at a cost, at least to some individuals. Consumers are relatively inexperienced when using brokers and they can be dependent on them for advice because of the confusing range of loans and providers; some brokers are prepared to exploit that dependency. This section of the report examines the current nature, structure and operation of the broker industry in Australia, and the way in which this can operate to both the benefit and disadvantage of consumers.

1.1 Size and value of the broker industry

The last ten years have seen a transformation of the Australian housing finance market. In 1986–87, Australians borrowed $15 billion in housing finance from lenders (who were then almost exclusively banks, building societies and credit unions). Fifteen years later, Australians borrowed $151 billion to buy, build or refinance their homes. Mortgage originators provided many of these loans. The bulk of these originators are small in scale, and have no branch network or existing distribution channels. They have relied on brokers to negotiate credit between consumers and third parties, and have given a huge impetus to the growth of the finance broker industry.

However, all types of lenders have become dependent on brokers for market share. Banks have compensated for the loss of business resulting from branch closures by utilising applications through brokers. On average, each bank has been using brokers for almost ten years, and currently receives loan applications from 740 brokers.[2] It is estimated that the four major banks received 60% of all broker loan applications in the March 2002 quarter.[3] Credit unions and building societies have been slower to establish relationships with brokers, with these institutions using,

[2] Australian Prudential Regulation Authority (APRA), "Report on Broker-originated Lending", January 2003, p. 6.
[3] Market Intelligence Strategy Centre (a research consultancy service), "Mortgage Broking", Media Release, 17 April 2002.

on average, only 13 brokers and having dealt with them for only three to four years.[4]

The use made of brokers by banks, credit unions and building societies is far from plateauing, with 38% of these institutions currently planning to increase their rate of broker usage, and 25 individual lenders arranging to use brokers for the first time.[5] One high profile example of this trend in the market was the recent announcement by three credit unions—Australian Central Credit Union, Australian National Credit Union and Credit Union Australia—that they had secured an 8.2% share in Mortgage Choice, the nation's leading mortgage broker organisation. The move was designed to increase the percentage of future broker-written credit union home loans, with these three credit unions being included on Mortgage Choice's panel of lenders.

The resultant increase in broker numbers has been enormous. Solomon Smith Barney, in a 2001 report into the Australian mortgage industry, estimated that there could be more than 10,000 individuals operating in the Australian broker market, with 50 new brokers entering the market each week.[6] Seventeen per cent of respondents to the "Broker Survey" had been operating for two years or less.[7] Data from the Market Intelligence Strategy Centre, while not measuring individual brokers, estimates that there are currently 2000 broker firms operating Australia wide.[8]

In addition, while there is significant concentration at the upper end of the broker market (a rough estimate from senior industry sources suggested that, prior to the entry of Aussie Home Loans into the marketplace, the top three players had around 40% of the market, while the top ten had around 55%), the industry has a long "tail" of small operators.

Precise figures on the number and value of the loans that brokers are responsible for are not available; estimates of these figures can vary significantly. Solomon Smith Barney estimated that the value of the Australian broker home loan market was $29.5 billion for the calendar year to December 2001.[9] However, APRA reported in January 2003 that brokers accounted for 23% ($76 billion) of home loans with banks, credit unions and building societies, and $86.6 billion of credit with these institutions in total.[10]

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[4] APRA, op. cit.
[5] Ibid., p. 2.
[6] Solomon Smith Barney, "Australia's Mortgage Market", 2 May 2001.
[7] See Table B.4 in Appendix B.
[8] Market Intelligence Strategy Centre, op. cit.
[9] Solomon Smith Barney, op. cit.
[10] APRA, op. cit., p. 2.

1.2 Categories of industry players

The expansion of the finance broker industry has seen the development of a number of different types of participants, with three broad categories of intermediaries:[11]

1. mortgage and finance brokers;
2. mortgage managers; and
3. intermediaries who promote "loan or debt reduction" schemes (in which the borrower refinances an existing home loan).

While all three types of intermediaries act as a link between the consumer and credit providers, they do so in different ways.

There is a fourth category of brokers, those who are active in soliciting funds from investors and making these available as loans to the public. Historically there have been problems with the conduct of brokers in this area, particularly in Western Australia, where the government held a number of inquiries into the conduct of brokers in the 1990s, resulting in criminal charges against approximately 20 brokers involved in fund-raising activities. This type of fund-raising is now more strictly regulated by ASIC, following amendments to the *Managed Investments Act 1998*. An examination of this part of the industry is outside the scope of this report.

Mortgage and finance brokers

The traditional view of the role of brokers is that they obtain information about the consumer's needs and financial position and then survey the products available in the marketplace in order to select the product that best meets those needs. Having assisted the consumer to select a loan, the broker will typically then arrange for the paperwork to be completed and forward it to the lender. Upon approval of the loan, the broker may continue to facilitate negotiations between the borrower and the lender until the loan is advanced. There is usually little need for a continuing relationship between the borrower and the broker after that time.

There are, however, considerable variations in practice in the extent to which brokers review different credit products, and to which they assess the consumer's personal and financial circumstances in order to determine which product to recommend. Some brokers will make their selection from a panel of over 40 lenders (and a greater number of products). Other brokers, while representing that they can "arrange finance", will forward virtually all loan applications to a few

[11] It should be noted that the nomenclature used to designate the different types of broker can vary significantly from state to state. For example, in Western Australia the term "mortgage broker" appears to be rarely used.

selected lenders (or, indeed, may channel all applications to one particular lender), and operate as de facto agents for those lenders.[12] Eleven per cent of brokers responding to the "Broker Survey" stated that they did not compare credit products, and 15% stated that they did not negotiate with credit providers.[13] In relation to assessing the consumer's circumstances (in order to recommend a product that is appropriate), it is the experience of caseworkers that this rarely happens in practice, and this is consistent with discussions CCLC (NSW) has had with senior members of the broker industry. In other words, there is a view, among at least some brokers, that their role is to provide finance for the consumer, but not necessarily to provide finance that is appropriate. It is acknowledged that in performing this function many brokers are simply following the instructions of their clients (to arrange finance of a particular amount). The nature of the broker's operation, and the extent to which competing products are analysed and compared, will not necessarily be apparent to consumers.

A key problem that has emerged from conversations with consumers, caseworkers and industry is that there are vastly different interpretations of what the role of the broker actually is. There is little consensus in theory and practice about whether the broker is supposed to be:

- advising the consumer about the best option or options available, from a broad range of products and taking into account their personal circumstances;
- presenting a range of options (with no express or implied recommendation) and allowing the consumer to select the product they consider most appropriate for their own circumstances; or
- facilitating a sale on behalf of one or more credit providers with their only obligations to the borrower being those imposed on the intermediary (as agent for the credit provider) under the UCCC.

The variation in views is highlighted by the comment of one broking firm in a recent edition of their on-line newsletter: "..our view is that brokers should be seen as essentially agents of lenders like salespeople in department stores. They have access to a range of products and knowledge of the market, so they are useful. But their 'advice' should be taken with a grain of salt."[14] However, it is suspected that many consumers would assume the broker is undertaking a broad review on their behalf and may not be advised, or otherwise realise, that the functions being carried out by the broker are, in practice, much narrower.

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[12] They are likely, nevertheless, to be treated in law as agents of the borrower and not the lender; see *Custom Credit Corporation Ltd v Lynch* [1993] 2 VR 469.
[13] See Table B.7 in Appendix B.
[14] See http://www.peachhomeloans.com.au/newsletters/newsletter15rippedoff.htm

On the other hand, the recommendations or options offered by brokers would in many circumstances qualify as personal or general advice under the *Corporations Act 2001* if credit transactions had been classified as financial products under that Act, because they are likely to influence the decision-making process of the borrower regardless of the broker's intention. In practice, the level of advice provided by brokers would generally fail to meet the standards imposed by the *Corporations Act*, as the intermediary either fails to address the broad range of factors the Act requires them to consider, or fails to provide documentary evidence of such consideration.

At a technical level, there is a distinction between mortgage brokers and finance brokers. Mortgage brokers are predominantly active in the home loan market, while finance brokers tend to also assist consumers seeking personal loans, or businesses seeking commercial or equipment finance. In practice, very few brokers would be restricted to one type of loan only, although they are generally less active, though still significant, players in the personal loan market. This report focuses primarily on mortgage brokers and the role of finance brokers in arranging personal finance (rather than business credit).

The mortgage and finance broker market is dominated by a number of "aggregators". These are organisations that provide infrastructure and administrative support to brokers who agree to become members. The aggregator organises a panel of lenders, facilitates the processing of loan applications and enters into commission-sharing arrangements with broker members. Examples of aggregators are the Australian Finance Group (which has 2000 broker members and processes in excess of 4000 residential mortgages exceeding $900 million per month), the Preferred Broker Network (which has a panel of 40 lenders and 348 broker members), and the Professional Lenders Association Network of Australia (which requires member brokers to adhere to a Code of Ethics).

Mortgage managers

Mortgage managers are linked to the wave of new non-mainstream mortgage financiers. The mortgage managers have arrangements with a wholesale lender to distribute the funds, usually through individually packaged home loans. The mortgage manager will arrange for the completion of a loan application, and the collation of documents supporting such applications. Once the loan is approved and disbursed, the mortgage manager will continue to administer the loan on behalf of the lender, by accepting payments, issuing statements, monitoring defaults and responding to any inquiries by the borrower. Some mortgage managers also operate as brokers, in that they will solicit loan applications, which are forwarded to lenders other than those for whom they manage the loans.

The distinction between brokers and mortgage managers is one that will not necessarily be apparent or easily understood by the consumer. In other words, consumers can easily believe that the mortgage manager is selecting the loan from a pool of products when this is not the case.

Intermediaries who provide loan-reduction services

The third category of intermediary promotes credit products indirectly, in that they advertise themselves as offering services that, it is claimed, will result in consumers being able to pay off their home loan more quickly than at present. These intermediaries therefore emphasise their advice services (as providing the key to paying off your home loan more quickly) rather than the credit product.

There is a broad range in the level of sophistication of these intermediaries, with some doing little more than arranging refinances or debt consolidations at a cheaper interest rate. However, other bodies promoting loan-reduction services arrange for the borrower to refinance their existing home loan to a different credit product which, it is represented, will allow the borrower to achieve savings through maximising the use of their money.

These operations usually:

- charge a significant upfront fee to give the borrower details of the methodology of their loan-reduction services;
- advise the borrower to refinance their home loan (and may earn commissions from the lender they recommend);
- arrange for the new loan to be connected with an offset account (so that living expenses are purchased by way of credit card, and the consumer's salary is offset against the home loan balance during the interest-free period on the card); and
- provide the borrower with budgeting advice, and encourage them to make increased repayments.

1.3 Remuneration within the broker industry

Brokers receive remuneration in three main ways:

1. fees charged to the client;
2. upfront commissions; and
3. trail commissions.

Generally, most brokers derive their revenue from commissions, or a combination of fees and commissions. Responses to the "Broker Survey"[15] indicated that:

- 97% of respondents received commissions or financial benefits from credit providers;
- 57% of respondents did not charge their clients fees; and
- 40% of respondents charged their clients fees and also received commissions.

There is currently no regulation of remuneration in Australia, with the exception of fees charged to clients in the Australian Capital Territory and in Western Australia. Individual brokers can therefore determine how they will be remunerated. Forty per cent of the respondents to the "Broker Survey" indicated that apart from charging their clients a fee for their service, they also received a commission from credit providers. The following matters are noted about commissions:

- the average initial commission paid by lenders was approximately 0.5% to 0.7% of the amount borrowed;
- the survey recorded one instance of a lender who paid an upfront commission of 4% of the amount borrowed;
- most lenders pay an average trail commission of approximately 0.3% of the outstanding balance of the loan. This amount is usually paid on a monthly basis;
- the highest trail commission noted in the "Broker Survey" was calculated at 1.7% of the outstanding loan amount; and
- bonuses can also be earned where the volume of business placed with a lender over a period of time meets or exceeds specified targets.

The recent APRA survey of Australian authorised deposit-taking institutions (ADIs) noted that banks, credit unions and building societies paid, on average, an upfront commission of 0.51% for commercial loans, 0.77% for personal loans and 0.57% for housing loans. The average trail commission paid by these institutions was 0.17% for commercial loans, 0.06% for personal loans and 0.23% for housing loans.[16] These figures suggest that some lenders, presumably non-mainstream operators, are paying commissions that are significantly above industry averages. Assuming that the cost of these commissions is recouped from the borrower, and that at least some of these borrowers could qualify for loans elsewhere, this raises,

[15] See Section B.4 in Appendix B.
[16] APRA, op. cit., p. 10.

at a general level, the issue of whether or not reverse competition leads these brokers to place loans with a lender who is more expensive but who pays a higher rate of commission.

The APRA survey also stated:

> *"Over half of the institutions (53%) base the broker's remuneration solely on the volume of business generated, providing brokers with an incentive to generate loan volume without appropriate regard for risk. With such an incentive structure, it is critical that ADIs have procedures in place to ensure their own credit assessment standards are rigorously applied to broker-introduced loans."*[17]

As with other industries, some lenders also provide soft dollar payments, through offering a range of financial benefits to selected intermediaries. These benefits can include marketing subsidies, assistance with office equipment, and profit-sharing arrangements. Where legislation imposes disclosure obligations on brokers, it generally excludes any requirement to disclose these types of financial benefits.

The prevalence of commission-based remuneration creates the possibility of conflicts of interest between the interests of the broker and their client. However, some of the broker firms, usually the larger ones or the aggregators, seek to mitigate the effect of commissions on the choice of product by rebating part of the payment to the borrower, or by paying fixed salaries to their employee brokers. Similarly, the aggregators generally have commission-splitting arrangements with individual brokers. These may vary with the identity of the lender and/or the volume of business placed. To the extent that broker remuneration is based purely on volume (rather than the identity of the lenders or the value of commissions offered), this may remove conflicts of interest that might otherwise arise in relation to the advice being offered. It does not, however, any conflicts of interest in relation to the size of the loans generated.

Finally, it is worth noting another form of payment common in the broker industry, namely payments by brokers to third parties for referring potential clients to them. These fees are widespread in the industry. The "Broker Survey" found that 65% of respondents promoted their services though a range of third parties, including real estate agents, accountants, lawyers, collection agencies, car dealers, building contractors and financial planners.[18] In the majority of these cases, the brokers offered commissions or other financial incentives for these referrals.

Where legislation imposes disclosure obligations on brokers, it only requires them to disclose payments that they will receive, not payments they make to third

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[17] Ibid., p. 9.

[18] See Table B.16 in Appendix B.

parties. Consumers will generally therefore be unaware of the existence of these payments.

1.4 Features of the broker industry

The broker industry currently has a number of features, including:

- no barriers to entry;
- increased reliance by lenders on brokers;
- a commission-based remuneration structure;
- reverse competition;
- inability of lenders to discipline “bad” brokers;
- use of “cold calling” to solicit clients;
- a limited capacity of consumers to differentiate between brokers;
- no ongoing relationship with clients; and
- a lack of accountability.

No barriers to entry

In the absence of a uniform or national occupational licensing regime, there are minimal barriers to entry to the industry. Currently, except in Western Australia, a person is not required to have training or educational qualifications before being able to practise as a broker. There are also minimal capital requirements since brokers can easily operate without premises or overheads, without employees and without personal indemnity insurance, encouraging “fly-by-night” operators. Some brokers have run significant practices without ever meeting clients, operating solely through telephone and facsimile contact. Solomon Smith Barney, as noted above, estimated in 2001 that there were 50 new brokers entering the market each week, with this number reflecting both a high level of inexperience in the industry and the attractiveness of the industry, due to the potential financial rewards.

Increased reliance by lenders on brokers

As noted above, reliance by lenders on brokers is increasing. Brokers are currently responsible for approximately 30% of all mortgage loans, with this figure projected to increase to over 50% in the next three to five years, with some estimates placing the figure as high as 70%.[19] The Australian Banking Industry Ombudsman has also noted “an apparent increase in the delegation to brokers by

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[19] Solomon Smith Barney, op. cit., note 1 at p. 2; see also Beth Quinlivan, “The home-loan heist”, *Business Review Weekly*, 9–15 May 2002, pp. 46–53, and Effie Zahos, “Banking on a broker”, *Money Magazine*, July 2002, pp. 53–63.

banks of the responsibility of explaining the loan offer or security documents or both, including an apparent refusal by banks in some cases to have direct contact with the borrower, instead referring all questions to the broker."[20]

The shift by major lenders in distribution channels from branch networks to brokers has also seen those lenders reduce their internal risk checks and credit assessment criteria. For example, APRA has recently noted that some credit unions and building societies were providing loan advance-to-valuation ratios of up to 100%, and that they were also accepting applications where the only deposit was provided through the Commonwealth Government's First Home Owners Grant (without the borrower therefore having any established savings history).[21] The use of brokers can leave lenders exposed to a higher risk of defaulting borrowers, and can also make them more susceptible to mortgage fraud.

A commission-based remuneration structure

As noted previously, the dominant method by which lenders remunerate brokers is through payment of commissions. Instances of inappropriate sales and pressure selling are typical of industries dominated by commission-based sales. This is true of the broker industry as intermediaries seek to maximise both the number of loans granted and the value of those loans. Most home loans are expected to have a life of seven years or less, so that the size of the upfront commission is likely to be the major influence on the broker's choice of loan. Trail commissions create only marginal incentives for brokers to place the borrower in a loan where they can afford the repayments.

There are significant variations in the level of disclosure by brokers of commissions paid to them by lenders, with consumers not always made aware of the existence or amount of these commissions; for example, 5% of respondents to the "Broker Survey" stated that they did not inform their clients about the existence of such commissions.[22]

Reverse competition

The fluid nature of the housing market indicates that a degree of reverse competition is taking place, with lenders competing against each other to gain access to broker distribution channels, through increasing the commission they are prepared to pay brokers. The resultant costs are ultimately borne by consumers generally (irrespective of whether or not they arrange a loan through a broker or directly). Where this happens, the effect of competition is to increase rather than decrease the cost to the consumer. The NSW National Competition Policy Review

[20] The Australian Banking Industry Ombudsman Ltd, Bulletin No. 36, December 2002.
[21] Media Release [MR 02/37], 19 September 2002.
[22] See Section B.4 in Appendix B.

of the *Credit (Finance Brokers) Act 1984* noted that lenders who do not pay commissions rarely receive business from brokers even where the product offered is superior to many others in the marketplace, including those commonly recommended by brokers.[23] Similarly, Peter James, Managing Director of RESI Mortgage Corporation, has made public statements about the difficulties RESI has experienced in attracting business from brokers, which he has attributed to the fact that it does not offer commissions to intermediaries.[24]

Brokers are therefore in a strong bargaining position, with lenders seeking to gain access to their client base. Many lenders, especially mainstream institutions, have implemented accreditation processes for brokers, assessing such matters as their experience, management capacity, professional indemnity insurance status, and tracking the outcomes of the loans submitted. However, these measures are by no means uniform, with APRA reporting that 32% of banks, credit unions and building societies will accept loans from non-contracted brokers.[25]

Inability of lenders to discipline "bad" brokers

It is also possible for brokers to manipulate the competition between lenders to avoid stringent supervision of their activities. Brokers are in a position where they can respond to attempts by credit providers to scrutinise their business by switching to different lenders. Ultimately the only sanction a lender can impose is to refuse to have further dealings with a broker (where, for example, they consistently submit poor or even fraudulent loan applications). However, this has no effect on whether or not the broker remains in the marketplace, as they can easily direct their credit applications to a new financier. The position is similar to that of life agents in the early 1990s, where "bad" agents (who had their employment terminated by one insurer) were able to rotate between different insurers.

APRA's "Report on Broker-originated Lending" noted that, since first utilising brokers, the average bank has ceased dealing with 70 brokers.[26] The three most common reasons for ceasing business with a broker are:

- poor quality of loan applications (59%);
- lack of volume of business (59%); and
- fraud (24%).[27]

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[23] Final Report of the NSW National Competition Policy Review of the *Credit (Finance Brokers) Act 1984*, p. 15.
[24] *The Bulletin* (from Liberty website).
[25] APRA, op. cit., pp. 7–8.
[26] Ibid., p. 6.
[27] Ibid., p. 8.

The report also found that, if a loan becomes impaired (through default by the borrower), only 25% of institutions have recourse to the broker, usually through ceasing to pay trail commissions, rather than being able to claw back the upfront commission.[28]

Lenders are liable to the borrower for the conduct of brokers only in extremely limited circumstances (see Section 2.5). Accordingly, they have minimal incentives to impose standards of conduct on brokers. Attempts at improving industry standards through self-regulation, discussed in detail in Section 2.4, are relatively undeveloped and, for a variety of reasons, have generally had at best a limited impact on the industry overall.

Use of "cold calling" to solicit clients

The finance intermediary industry is an area where "cold calling" (or an unsolicited approach to potential customers) takes place on a regular basis. For example, the "Broker Survey" indicated that 22% of brokers employed cold calling as a marketing strategy, with brokers using telephone contact and visits to consumers' homes and workplaces to initiate contact.[29] Consumers in their own home are particularly vulnerable to making uninformed decisions due to a variety of factors, including:

- the inability to walk away from a sale;
- an inherent politeness towards a person who is a guest in their own home;
- the nature of the sales staff who are often trained to exploit this sense of obligation and who may refuse to leave until the sale is complete; and
- logistical difficulties in comparing prices, often resulting in the consumer committing themselves to paying excessive fees.

Limited capacity of consumers to differentiate between brokers

Currently brokers are under no obligation to disclose to borrowers the reasons for recommending a particular credit product, and they are only under limited and nationally inconsistent obligations to disclose the fees and commissions they will receive. Where consumers are only provided with limited information it is difficult for them to assess the quality and cost-effectiveness of the services the broker is providing. The difficulties in comparing the services offered by brokers are exacerbated where the initial approach is made by the broker visiting the consumer in their own home.

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[28] Ibid.
[29] See Table B.10 in Appendix B.

No ongoing relationship with clients

Most brokers (as distinct from mortgage managers) will have only limited contact with the borrower once they have been placed in a loan. Once the loan or credit has been arranged, the broker has little reason to continue to be involved. The relationship is different from other intermediaries, such as insurance brokers or financial planners, where there is a need to provide ongoing advice in relation to the investment or insurance product initially recommended. While some brokers do provide a continuing service to their clients after they have arranged the loan for them, the results of the survey of brokers suggests that this is limited to a small minority. The absence of any ongoing relationship means that the broker has minimal financial incentives (through earning ongoing fees or business from the borrower) to ensure their initial advice and choice of product is sound and reasonable.

Lack of accountability

Where consumers have suffered damage or loss as a result of the conduct of a broker, they are usually unable to access timely and effective remedies. Brokers, unlike other intermediaries in the financial service industry, are not required to be members of an alternative dispute resolution scheme, so that consumers have few options for obtaining redress apart from instigating legal action, with its attendant uncertainty and expense. The lack of accountability by brokers means that they can refuse to respond to complaints, even where a community advocate helps the consumer, because of the difficulties and cost in taking Court action.

A further complicating factor for consumers is that generally they will not have any redress against the lender for the conduct of the broker; in other words, the development of the broker industry has seen responsibility at the point of sale shift from lenders to brokers, who are in practice often unaccountable.

1.5 Problems between consumers and brokers

The combination of features described in Section 1.4 means that retail consumers face a series of risks in relying on advice provided by finance brokers. These risks are:

- the advice may not be prepared competently;
- the advice may be tainted by conflicts of interest of the adviser;
- the advice may be not have a reasonable basis, due to the failure of the broker to properly consider the consumer’s individual needs, objectives and financial circumstances, and/or to properly research a range of loans or credit facilities;

- the consumer may not receive information about the nature of the advisory services provided by the intermediary or their rights in relation to those services; and
- effective and easily accessible remedies are not available to the consumer where advisers fail in their advisory obligations.

The growth in the broker industry has been matched by an increase in complaints about brokers to ASIC, State and Territory fair trading departments, and community legal centres. One Minister for Fair Trading has summarised the problems faced by consumers as follows:

> *"The main risks faced by consumers of finance broking services are: lack of broker independence where commission is paid by lenders, which may result in consumers entering into overpriced credit arrangements; consumer loss where the broker's commission is paid in advance and the credit is not subsequently obtained; the charging by brokers of excessive, undisclosed commissions or other fees; unethical conduct whereby consumers are persuaded to borrow larger amounts than needed or to include fraudulent information in credit applications; and difficulty in obtaining redress where the consumer has not been provided with a copy of his or her agreement with the broker."*[30]

Broadly speaking the broker industry can be split into two types of players—mainstream and fringe—with each player targeting different markets and creating different types of problems.

It cannot be stressed enough, however, that while the problems may be different they have similar causes, namely the combination of factors discussed in Section 1.2. The difference is in the conduct of the brokers, with some prepared to act with a more extreme and unchecked disregard for the interests of the consumers they are supposedly assisting.

Mainstream players—quality of advice

Currently, brokers are under no statutory obligation to undertake inquiries and research in order to have a reasonable basis for recommending a particular credit product. If such an obligation existed in law, brokers would have to consider a range of factors, including:

- the capacity of the borrower to meet repayments, both currently and taking into account reasonably foreseeable circumstances (eg increases in interest rates, any plans by the borrower to start a family in the near future);

[30] 2nd Reading Speech of the *Consumer Credit Administration Amendment (Finance Brokers) Bill 2002*, NSW Legislative Assembly Hansard, 24 September 2002.

- a comparison of the cost of different products available from a pool of credit products;
- consideration of the terms and conditions of the loan, including matters such as whether interest rates can be varied under the credit contract, whether the loan is principle and interest, interest only, or a line of credit, the extent to which redraws of credit are available, the consequence of any default by the borrower, and the penalties, if any, for repaying the loan early;
- where the recommendation involves refinancing an existing credit product, such as a home loan, an analysis of the advantages and disadvantages of proceeding with the refinance (eg a comparison of interest rates and fees and charges between the loans and an assessment of the effect of transaction costs);
- the loan amount requested by the consumer, the use of those funds and any time frame within which the funds are required (eg settlement of a property purchase); and
- the extent to which the individual needs a buffer of funds in order to meet unexpected contingencies.

Brokers are also not currently required by law to provide consumers with a written statement setting out the reasons for recommending a particular product. In preparing this report, caseworkers did not come across any instances or examples where consumers were provided with a recommendation setting out these matters. The current level of regulation of brokers is inadequate in that it effectively denies consumers the opportunity to test or evaluate the broker's advice.

The extent to which brokers review the range of factors listed above in determining which credit product to recommend is unknown, and presumably varies significantly between brokers. However, the range of problems identified in the case studies and the responses by brokers to surveys provide evidence of a failure by some brokers to address the consumer's personal circumstances or research the range of products available. For example, 11% of the brokers surveyed advised that they did not compare credit products. Similarly, only 54% of brokers had a written agreement with their client, setting out the type of credit sought by the client. Of this figure of 54%, only 73% advised that the agreement addressed the amount of credit and type of loan being sought, and only 51% advised that the agreement specified the interest rate requested by the client.

These results suggest that some brokers either do not obtain clear instructions from the consumer about the finance required, or that they do not record or communicate these instructions in a manner that ensures borrowers have a clear appreciation of the terms of the broker's engagement. In practice, this can result in

brokers channelling clients to the same credit provider, or same few credit providers, without adequately considering the consumer's circumstances or the price of competing products. In extreme cases, the broker agreement can be completed in terms that are self-serving and designed to secure the broker's fees irrespective of the quality of the service provided by the broker. An example of such self-serving conduct is broker agreements (sighted by caseworkers) stating that the credit to be arranged should have an interest rate of between 6% and 20%, which allows the broker to fulfil the terms of their engagement even if arranging finance that is disadvantageous to the borrower.

APRA has recently expressed concerns about credit unions and building societies adopting an overly aggressive approach to residential property lending due in part to an increased reliance on brokers to originate business and a lack of due diligence by the lenders in assessing the creditworthiness of applicants.[31] This is consistent with some brokers both failing to adequately consider the capacity of their clients to meet repayments under the credit arrangements they are recommending, and arranging for their clients to borrow the maximum amount possible.

The experiences of consumers and caseworkers indicates that the failure by the broker to properly research the client's circumstances or range of products available has resulted in the following problems:

- brokers not recommending products where no commission is offered by the lender (irrespective of the merits of these products);
- brokers choosing from a limited pool or panel of lenders: 7% of brokers who responded to the survey advised that they had a panel of one to five lenders, and an additional 11% advised that they selected loans from a panel of six to ten lenders;
- brokers being unable to arrange home loans prior to settlement of a purchase, in part due to the limited pool of lenders used by some brokers;
- brokers advising consumers to refinance their home loan without conducting any inquiry, or any rigorous inquiry, into the advantages and disadvantages of refinancing, and, in some cases, brokers recommending that the consumer refinance at a higher interest rate. For example, brokers may recommend, when arranging finance for the purchase of an investment property, that the borrower's home loan is also refinanced, irrespective of the transaction costs involved;
- brokers "upselling" consumers by advising them to borrow the maximum amount of money (in order to increase the amount of commission payable

[31] Media Release [MR 02/37], 19 September 2002.

to the broker, as typically this is calculated as a percentage of the amount borrowed). This can be done in a number of ways, such as recommending inappropriate refinances or arranging for a loan to be "interest only" for the first few years. This practice leads to a risk of borrowers being overcommitted and at risk of being unable to meet repayments;

- brokers recommending home loans with offset accounts linked to credit cards, where the consumer is at risk of being charged interest at credit card rates if they are unable to pay the monthly balance off in full, where the broker has failed to properly investigate the consumer's spending patterns and cash flow in order to assess their capacity to meet the monthly payment on the credit card; and
- brokers arranging a loan that was at a higher interest rate than that specified as the maximum rate in the agreement between the broker and the client.

Financial cost of poor recommendations

The potential costs of poor recommendations can be very high in that even a small differential in the interest rate applicable to a 25-year home loan can produce very different results. The effect is illustrated in the following examples of a refinance to a less competitive product:

- *Loan A*—a loan of $175,000 at 5% repaid over 25 years with fortnightly repayments will have repayments of $469.94; and
- *Loan B*—a loan of $175,000 at 5.5% repaid over 25 years with fortnightly repayments will have repayments of $493.72,

resulting in an additional $15,547 being paid by the consumer over the life of Loan B.

In practice, the costs of refinancing will be even higher due to costs incurred from the change in loans. This is illustrated by the following case study.

Case study

Ms J had a standard variable interest rate home loan with an outstanding balance of $114,000. Ms J was cold called by a telemarketer offering to talk to her about how she could save money on her mortgage. Ms J was interested in increasing her loan to buy a computer (to work from home) and agreed to a visit.

The person who visited Ms J only discussed finance with one particular lender, and did not disclose that he was a broker. He led Ms J to believe he acted for that lender, and that she would only have to pay the lender's application and loan fees. The broker gave Ms J a series of documents to sign. These included a broker agreement (which was not explained to her) and an application for a loan of

$120,000. In fact, the loan was to be provided through a line of credit. This type of finance was completely inappropriate and unnecessary for Ms J, while the interest rate was more expensive than on her existing loan.

When the loan settled, Ms J paid around $4000 in fees, including nearly $3000 to the broker, as well as the lender's application fees and solicitors costs. This meant there were insufficient additional funds available for her to buy a computer.

Mainstream players—disclosure obligations

In general terms, the statutory requirements on brokers to disclose their fees are minimal in character (see Section 2.3). Nor has self-regulation led to universally high levels of disclosure. The broker survey results showed that 25% of brokers who charged fees to their clients provided that information to their clients in an oral form only, and not in a formal document. Similarly, 35% of brokers who received commissions from the lender only advised their clients of this orally, while 5% stated that they did not inform their clients about commissions at all.

Payments by brokers to third parties for referring potential clients to them are widespread in the industry. As noted previously, the "Broker Survey" found that 65% of respondents promoted their services though a range of third parties.[32] In the majority of cases, the brokers offered commissions or other financial incentives for these referrals. The types of third parties who received commissions included real estate agents, accountants, lawyers, collection agencies, car dealers and building contractors, where the consumer would not ordinarily assume or consider a commission might be paid. Jon Denovan, Chairman of the MIAA Legislative Committee, has described these payments as "among the most objectionable of practices in the industry."[33]

It is the experience of caseworkers that these commissions or payments are never disclosed to the consumer, and that the referral to the broker is therefore seen by the consumer as personal and reflecting a positive experience by the third party. In fact, the payment of the commission means that the referral is not impartial, and the failure to disclose this payment means the consumer is not in a position to objectively assess the value of the referral. It also suggests that the standards applying to disclosure of fees and commissions within the industry are generally poor.

[32] See Table B.16 in Appendix B.
[33] Quoted in "Amendments fail to stop referral kickbacks", *Mortgage Professional Australia*, Issue 2.11, p. 24.

Fringe players—quality of advice

Some of the fringe players have developed scams clearly designed to exploit and manipulate consumers who are desperate for finance. A number of these scams are sophisticated in design and operation and are targeted at these vulnerable consumers.

An example of one such scam is a broker who attracts clientele through newspaper advertisements with statements such as: "No credit checks. Finance OK if not working." When consumers approach the broker, they are told they need to pay a $600 application fee. If they cannot afford the fee upfront, the broker tells them to apply for a credit card and then pay the fee through a cash advance. The broker then may or may not arrange a loan for the consumer, depending on the person's circumstances.

A number of the case studies in Appendix A involve disputes about the quality of advice provided by brokers. The conduct identified through the case studies includes:

- brokers recommending interest only loans in inappropriate circumstances;
- brokers misrepresenting the savings available from changing a home loan;
- brokers arranging for borrowers to declare, incorrectly, that a loan is for investment rather than personal use (with the result that the consumer loses statutory protections provided under the Uniform Consumer Credit Code);
- brokers charging excessive fees, or fees in circumstances where the broker is aware that there is little prospect of the borrower being approved for a loan;
- borrowers being placed into a loan where they could only afford the repayments with substantial hardship (81% of the caseworkers surveyed by the CCLC (NSW) who dealt with broker complaints indicated that they often saw problems of this type); and
- brokers arranging finance for an amount less than that requested by the customer (particularly where the funds were required to complete a property purchase).

These practices result in higher costs to consumers, an increased risk of default by the borrower, and exposure of their home where this was used as security for the debt.

The first two issues are examined in more detail below.

"Interest only" loans

The case studies indicate that brokers are making widespread use of "interest only" loans. The repayments on these loans only meet the interest charged on the credit, so that at the expiration of the term of the loan (commonly one or two years only), the capital must be repaid. The repayments may be lower than a mainstream home loan, as they only meet interest rather than also reducing the outstanding capital (although this depends on the interest rate charged). Interest only loans are therefore generally of benefit only to small and specialist categories of borrowers, such as those experiencing short-term cash flow problems (where the short time frame means that the consumer will have to bear the costs of refinancing their home loan within a short period of time) or professional property investors seeking enhanced tax benefits.

The following case study demonstrates that the recommendation of interest only loans by brokers to borrowers outside these particular categories can result in the borrower being at risk of losing their home.

Case study

Mrs M is an aged pensioner. As her only income is the pension, she was struggling to meet even her basic living requirements. She is poorly educated and has difficulty reading and writing. She owned her own home in country Victoria, a property valued at $40,000. Mrs M decided to consolidate her debts, primarily a debt owed to Legal Aid (incurred for divorce and custody proceedings). Legal Aid was not demanding payments from Mrs M, but she felt she should pay off the debt. Mrs M found an advertisement for a finance broker in a newspaper. The advertisement stated "no credit checks" and "loans up to 90% of valuation". Mrs M rang the broker and gave some initial details over the phone. She then attended an appointment at the broker's office with a friend.

The finance broker advised at this meeting that he could arrange a loan of $24,000 for her, although it would have to be secured with a mortgage over Mrs M's property. The broker provided her with a loan document and mortgage. Due to her literacy problems, which would have been evident to the broker, she was unable to understand them. Her friend suggested she take them to a solicitor, but the finance broker told her she could not do so, and that if she wanted the loan, she would have to sign immediately. Mrs M asked how long the loan was for, but an evasive answer was given. The broker did not explain that the loan was "interest only" in nature, and that the principal had to be repaid in 12 months. The interest rate on the loan was 13% and the contract provided for the broker to receive a procuration fee of $1500 (or 6.25% of the amount of the loan).

Mrs M felt she had no choice except to sign the documents. She was able to meet the monthly repayments, although with some difficulty. When the term of the loan expired, Mrs M was unable to repay the capital sum of $24,000. She sought legal assistance and was advised to sell her home as otherwise she risked losing her outstanding equity in the property in legal action that was likely to be unsuccessful.

There is a variation to this practice, whereby brokers recommend home loans (often with mainstream lenders) where the repayments cover interest only for the first few years. The amount of the repayments can then increase significantly to cover both principal and interest. The highly leveraged/geared nature of these loan means the borrower will have to change established spending habits in order to meet repayments that can increase by up to 40% (without taking into account any additional amounts payable due to rises in interest rates). Accordingly, loans of this type have greater risks for consumers than traditional principal and interest loans, as the initial "interest only" nature of the repayments means that they are paying significantly more overall, and that - during the period when repayments are only covering interest - any equity is only being accrued through increases in the value of any property purchased with the funds. Brokers recommending these products without carefully explaining to borrowers the way in which they operate and ensuring that the consumer is comfortable with the increase in repayments place borrowers at risk of being overcommitted, possibly not at present, but when repayments increase.

Misrepresenting the financial benefits available

Some intermediaries market themselves on the basis that, where the consumer has an existing home loan, they are able to offer the consumer a more competitive product that will enable their mortgage to be paid off more quickly. This approach uses as a marketing tool the confusion created in consumers by the proliferation of products in the marketplace. It is likely that most consumers believe that there are home loans that are cheaper or better than their own, but that they also find the task of searching the marketplace to identify these loans too daunting. Some brokers actively manipulate this sense of unease by offering to place the consumer in a loan that can be paid off in a much shorter period of time than their existing home loan. In the majority of cases, the representations on the potential savings are based on the consumer:

- making increased repayments, a strategy which requires the borrower to adhere to a revised budget; and
- being placed in a loan with an offset account (so that living expenses are purchased by way of credit card, and the consumer’s salary is offset against the home loan balance during the interest-free period on the card).

The justification for switching loans may be problematic for a number of reasons. First, as the bulk of the savings derive from increased repayments, there may not be any economic advantage in the consumer switching home loans (given the transaction costs they will incur). Secondly, assessing the capacity of the consumer to adhere to a revised budget is difficult and time-consuming and rarely done thoroughly (by, for example, reviewing their spending habits over a period of time). No provision may be made for cash reserves for contingencies (such as the unexpected need to replace a car). Thirdly, if the borrower is unable to repay the amount outstanding on the credit card in full each month, they become liable for interest on that sum at credit card rates. As a result, the representation that the borrower may save years on their home loan can easily result in them being switched into a more expensive product, and one that has high-risk consequences if they are unable to maintain a budget.

Fringe players—fees

Case studies involving disputes about fees raise the following issues:

- brokers charging fees that are excessive—46% of the caseworkers who dealt with broker complaints indicated that they often saw problems about brokers charging excessive or undisclosed fees;
- brokers charging fees that appear to be calculated according to the bargaining capacity of the individual consumer, and not according to the work to be undertaken. The broker survey showed that, in relation to brokers who varied the fee they charged to the client, only 8% varied the fee according to the amount of work done to arrange the finance (other responses indicated the fee was varied according to the amount of the loan, the type of finance, and the outcome of negotiations with the client);
- brokers not disclosing to consumers the amount of the fees that they would charge (with this figure only becoming apparent on settlement of the loan, when the broker deducts their payment from the loan proceeds);
- brokers refusing to leave a consumer’s home until they have signed an agreement committing them to paying a significant fee to the broker;
- brokers charging either the full amount of their fees, or a significant proportion of them, even where the broker was unable to arrange a loan or the consumer was dissatisfied with the product recommended by the broker and did not proceed with the recommendation; and
- brokers using unfair tactics to enforce payment of their fees.

Case studies

Mr and Ms J had experienced difficulties in obtaining a loan from a mainstream lender. They contacted a broker who had placed newspaper advertisement offering loans with “no credit checks”. They paid an initial fee of $200 to the broker to arrange them a home loan. The broker did not provide them with a written broker agreement, in breach of the requirements of the *Consumer Credit (Victoria) Act 1995*. Before the broker had been able to arrange a loan, Mr and Ms J changed their mind about going through with the transaction, as they considered they would be unable to afford the repayments under a home loan.

The broker then demanded fees of $2000 from Mr and Ms J, who then approached the Consumer Credit Legal Service (CCLS) for assistance. CCLS wrote to the broker stating that no fees were payable as he had failed to provide them with a written agreement. The broker wrote back stating that the reason he did not provide Mr and Ms J with any documents was because they told him they wanted to purchase a property as an investment, as they were unable to afford finance for a residential property. Mr and Ms J advised CCLS that they had told the broker the finance was only for a home they would live in themselves. CCLS was able to get the broker to drop his claim for the $2000 brokerage fee, and to refund the $200 fee paid to the broker by Mr and Ms J.

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Ms O and her partner arranged for a broker to visit them at home to discuss options for refinancing her home loan. The broker advised Ms O that he would be able to find them a cheaper loan, and, as a result, Ms O and her partner signed a broker agreement that day. They did not read it before signing it, and the broker did not explain it to them.

The broker subsequently contacted Ms O and sent her documents to sign to enter into a new loan, to refinance her home loan. However, when Ms O examined the agreement she decided not to go ahead with it, as it was not cheaper and she believed she would not be able to afford the higher repayments. She is now being pursued for a $6000 brokerage fee referred to in the broker agreement, even though the finance arranged by the broker did not meet her needs.

Disparities in market information between brokers and consumers

Many of the disputes covered by the case studies indicate a number of structural issues in the consumer–broker relationship. There is a disparity in market information between the broker and the consumer, which is capable of being exploited by the broker for their own financial advantage. Matters about which the consumer would ordinarily be unaware include the range of loans reviewed by the

broker, the range of commissions offered to the broker by those credit providers, and the different interest rates and fees charged in respect of those loans. Most consumers would also be unaware that by signing a declaration that the loan is for investment purposes (and therefore outside the UCCC regime), they make it significantly easier for the lender to take possession of any security, such as the their home, in the event of default.

Responses by caseworkers and the case studies provide some instances of consumers agreeing to refinance their home loan in circumstances where the economic benefits of doing so were questionable at best, either because of the high fees charged by the broker or because the refinanced home loan was at a higher interest rate. These transactions suggest that there was either reliance by the consumer on oral statements by the broker, or an implicit understanding by the consumer that the broker is acting in the interests of the consumer to obtain the "best" loan, or, at a minimum, a loan that reasonably meets their needs. This means that the broker and the client may have completely different views of the transaction, which allows the broker to charge high fees.

Many brokers charge a significant percentage of their fee if the borrower decides not to proceed with the loan. This, combined with the absence of any explicit obligation on the broker to make a recommendation that is reasonably suitable (or any sanction on the broker when they fail to do so), inhibits the capacity of consumers to negotiate with brokers, or to select a cheaper loan than that recommended by the broker. The European Union, as discussed in Section 4.2, prohibits brokerage fees in circumstances where the broker is remunerated by commission from the lender, or where no finance is actually arranged.

1.6 Brokers and fraud

A significant and, from a regulatory viewpoint, disturbing trend in the broker industry is the incidence of fraudulent mortgage applications. The shift in responsibility for the preparation of the loan application from persons such as bank employees to brokers has seen a shift in the interests of that person, from applying proper risk assessment techniques to earning commissions through having the loan approved. Increased reliance on brokers therefore creates an increased risk of this type of mortgage fraud.

At the soft end, mortgage fraud can involve the broker misrepresenting the consumer's personal or financial information in order for the lender to finance a marginal application for credit. Because brokers have ongoing contact with a credit provider, they become familiar with its lending criteria and can manipulate the content of applications to ensure the loan will be approved. There are a number of ways in which the broker can camouflage the borrower's circumstances, such as

not disclosing all liabilities, reducing the number of dependants, or inflating the value of assets.

More sophisticated mortgage frauds can involve "identity theft", where the application is made on behalf of a non-existent or reconstructed individual, the security offered is illusory or vastly inflated in value, and the funds advanced by the lender are simply stolen. According to a recent report, mortgage fraud is a "thriving suburban industry" in Sydney, with finance brokers manufacturing false identities for customers and then arranging loans of up to $50,000.[34]

Mortgage fraud practices have undoubtedly taken advantage of the search for increased market share by lenders. John Kavanagh, a financial services journalist, writes:

> *"Among police and fraud experts, there is a belief that in the fiercely competitive home loan market, some big banks—in their effort to secure market share—were prepared to deal with almost any broker who brought them business. This meant that, in the past, they have lent money to home buyers through brokers who had no relevant qualifications or experience in the industry, no business record, who were not members of the industry association, and who were known to use heavy-pressure sales tactics on consumers."*[35]

Precise figures on the scale of mortgage fraud are not available, but it has been estimated that this type of fraud accounts for 3.2% of all frauds committed against financial institutions, and for 12.9% of the value of all financial institution losses.[36] The extent of the problem is such that some professional indemnity insurers have identified those lenders who are known to have particularly lax lending practices (leading to an increased risk of fraud), and have refused to provide insurance cover to valuers in transactions involving those lenders. The cost of these frauds is passed on to all consumers through increased interest rates, to cover the losses incurred by lending institutions.

Case study

A broker previously worked for a particular lender. He then left the lender and began contacting some of its clients, telling them that he had left because "that lender is stealing your money" and offering to help them refinance. Mr H was one of the clients approached by the broker. Mr H had recently been retrenched, and had income from a part-time job only. Mr H had purchased an investment unit off

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[34] *Daily Telegraph*, 24 February 2003, p.11.
[35] "Bridle the brokers", *Business Review Weekly*, 28 November 2002, p. 64.
[36] Simon Purcell, Legal Director of Latrobe Capital and Mortgage Corporation Ltd, "Warning: Mortgage fraud on the rise", *Money Management*, 27 June 2002, p. 26.

the plan sometime previously. The unit was nearly completed, with settlement approaching.

The broker told Mr H that he could arrange for him to refinance his existing loan, and get finance for the purchase price of the investment unit. The broker arranged for false documents to accompany Mr H's loan application, including doctored bank statements, and a false reference from an employer, suggesting that Mr H was employed in sales, and earning over $80,000 in commission annually. The loan application was approved.

The prevalence of mortgage fraud is an additional reason why there have been calls for national regulation of the broker industry. Simon Purcell is the Legal Director of Latrobe Capital and Mortgage Corporation Ltd, part of the Latrobe Group, which has a mortgage book of $1.2 billion. He has stated:

> *"The undisputed existence of mortgage fraud has prompted moves to more tightly regulate the industry, especially at broker level. Hopefully, this intent to weed out mortgage fraud will result in industry support for a single national regulator for all secured loans; and broker licensing requirements along the lines of those applying to stockbrokers and financial advisors. Meanwhile the Mortgage Industry Association is intent on weeding out fraud and is working on its own self-regulatory regime. However this appears likely to fail unless it can force the national registration and licensing of every mortgage broker within the next two years."*[37]

There is also evidence that some brokers flout the law by charging fees in advance of securing credit for their clients, in direct contravention of legislative prohibitions in some States.[38] The existence of fraudulent conduct by brokers and disregard for legislation is consistent with some of the extreme conduct identified in the case studies—behaviour that is driven solely by profit motives rather than acting in the best interests of the client—and suggests that some brokers are able to exploit both the significant existing weaknesses in the regulatory framework and the trust placed in them by their clients for their own ends. The structural factors driving this conduct (as identified in Section 1.3) suggest that this conduct will continue unabated, in the absence of stringent and robust government intervention.[39]

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[37] Simon Purcell, Legal Director of Latrobe Capital and Mortgage Corporation Ltd, "Defrauding the great Australian dream", *Journal of Banking and Financial Services*, 116, August 2002, p. 7.
[38] Final Report of the NSW National Competition Policy Review of the *Credit (Finance Brokers) Act 1984*, p. 16.
[39] Industry efforts to deal with fraud and other improper practices are detailed in Section 2.4 of this report.

Finally, it should be noted that the nature of the fraud in these types of transactions often makes enforcement actions problematic. Applications for credit that contain false information about the borrower's financial position are invariably signed by the consumer. Establishing that the false details were included without the borrower's consent or knowledge can be extremely difficult. Other complicating factors can be the existence of oral representations by the broker, the complex nature of the transaction, and, potentially, significant time lapses between the conduct of the broker and its discovery by the borrower. When added to the relatively small amounts of money involved, these factors mean that there are considerable difficulties in having a significant number of these matters investigated and prosecuted by the police.

Section 2: Regulation of brokers in Australia

2.1 Regulation of credit in Australia

In order to appreciate the extent to which the activities of finance brokers are regulated in Australia, it is necessary to understand how credit is regulated. The main legislative instrument regulating credit for consumer use is the *Uniform Consumer Credit Code* (UCCC). The UCCC is based on template legislation enacted by the Queensland Parliament,[40] with all other States and Territories (with the exception of Western Australia) passing legislation applying the *Consumer Credit Code*, as in force in Queensland from time to time, as their own law. The Western Australia Parliament chose to pass alternative consistent legislation, with a few minor differences.

The approach taken by the UCCC to regulating credit depends on the classification of a product, as to whether or not it is "credit" (as defined in the UCCC), and, if it is credit, whether or not it is credit of a type regulated by the UCCC (with the UCCC seeking to exclude loans for business or investment purposes). Where the UCCC applies to a transaction, the lender is required to assist the borrower to make an informed decision by prescribing in detail information about the credit (and related aspects of the transaction) that must be supplied to the borrower. The UCCC also regulates the variation and enforcement of credit transactions, and related transactions (such as the provision of mortgages and guarantees, sales of insurance and, in some situations, sales of goods and services financed through credit contracts).

The UCCC does not seek to regulate the conduct of brokers in arranging credit transactions, by, for example, enumerating particular matters that they must consider before recommending a particular credit product (although some of the obligations placed on credit providers, such as providing copies of documents, may, in practice, be carried out by brokers). This to some extent reflects the long gestation period of the UCCC while national uniformity was negotiated. Its initial conception and drafting pre-dated the rapid expansion of the broker industry, and thus it does not address the issues that arise in relation to this type of intermediary.

Instead, regulation of brokers is a matter that has been left to each Australian jurisdiction to address individually. Section 2.3 of this report examines the nature and effectiveness of State and Territory regulation. In general terms, there is no comprehensive regulation of the activities of finance brokers, with broker-specific

[40] The *Consumer Credit Code* is set out in an Appendix to the *Consumer Credit (Qld) Act 1994*.

legislation existing only in New South Wales, Victoria, the Australian Capital Territory and Western Australia. As a result, brokers are subject to minimal disclosure obligations when making recommendations about credit products.

2.2 The role of the Australian Securities and Investments Commission

ASIC has had the federal regulatory role in relation to credit, including the conduct of brokers, since 11 March 2002. Federal oversight of credit was transferred to ASIC from the ACCC as part of the reform of business and investment regulation under the Corporate Law Economic Reform Program.[41]

ASIC's responsibility for credit and finance brokers arises under the *ASIC Act 2001* (the ASIC Act)*,* which regulates conduct in relation to "financial products". The definition of "financial product" in s12BAA(7) of the ASIC Act was amended to include, from 11 March 2002, a "credit facility" as defined in reg 2B of the ASIC Act. The definition of "credit facility" is expansive, and includes household and investment and small business credit. The ASIC Act regulates conduct in relation to credit facilities, which encompasses brokers providing advice or recommendations either generally or in relation to particular credit products.

The ASIC Act does not prescribe detailed disclosure or contractual requirements in relation to credit (as regulation at this micro level has been left to the States and Territories through the UCCC). Rather, the ASIC Act sets out a small number of broad standards of conduct in relation to credit facilities, including:

- it prohibits unconscionable conduct and misleading or deceptive conduct;
- it prohibits making false or misleading representations; and
- it implies warranties of due care and skill and fitness for purpose into contracts for the provision of financial services.

ASIC can take action where a finance broker has breached the statutory prohibitions on or after 11 March 2002. The ACCC has residual jurisdiction where the conduct occurred before 11 March 2002.

The level of regulation of brokers under the ASIC Act is therefore responsive, in that ASIC can only take action for breaches of the legislation (ie where unfair conduct has already occurred). The position with brokers is different from that of other intermediaries in the financial services industry such as insurance agents or financial planners. By way of comparison, the *Corporations Act 2001* requires these categories of intermediaries:

[41] The ACCC retains joint jurisdiction in relation to unconscionable conduct in business-to-business credit.

- to be licensed, either directly or by the holder of an Australian Financial Services Licence. The licensee is responsible for ongoing training and supervision of its representatives;
- to only recommend products where they have a reasonable basis for such recommendations (and, where changing a product is recommended, listing the advantages and disadvantages of such a change); and
- to meet detailed disclosure requirements (including specifying commissions and financial benefits received and paid as a result of the recommendation).

An unknown number of intermediaries regulated by ASIC, particularly financial planners, also provide advice in relation to credit or have established links with credit providers to facilitate the provision of finance for some of the investments they recommend. The regulatory position with these intermediaries is anomalous, however, in that their conduct when acting as finance brokers can be taken into account by ASIC, but only in determining their eligibility to continue practising as financial planners and not as finance brokers. Even if ASIC bans an individual from being a financial planner, it cannot take any action to prevent them continuing to work as a finance broker.

For example, CCLC (NSW) is aware that at least one mortgage broker that came to its attention previously worked as a financial planner. ASIC had obtained an order banning him from operating as a planner, as he had stolen client funds. However, the current legislation does not allow ASIC to take action to prevent him working as a mortgage broker. ASIC can only take action against him if a specific breach of the ASIC Act comes to its attention.

2.3 State and Territory legislation

The level of statutory regulation of finance brokers varies from jurisdiction to jurisdiction within Australia. New South Wales, Victoria, the Australian Capital Territory and Western Australia have broker-specific legislation, although Western Australia is in the process of amending its legislation.

Licensing and registration of brokers

No State or Territory, apart from Western Australia, has an occupational licensing regime, under which a finance broker must satisfy certain requirements before they can practise as a broker. In general terms:

- Victoria and the Australian Capital Territory require a person to be registered as a finance broker before commencing practice. A broker does not need to have any particular qualifications, skill or experience to be

registered. In Victoria, some categories of people are excluded from being registered as brokers, such as insolvents, persons convicted of offences of fraud or dishonesty (or breaches of the UCCC), or persons who have had a licence to practise a different occupation cancelled or suspended.[42] In the Australian Capital Territory, an applicant must be registered unless they have been specifically disqualified from acting as a broker;[43] and

- New South Wales, South Australia, Queensland, Tasmania and the Northern Territory do not require a broker to be either licensed or registered before commencing practice. In these jurisdictions, it is therefore impossible to ascertain the number of people working as finance brokers, or to identify those people operating in the industry.

The position in Western Australia is more fluid and has been influenced by the involvement of finance brokers in raising funds from private individuals (usually pensioners) to invest in fraudulent and over-valued business ventures. Two inquiries, the Gunning Committee of Inquiry into Fair Trading Boards and Committees and the recent Temby Royal Commission into the Finance Broking Industry, found that there was a chronic failure by the Finance Brokers Supervisory Board to carry out its consumer protection and licensing functions. Accordingly, both reports recommended the repeal of the licensing requirements in the *Finance Brokers Control Act 1975*.

The Western Australian government has recently announced that it proposes to replace the licensing regime under the *Finance Brokers Control Act 1975* with a system of mandatory registration of brokers. Registration would be automatic for those meeting prescribed qualifications and not otherwise excluded (eg on the grounds of bankruptcy, or convictions for fraud or dishonesty). Brokers would be subject to a mandatory code of conduct and could be disqualified for dishonest or unfair conduct, or breaching the code. The terms of the code and the qualifications are yet to be announced, although legislation is expected to reach the parliament in the autumn session.

Given the uncertain nature of the specific requirements that will be imposed on brokers by the Western Australian Government, the position in that State will not be considered further in this section of the report.

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[42] See s37C–37E of the *Consumer Credit (Victoria) Act 1995*.
[43] See s43(1) of the *Consumer Credit (Administration) Act 1996*.

Disclosure obligations on brokers

The disclosure obligations on brokers vary from jurisdiction to jurisdiction. In general terms, these obligations are as follows:

- both Victoria and the Australian Capital Territory encourage brokers to have a written agreement with their clients by providing that if the broker does not have a formal agreement, a civil penalty applies in that they are prohibited from demanding or receiving any fee from the client. It is arguable, however, that the absence of a written agreement does not prevent the broker from receiving commissions or payment from the lender;[44]
- in Victoria and the Australian Capital Territory, where the broker has a written agreement with their clients, that document must include a number of specified matters. The list of specified matters is relatively brief and does not include matters such as disclosure of commissions paid by lenders, commissions or "spotters fees" paid by brokers to third parties, or any time limits within which the credit must be arranged;[45]
- the New South Wales Government has introduced legislation requiring brokers to disclose a broader range of matters than those under the Victorian and Australian Capital Territory legislation.[46] The Bill requires brokers to disclose matters such as that loan recommendations will be drawn from a limited pool of lenders, the time within which the broker must secure the finance, and the nature of commissions and financial benefits that will be received by the broker from credit providers; and
- in South Australia, Queensland, Tasmania and the Northern Territory, brokers are not under any legislative obligation to have a written agreement with their clients (setting out the terms on which they have been employed), or to otherwise disclose commissions or fees to consumers.

Limitations of current State and Territory regulation

The main limitation of State and Territory legislation is that its operation can be avoided, by both lenders and brokers, if the credit is characterised as being for investment purposes. As noted above, New South Wales, Victoria and the Australian Capital Territory have introduced broker-specific legislation. However,

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[44] This issue depends on the interpretation of s37J of the *Consumer Credit (Victoria) Act 1995* and s35 of the *Consumer Credit (Administration) (ACT) Act 1996*, which refer to the broker demanding, accepting or receiving payment. The wording of the Australian Capital Territory Act suggests this phrase should be interpreted as referring to a payment from the borrower only, and not from a third party to the broker. Arguably, the Victorian legislation has a broader interpretation.
[45] See s37J of the *Consumer Credit (Victoria) Act 1995* and s35 of the *Consumer Credit (Administration) Act 1996*.
[46] See s4C of the *Consumer Credit Administration Amendment (Finance Brokers) Bill 2002*.

the legislation does not apply to brokers generally, but instead applies only to those transactions regulated by the UCCC.

The UCCC generally excludes regulation of credit for business purposes. It seeks to enable a lender to determine whether or not a credit product is regulated prior to entering into the transaction. The mechanism for achieving this objective is s11(2) of the UCCC, which provides that a loan will be conclusively presumed to be for business or investment purposes if the borrower completes a declaration to this effect (in a prescribed form).

Section 11(3) provides that a declaration will be ineffective:

> *"…if the credit provider (or any other relevant person who obtained the declaration from the debtor) knew or had reason to believe, at the time the declaration was made, that the credit was in fact to be applied wholly or predominantly for personal, domestic or household purposes."*

The phrase "any other relevant person" is defined to include a finance broker. However s11(3) will only apply where it is the finance broker who obtains the declaration from the debtor. Where the declaration is obtained by a third party (eg a solicitor), the actual knowledge of the broker is irrelevant in determining whether or not the loan is regulated by the UCCC and, in turn, whether or not the conduct of the broker is regulated by the relevant legislation in New South Wales, Victoria or the Australian Capital Territory.

An additional problem is that the wording of Section 11(3) requires the consumer to produce evidence of the state of mind of the credit provider[47]; this creates logistical difficulties for those advising consumers. Tribunals have tended towards a conservative interpretation of Section 11(3), as requiring a robust level of proof in order to displace the presumption created by the execution of the declaration or to otherwise establish that the credit provider was aware that the loan was not for business purposes[48]. Some Tribunal decisions have allowed the credit provider to rely on the content of the declaration, not withstanding that it is in an ineffective form.[49] These problems make it exceedingly difficult for consumers to challenge a business purposes declaration, even where it misdescribes the use to be made of the credit.

In other words, brokers can avoid the limited regulation that exists through the UCCC, and the broker-specific legislation in New South Wales, Victoria and the Australian Capital Territory, provided they do not obtain the declaration from the

[47] In relevant cases, the inquiry can also address the broker's state of mind.

[48] *Taylor and Another v Third Szable Holdings Pty Ltd* (2001) ASC 155-050.

[49] See, for example, *Neuendorf v Rengay Nominees Pty Ltd*, decision of the Victorian Civil and Administrative Tribunal, No. M31/2001.

borrower. This is the case even where the broker has actual knowledge that the credit is for personal use. The broker can misrepresent to the lender the purpose of the loan, as being for business or investment purposes. If it is the case that the credit provider then arranges the execution of the declaration (or this is done by a third party), both the credit provider and the broker can rely on the conclusive presumption in s11(2) of the UCCC.

Some fringe lenders, particularly those providing interest only loans, will only provide credit where the borrower has executed a business purposes declaration. Case studies suggest that borrowers are often unaware of the effect of signing these declarations, and that brokers are instrumental in obtaining these declarations, even where they are aware that they are not consistent with the actual purpose of the loan. As a result, borrowers who are entering into the most disadvantageous form of credit are also those being denied the protection of the UCCC.

The Commonwealth has had to consider this issue, albeit in a different context, when determining the scope of the *Corporations Act 2001*. Section 761G of that Act adopts a definition of retail client, which relies on a number of objective criteria, so that the application of the legislation is not susceptible to manipulation by financial services intermediaries or product providers.

Other limitations in the legislation include:

- limited and inconsistent obligations to disclose commissions received by lenders;
- no limitations on the amount of brokerage fees that can be charged, the circumstances in which they can be charged or how these fees are to be disclosed;
- no obligation to disclose financial benefits received from lenders, apart from commissions;
- no obligation to disclose the range of lenders and products that the broker can arrange, or to disclose whether the broker offers independent advice or merely channels loan applications to one or a few selected lenders;
- absence of any guidelines for distinguishing between the liability of the lender according to the status of the broker/intermediary;
- limited circumstances in which the lender will be held accountable for the actions of the broker;
- no obligation to assess the borrower’s capacity to meet repayments under the recommended credit product;
- no minimum statutory standard of quality that advice must meet; and

- no obligation to provide clients with any analysis of the advantages or disadvantages of refinancing an existing credit contract.

Disclosure obligations on lenders

Lenders are required to disclose commissions paid by them to brokers where the credit is regulated by the UCCC. This information must be disclosed in the loan contract document, which means that the borrower will usually have an opportunity to sight this information only after the broker has arranged the credit. The disclosure by the lender of commissions paid to the borrower has limited practical value to the borrower, as it will usually be impracticable for them to refuse to go ahead with the credit transaction at this late stage.

Other regulation of broker conduct

The prohibitions on false representations and unconscionable and misleading or deceptive conduct contained in the ASIC Act are replicated in the Fair Trading Acts enacted in each Australian State and Territory.

It should also be noted that in the Australian Capital Territory, the amount brokers can charge by way of fees is capped, with brokers permitted to charge clients 2% of any amount negotiated up to $5000, and 1.5% of any amount greater than $5000.[50] This cap only applies to credit regulated by the UCCC (ie credit for personal or domestic use).

2.4 Self-regulation initiatives

As a general principle, self-regulation initiatives have the greatest influence in industries with a relatively small number of players, where those players are homogenous in operation, and where there is a single strong industry body. In these circumstances, the interests of the players tend to converge, giving them a similar commitment to improving standards of conduct through self-regulation. This is not the case in the mortgage and finance broker industry; it has a large number of players of significantly different size, market segments and structure. This fractured nature is reflected in the number of bodies representing different sectors of the industry.

There are two main industry bodies: the Finance Brokers Association of Australia (FBAA) and the Mortgage Industry Association of Australasia (MIAA). These bodies seek to impose standards of conduct on their members through internal codes.

[50] Regulation 2 of the *Consumer Credit (Administration) Regulations 1996*

There are also a number of smaller, specialist industry bodies, such as the Australian Equipment Finance Association.

Finance Brokers Association of Australia

As at 1 March 2003 the FBAA had 582 members across the country, representing approximately 2500 individuals. Ninety five per cent of its members are either individual operators or small businesses whose predominant activity is acting as credit intermediaries or introducers. Approximately 45% of its membership is made up of brokers who act as intermediaries in the chattel, lease and rental finance, and plant and equipment area, with the remaining 55% comprising brokers who act as mortgage and home loan intermediaries.

All FBAA members are obliged to comply with a Code of Ethics that contains a number of obligations, usually expressed in general terms. The code, among other things, provides that they must:

- act in the best interests of the client at all times by providing full and accurate information;
- provide clients with the most appropriate credit facility for their needs; and
- ensure the validity and accuracy of all documentation provided.

The code does not contain:

- any mechanisms for enforcement of these standards by the FBAA;
- any requirement for the member to have an acceptable internal complaints handling mechanism, or that the member belong to an alternative dispute resolution scheme;
- any means for monitoring compliance with the code; or
- any specific disclosure requirements.

The “Broker Survey” suggests a distinct lack of awareness by members of the FBAA of the requirements of the code: 85 respondents to the survey stated that they were members of the FBAA, but only 32 of these 85 brokers indicated that they were bound by a professional code of practice. [51]

Mortgage Industry Association of Australia

The membership of the MIAA encompasses individuals and organisations that specialise in the finance sector, primarily mortgage originators and mortgage managers, but it also includes credit providers and mortgage insurers. As at August

[51] See Section B.8 in Appendix B.

2002, the MIAA had 570 full members and some 2000 affiliate members and accredited mortgage consultants.

MIAA members are bound by a Code of Practice, which sets out minimum standards of conduct. By comparison with the FBAA Code of Ethics, the MIAA Code of Practice contains a number of detailed standards, including requirements that members:

- disclose all relevant details about a proposed loan to the client at the time of application and make enquiries to determine the client's ability to repay the proposed loan;
- always disclose any fee or commission payable in relation to the loan application (including both commissions paid by the member and to the member);
- never charge a client a non-refundable application fee for a loan submission where the member believes there is little or no chance of the loan being approved;
- disclose any conflict of interest they may have;
- establish and maintain an adequate internal complaints procedure; and
- allow clients to have complaints heard and determined by the Mortgage Industry Ombudsman Scheme.

Limitations of current self-regulation

In general terms, the effectiveness of the current codes of the FBAA and the MIAA is limited in that:

- the codes do not contain any mechanism allowing the industry body to take action against a member who breaches the code; and
- the codes only apply to members of the relevant industry body.

The limitations of the self-regulatory regime established by the FBAA and the MIAA have been acknowledged across the broker industry, with both peak industry bodies and a number of major industry players calling for a greater degree of government regulation. Ray Weir, chief executive of the FBAA, has stated that uniform national legislative registration of brokers within three years, with mandatory training requirements for entrants, is one of the main goals of the Association.[52] As noted in the Executive Summary, Phil Naylor, chief executive of the MIAA has also said that self-regulation is not adequate to address the challenges posed by the conduct of brokers.2.5 Supervision by lenders

[52] "FBAA chief seeks national registration", February 2003 at www.mortgagemagazine.com.au.

Liability of lenders for conduct of brokers

Generally, brokers are characterised in law as an agent for the borrower and not the lender. Where there is a written agreement between the lender and the broker this usually stipulates that the broker is not an agent of the lender. Prima facie, therefore, the lender will generally not be held responsible for any unfair conduct by the broker towards the borrower. Where the broker has acted unfairly and yet is not an agent of the lender, the borrower cannot rely on the broker's conduct as a defence to any Court action brought against them by the lender. For example, if the broker misrepresented the interest rate charged by the lender, the borrower would not be able to take the lender to Court and argue that the lender had to charge the lower (misrepresented) interest rate. The borrower’s remedy would be against the broker, seeking compensation for the additional interest charged.

However, there are three exceptions to this general rule, where the borrower may be able to seek relief directly against the lender for the conduct of the broker:

1 the first exception is where there are unusual facts that lead to the conclusion that the broker has either actual or ostensible authority to act as the agent of the lender, not the borrower. The fact that the broker receives a commission from the lender, and that the broker has been supplied with credit applications by the lender and been instructed how to complete them, will in themselves not usually be sufficient circumstances to establish actual or ostensible authority.[53] This approach is outmoded and does not adequately address the situation where the broker regularly or invariably channels credit applications to only one lender, or to a small number of lenders (and where volume-based commission arrangements are designed by the lender to create financial incentives for this to happen);

2 the second exception is where the credit is regulated by the UCCC and the broker is a linked supplier with the lender. In this case, the lender will be responsible for statements made by the broker, under s118 of the UCCC. There are a number of preconditions that must be satisfied before this section will apply which inhibit the extent to which consumers can rely on it; and

3 borrowers can seek relief from unjust credit contracts under s70 of the UCCC and, in New South Wales, under the *Contracts Review Act 1980*. Under the *Contracts Review Act 1980*, a credit contract can be found to be unjust because of the conduct of a third party (such as a broker), even where the lender was ignorant of that conduct. However, the state of

[53] See, for example, *Morlend Finance v Westendorp* [1993] 2 VR 284; *Custom Credit Corporation Ltd v Lynch* [1993] 2 VR 469.

> knowledge of the lender will be relevant in determining whether or not to grant relief, as the competing claims of the lender and the borrower need to be considered.[54] The issue has not been considered in relation to the interpretation of s70 of the UCCC, but it is possible that the Courts will find that a similar two-stage inquiry should be undertaken. If this is the case, then in extreme or exceptional circumstances, the Courts may grant relief to a borrower with respect to the lender, even though the lender was unaware of the conduct of the broker.

In general terms, lenders have minimal incentives to maintain vigorous and regular supervision of the conduct of brokers given their limited legal liability for the conduct of the brokers, and the additional expense and cost that would be incurred in doing so. Lenders, where confronted by a wayward broker, can adopt the straightforward, cost-effective approach of refusing to deal with that broker.

Accreditation of brokers by lenders

APRA recently released the results of a survey of use of brokers by ADIs (ie banks, credit unions and building societies). The survey found that approximately 60% of these institutions had in place an accreditation process for brokers. The process could include:[55]

- only accepting business from approved, contracted brokers;
- identifying and tracking broker-introduced loans;
- internal review of loan applications;
- maintaining records of rejected broker-introduced applications; and
- regular reviews of the broker.

APRA commented that "there is a high proportion of ADIs doing business with brokers about whom they have relatively little knowledge."[56] It can be speculated that the level of supervision of brokers by non-ADIs is generally less rigorous.

Before releasing the report, APRA had publicly called on lenders to review or improve the due diligence assessments they make of brokers who submit applications to them. Charles Littrell, APRA's Executive General Manager of Policy Research and Consulting, said:

> *"One hopes lenders are keeping track of the quality of the loans that brokers are sending them. It is the broker's role to maximise the size of the loan that it can secure for the client and to present the client to the lender in the most*

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[54] *Nguyen v Taylor* (1992) 27 NSWLR 48.
[55] APRA, op. cit., p. 8.
[56] Ibid.

> *favourable light. To that extent, loan broker intermediation has the ingredients for higher default rates."*[57]

This statement urges lenders to actively supervise brokers. Consistent with this approach, Wizard Financial Services and RESI Mortgage Corporation have recently jointly released ten ethical guidelines for brokers. The guidelines are a response to their concerns about the extent to which the conduct of some mortgage brokers is damaging the industry as a whole. They have made public calls for the guidelines to be imposed nationally, as representing minimum standards of conduct for brokers. The release of these guidelines is in itself recognition of both deficiencies in the standard of behaviour within the broker industry, and the inability of lenders to regulate or properly supervise brokers.

[57] Quoted in "Bridle the brokers", *Business Review Weekly*, 28 November 2002, p. 65.

Section 3: Effectiveness of consumer redress

3.1 Problems for consumers in obtaining redress

The current mechanisms for obtaining redress against brokers are generally inadequate to provide timely and effective remedies for consumers. There are a number of reasons for this.

The first reason is that consumers have few options for obtaining redress apart from instigating Court action, with its attendant uncertainty and expense. Brokers, unlike other intermediaries in the financial service industry, are not required to be members of an alternative dispute resolution (ADR) scheme, giving consumers a choice apart from Court action. The "Broker Survey" indicated that only 51% of brokers had in place a formal procedure for responding to customer complaints. Similarly, 26% of the caseworkers surveyed by CCLC (NSW) who dealt with broker complaints indicated that direct negotiations with the broker were never successful in resolving complaints.[58] These responses are consistent with a lack of accountability by brokers, and the lack of any incentives for them to adopt effective complaints handling procedures. They reflect the fact that brokers, if they are so minded, can ignore complaints, even where the consumer is assisted by a community advocate, because of the difficulties for the consumer in taking action elsewhere.

The second reason why redress is difficult to obtain is that commonly the loss suffered by a consumer will be the amount they are required to pay a third party. Usually the third party will be the credit provider, but it may also be, for example, the vendor of a property when the consumer cannot pay the purchase price because the broker failed to arrange finance. The consumer will be under financial pressure because of the third party either having received or demanded payment, and the focus of their attention will be on resolving the dispute with the third party. The fact that a third party is involved inhibits the capacity of the borrower to contemplate or bear the cost of any legal action.

The following case study illustrates the problems that can arise for a consumer.

[58] See Section C.5 in Appendix C.

Case study

Mr B is a single father with a young child, working four days a week. He was living in his own (mortgaged) home, and was interested in buying an investment property, as a way of becoming more financially secure. Mr B approached a broker for advice, initially to determine whether or not he could borrow money to purchase an investment property, and, if so, how much. The broker informed him that he would be able to borrow over $300,000, with the precise figure depending on the rental income received from the investment property to be purchased. Relying on this advice, Mr B found a property for about $250,000.

The broker then lodged an application for finance for Mr B with a bank, which was approved. However, when Mr B began budgeting to meet the repayments, he realised he could not afford them. He contacted the bank and the broker, and discovered that the broker had misrepresented his financial situation on the application form to the bank, by suggesting that he would be getting additional rental income from the property in which he and his child were living.

Mr B was advised that if he did not proceed with the purchase of the investment property, he would lose his deposit. He therefore has had to move out of his home, and live with his parents. Despite this, he still finds it difficult to meet repayments on both loans and is considering selling one of the properties.

3.2 Access to alternative dispute resolution

Unlike other intermediaries or product providers in the financial services area, there is no alternative dispute resolution (ADR) scheme with comprehensive coverage of brokers.[59] In fact, consumers can only have a dispute in relation to the conduct of a broker heard by an ADR scheme in the following limited circumstances:

- where the intermediary is a member of the Mortgage Industry Ombudsman Scheme (MIOS), established under the MIAA Code of Practice. The limitations of this scheme, the only broker-specific ADR scheme, are shown in that only 51% of new complaints from July 2001 to June 2002 were within its jurisdiction[60];

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[59] Only 37% of respondents to the "Broker Survey" were members of an ADR scheme; see Table B.18 in Appendix B.

[60] There were 1961 inquiries: 19% related to non-members of MIOS, and 30% related to members of MIOS but were outside the terms of reference of the scheme; MIOS Annual Report, 2001-02, p. 8.

- where the intermediary or their employer is a member of the Financial Industry Complaints Service, usually because the intermediary is a financial planner and has recommended or assisted the borrower to take out credit as part of an overall investment plan;
- where the intermediary is a related corporation to a bank. In these cases, the consumer can complain to the Australian Banking Industry Ombudsman (ABIO) about the conduct of the broker; and
- where the lender is a bank or a credit union and the consumer may be able to claim relief against the lender rather than the broker (on one of the limited grounds outlined in Section 2.5). In these cases, the consumer can complain to either the ABIO or the Credit Union Dispute Resolution Centre. However, even where the broker may be found to have acted as an agent of the credit provider, these two schemes may still be unable to hear complaints about matters such as the fees charged by a broker, or where the broker failed to obtain a loan for the client, or failed to do so within any time limits specified by the consumer.

The limited access to an ADR scheme means that many consumers have little option but to go to Court, particularly when dealing with the smaller or fringe brokers. Perversely, these brokers are those most likely to adopt unfair practices and therefore to have dealings with consumers who are most likely to need redress.

This lack of access also means that brokers have little incentive to adopt formal internal dispute resolution or complaint handling procedures. This is reflected in the low percentage of respondents (only 51%) to the "Broker Survey" who have such procedures in place.[61]

3.3 Australian Securities and Investments Commission

As mentioned previously, since 11 March 2002, ASIC has been responsible for monitoring the prohibitions on misleading, deceptive or unconscionable conduct in relation to credit. While ASIC is still developing regulatory priorities in credit, its current position is that it "will generally focus on issues that are national in scope and/or have a clear systemic aspect".[62] Where a consumer needs immediate assistance about a problem with a loan or other credit product, ASIC has stated that "because [it] can often not help directly in these cases, [it] will have an important referral role to play".[63]

[61] See Section B.6 in Appendix B.
[62] See www.asic.gov.au/asic/asic_polprac.nsf/byheadline/Credit+homepage
[63] Ibid.

3.4 State/Territory fair trading departments

ASIC shares the credit jurisdiction with State/Territory fair trading departments (or their equivalent), as analogous prohibitions exist in the various Fair Trading Acts. In addition, these departments are also responsible for monitoring compliance with the UCCC. Generally, they take a similar response to ASIC in relation to individual complaints. However, they also usually have dedicated resources to negotiate hardship variations in repayments with the credit provider, where the credit contract is regulated by the UCCC.

3.5 Legal redress

Consumers considering taking legal action against brokers face a number of barriers including the inaccessibility, delays, daunting formality and high costs of the Court system. In addition, it is the nature of broker disputes that they tend to be either about fees (where the amount of money involved is relatively small compared to the costs of legal action), or arise in circumstances where a third party is involved and demanding payment from the consumer (commonly the lender or the vendor of a property if a sale does not proceed). In some cases, the consumer can be left with a dispute with a lender that is the direct result of the actions of the broker, and where the broker may not be able to be located, or where enforcement of any judgement against the broker is problematic, and the lender refuses liability on the basis that the broker was the borrower's agent.

As discussed in Section 2.5, brokers are often characterised in law as agents for the borrower and not the lender (even where the broker has received a commission from the lender and that the broker has been supplied with credit applications by the lender and been instructed how to complete them). Practical examples of the difficulties this characterisation creates for borrowers include:

- misrepresentations by the broker about a break cost or the availability of features such as redraws are unlikely to be attributed to the credit provider;
- unconscionable behaviour such as the broker misrepresenting the nature or terms of the finance to third parties who do not benefit from the loan, but become parties to the transaction (either as guarantors or borrowers) will not be attributed to the credit provider where there is nothing on the face of the application to suggest that this has occurred. The unjust contract provisions of the UCCC may not provide relief as the court will have to decide between the competing interests of two "innocent" parties, the third party borrower/guarantor and the credit provider.
- similar limitations apply where the broker misrepresents the borrower's financial or personal circumstances, without the knowledge of the borrower. Relief that may have been available against the credit provider for knowingly overcommitting the consumer will not be available unless

the consumer can somehow demonstrate knowledge of the misrepresentation by the credit provider.

Other problems for consumers in taking action directly against the broker include an absence of corroborating evidence (where the consumer relied on oral statements contrary to written documents), lack of access to documents held by the lender, and possible time delays. It is also not easy to evaluate the prospects of success of any Court action, given the lack of clear standards within the industry, as to what constitutes acceptable behaviour.

A particular problem arises for borrowers where they have signed an effective declaration that the loan is for business purposes, under s11(2) of the UCCC, even though the money is in fact for personal use. In these circumstances, the borrower will be unable to access the statutory remedies in the UCCC, including redress for breach of disclosure requirements and relief from unjust contracts in s70 of the UCCC. These remedies are generally broader than other actions.

It should also be noted that s70(2)(l) of the UCCC directs the Court, in determining whether or not a transaction is unjust, to consider:

> *"whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship…"*

This provision was included, in part, because of the reluctance of the Courts to acknowledge that over-commitment of borrowers might, in itself, constitute grounds for relief. CCLC (NSW), and other caseworkers, have noted that some non-mainstream and fringe lenders (particularly those providing "interest only" loans) systematically use the business purposes declaration to avoid the jurisdiction of the UCCC. Borrowers using such lenders tend to be financially desperate, so that one specific consequence of the use of these declarations is to deny them access to the sole statutory remedy available for redress (and when any non-statutory remedy is legally problematic).

Disempowered consumers are rarely in a position where they are able to commence proceedings regardless of the actions of the broker. They either attempt to withdraw from the relationship with the broker, or they proceed with the transaction and problems arise when they are unable to meet their commitments under the loan contract. In the former case, typically it is the broker who commences legal action in order to recover their fees, usually on the basis of a written document that is difficult to refute in a court of law. In the latter case, the consumer is in dispute with the credit provider and the broker's fees, while often

substantial, pale into insignificance against the costs and consequences of an expensive and unsuitable loan.

The range of difficulties confronting consumers contemplating taking legal action against brokers means this is rarely pursued as an option, even where the conduct of the broker has been extreme and may have caused the loss of the family home.

Case study

Mr K had been sick and working part-time. He was behind in his home loan repayments and had outstanding credit card debts. He received a default notice from the mortgagor. The bank declined his application for a loan to meet the arrears. As a result, he contacted a broker advertising in the newspaper as being able to find finance for people rejected by other lenders. The broker told Mr K he could organize a loan, but that he would have to refinance his existing home loan. Mr K's original lender charged a break fee of several thousand dollars. The broker arranged an interest only loan, and charged a fee of $2600. The lender charged an establishment fee of over $3000. Mr K soon fell into arrears on the new loan, and Court proceedings were commenced. The lawyer examined the documents he had signed when applying for the loan. These included documents outlining the fees charged, and a business purposes declaration. The lawyer advised Mr K that the costs of fighting the Court case would be significant, and he was unlikely to succeed in arguing that the loan was regulated by the UCCC, or therefore that the loan was unjust.

Section 4: The mortgage broker industry and its regulation internationally

This section of the report reviews the nature of the broker industry in a number of other countries, and the models of regulation in those countries. It should be noted that regulation is generally restricted to broking in relation to lending secured by way of mortgage over real estate.

4.1 United Kingdom

In the United Kingdom, it is estimated that brokers are responsible for approximately 60% of mortgages.[64] In order to have lenders accept applications, brokers usually have to be registered with the Mortgage Code Compliance Board; in 2000, there were 10,470 broker firms, representing 43,569 mortgage advisers.

The main industry body for the mortgage lending industry is the Council of Mortgage Lenders (CML). It has 145 members who provide over 98% of the first mortgages on residential property in the United Kingdom. The CML also sponsors a voluntary Mortgage Code that covers the activities of both lenders and mortgage intermediaries. Generally, lenders who subscribe to the Code do not accept business from brokers who have not also agreed to adopt the Code.

The Code obliges brokers to:

- disclose their status with respect to the lender and the borrower;
- disclose at the outset whether they receive a fee for arranging the client's mortgage;
- provide clients with fair terms and conditions, setting these out clearly and in plain language;
- have internal procedures for handling complaints fairly and speedily; and
- be a member of an alternative dispute resolution scheme (typically the Mortgage Code Arbitration Scheme).

Government regulation of broker activities in the United Kingdom currently takes place through the *Consumer Credit Act 1974*, the Office of Fair Trading

[64] See www.cml.org.uk. See also Jason Clout, "Mortgage broking looks set to expand", *The Australian Financial Review*, 12 April 2002, p. 70.

Guidelines for Non-Status Lenders and Brokers, and precedents under the *Unfair Contract Terms Regulations 1999*.

The *Consumer Credit Act 1974* encompasses all forms of consumer credit and hire purchase and prohibits false or misleading advertising. The “Non-Status Lending Guidelines for Lenders and Brokers” is a series of guidelines issued by the Office of Fair Trading (OFT). They are specifically directed at enhancing the protection provided to consumers whose credit rating made it difficult for them to obtain finance. The guidelines apply to both lenders and brokers and provide that:

- there should be transparency in all dealings with potential and actual borrowers, with full and early disclosure and explanation of all contract terms and conditions, and all fees and charges payable;
- contract terms and conditions should be fair, and should be written in plain English to ensure that borrowers understand the nature of the loan agreement and their rights and responsibilities under it;
- there should be no high pressure selling, and adequate time should be allowed for the borrower to reflect on the terms and conditions of the loan and to obtain independent advice before signing;
- advertising and other promotional material should not mislead, and there should be no cold-calling or canvassing of trade premises without the borrower’s prior consent;
- brokers should disclose at the outset their status with regard to the borrower and the lender, the extent of the service offered to the borrower, together with any brokerage fee or commission payable by the lender;
- lenders should take all reasonable steps to ensure that brokers and other intermediaries regularly marketing their products do not engage in unfair business practices, or act unlawfully, and that they serve the best interests of the borrower; and
- there should be responsible lending, with all underwriting decisions subject to a proper assessment of the borrower’s ability to repay.

However, from mid-2004, the Financial Services Authority (FSA)[65] will be responsible for regulating mortgage lending, and brokers to the extent that they arrange mortgage loans.[66] This change has been triggered by the need for the UK to meet standards set by the European Union. To avoid dual regulation, mortgages entered into after the FSA assumes responsibility for mortgage lending will be

[65] An independent, industry-funded body that regulates the financial services industry in the UK. See www.fsa.gov.uk
[66] *CP 146: The FSA’s approach to regulating mortgage sales*, FSA, August 2002.

carved out of the jurisdiction of the *Consumer Credit Act 1974* and will be regulated solely by the FSA.

The FSA proposals include:

- brokers will either be licensed by the FSA directly, or authorised to operate by an entity that is itself licensed by the FSA;
- brokers must advise borrowers whether or not they are acting on an execution only basis, or providing advice, and, if the latter, provide details of the number of lenders and credit products reviewed prior to making the recommendation;
- the broker must assess whether or not a loan secured by mortgage is appropriate for the borrower, and, if so, further consider what type of loan is suitable and which product best meets the consumer's needs and financial circumstances;
- a higher level of regulation applies to mortgages identified as inherently more risky for the borrower (such as "equity release" mortgages for older borrowers); and
- brokers will be subject to the compulsory jurisdiction of the Financial Services Ombudsman (the complaint scheme for financial services in the UK). They will also be required to meet internal complaint-handling benchmarks.

4.2 European Union

In the European Union, brokers (or "credit intermediaries") are subject to limited regulation by European Union (EU) legislation under Consumer Credit Directive 87/120/EEC.[67] The legislation has recently been redrafted with brokers now subject to the following obligations:

- brokers must be registered within each Member State in which they operate;
- brokers must offer or arrange the most appropriate type of credit, taking into account the financial situation of the consumer, the advantages and disadvantages of the recommended product, and the purpose of the credit;
- brokers must indicate, in advertising and documents provided to clients, whether or not they work exclusively with a limited number of lenders, or whether they operate independently; and

[67] See www.europa.eu.int/comm/consumers/index_en.html

- brokers cannot demand or receive brokerage fees from clients where they are remunerated by commission from the lender, or where they do not arrange finance for the client.

4.3 United States of America

In 2000, there were approximately 30,000 mortgage broker companies in the USA, employing an estimated 240,000 brokers. Mortgage brokers are the biggest source of mortgage lending and are responsible for approximately 72% of home loans originated in the United States.[68] The National Association of Mortgage Brokers (NAMB) is the only national trade association representing the US mortgage broker industry. It currently has only 13,000 members who are obliged to subscribe to a Code of Ethics and to "Best Business Guidelines". These are significantly less detailed than the UK Mortgage Code. The code and the guidelines stipulate that members must:

- conduct business in a manner reflecting honesty, honour and integrity;
- conduct their business activities in a professional manner;
- endeavour to be accurate in all advertisements and solicitations;
- avoid unauthorised disclosure of confidential information;
- conduct their business with all applicable laws and regulations;
- disclose any equity or financial interest they may have in the collateral being offered to secure a loan; and
- provide written disclosure of fees, and thoroughly explain the loan process to their clients.

The NAMB also provides members with a model borrower–broker disclosure agreement, which explains to clients the relationship their broker has with lenders.

The mortgage broker industry in the United States is currently regulated by ten Federal laws, five Federal enforcement agencies and over 45 State laws or licensing boards.[69] The main Federal Act regulating the activities of mortgage brokers is the *Real Estate Settlement Procedures Act 1974*, which is administered by the US Department of Housing and Urban Development (HUD). On 5 October 2001, HUD issued *Statement of Policy 2001–1,* which detailed HUD's position on broker fees. HUD stated that:

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[68] See www.namb.org. See also Jason Clout, "Mortgage broking looks set to expand", *The Australian Financial Review*, 12 April 2002, p. 70.
[69] Details of individual licensing requirements can be found at: http://www.namb.org/gov_affairs/state_licensing.htm

- broker payments must be commensurate with the amount normally charged for similar services; and
- in order for broker fee disclosure to be meaningful, it must specify what services a mortgage broker will perform and the broker's total compensation for performing those services (including any commission paid by the lender).

This information must be disclosed as early as possible in the broker–consumer transaction.

There is considerable variation in the regulation of brokers at a state level in the United States. New York State provides an example of an interventionist regulatory model. In New York State, mortgage brokers are required to be registered under Article 12–D of the *Banking Law and Superintendent's Regulation Part 410*. Broker conduct is regulated chiefly by the *General Regulations of the Banking Board Part 38* and *Part 41*, both of which are administered by the State of New York Banking Department.[70] Part 38 prohibits fraudulent, deceitful or misleading broker advertising. Advertisements that promise immediate loan application approval fall into this category. Brokers are required to disclose, either in writing or via electronic media, a number of specified matters including:

- that the broker cannot guarantee acceptance into any particular loan program, nor promise any specific loan term or conditions;
- whether the broker places loans primarily with any three or fewer lenders;
- the maximum commission and/or any premiums or bonuses payable by the lender to the broker;
- any fees to be paid by the borrower directly to the broker (with a prohibition on these fees being calculated as a percentage of the principal amount of the loan or amount financed); and
- whether or not a loan imposes a pre-payment penalty on the borrower.

The legislation also contains a number of measures designed to protect consumers from brokers who regularly place their customers in high cost or "predatory" home loans.[71] These measures include requirements that:

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[70] A summary of *Part 41* can be found at: www.banking.state.ny.us/41ov.htm

[71] For a first mortgage to be characterised as a high cost loan, the loan must have an annual percentage rate that exceeds by more than eight percentage points the yield on US Treasury securities having comparable periods of maturity *or* the fees associated with the loan must exceed 5% of the total loan amount.

- brokers must not publish fraudulent, deceitful or misleading broker advertisements, such as those promising immediate approval of loan applications;
- borrowers must sign a statement, in a minimum 12-point type, advising them to shop around and determine comparative interest rates and other fees and charges; and
- brokers must not offer repayment terms that exceed the borrower's capacity to repay the loan.

Recent amendments to the legislation have placed additional obligations on brokers who organise high cost home loans, including that:

- borrowers receive certification from a financial counsellor that the borrower has received counselling on the advisability of the loan transaction; and
- brokers arrange a refinance only when the new home loan has a tangible net benefit to the borrower.

4.4 Canada

In Canada, the leading industry body is the Canadian Institute of Mortgage Brokers and Lenders (CIMBL). It currently has over 2500 members and it estimates that 25% of all new mortgage business is written by brokers, although there are significant variations between provinces.[72] In Ontario, for example, brokers are said to generate some 70% of new mortgage business.

Members of CIMBL are obliged to abide by the Institute's Code of Ethics, which is administered by internal committees. The main thrust of the provisions in the code relate to disclosure, conflict of interest and advertising.[73] The committees can impose significant penalties for violations of these provisions, including compensation to clients, fines and termination or suspension of membership.

The activities of Canadian finance brokers are regulated by the individual provinces, rather than nationally. In Ontario, mortgage broker activities are governed by the *Mortgage Brokers Act 1990*. Mortgage brokers are required to be registered, and the Superintendent of Financial Services has the power to refuse registration of a mortgage broker who makes false, misleading or deceptive statements in any advertising material.

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[72] Canadian Institute of Mortgage Brokers and Lenders, "Blueprint for change in the Canadian mortgage broker industry: Recommendations for effective mortgage broker regulation", 28 September 2001, p. 5. See www.cimbl.ca/journal.html

[73] See Code of Ethics at http://www.cimbl.ca/ethics.html

In British Columbia, mortgage brokers are regulated under the *Mortgage Brokers Act 1996* and must be registered. Brokers are prohibited from arranging a mortgage on behalf of a borrower unless the broker has a written agreement specifying the remuneration of both the mortgage broker and any other person for all services related to arranging the mortgage. Brokers must also provide a written disclosure statement, which outlines any direct or indirect interest the broker (or any associate or related party of the broker) has or may acquire as a result of the transaction.

4.5 New Zealand

It is estimated that 25% of all mortgage business in New Zealand is sourced through mortgage brokers.[74] The peak mortgage broker industry body is the New Zealand Mortgage Brokers Association (NZMBA), which currently has over 320 members. To become a member of the NZMBA, a broker must have:

- a proven history of relevant experience;
- an acceptable personal record;
- no ratified public objection to their membership;
- mortgage broking as their principal activity;
- approval from at least six major financial institutions;
- at least $1 million in professional indemnity insurance cover; and
- a full range of product types and options on offer.

All members must also have completed (and passed) an approved training and accreditation program.

The NZMBA requires members to adhere to a Code of Ethics and Standards, which contains a number of general obligations. For example, it requires member brokers not to misrepresent, conceal or exaggerate any pertinent facts relating to any transaction in which they are involved. Additionally, the NZMBA code places a duty on brokers to maintain their knowledge and skills at a level required to ensure that their clients receive competent service based on up-to-date knowledge and practice.

A recent article on the New Zealand broking experience has commented on the influence of commissions on market share:

[74] See www.nzmba.co.nz/entry.html

> *"In 1999, ANZ was the only New Zealand bank to offer trailer commissions to brokers and they received a larger share of their business from this channel than other banks. In 2000, the National Bank and Westpac instigated similar commission structures and were rewarded with an increased share of business through brokers, and ANZ's share decreased."*[75]

There is currently no specific regulation of finance broker activities in New Zealand. Similar to some jurisdictions in Australia, the activities of finance brokers are regulated by more generic fair trading legislation, as well as the credit legislation where the broker arranges a credit contract, which is subject to that legislation.

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[75] Shaun Drylie and Claire Matthews, "Going for Broker", *Journal of Banking and Financial Services*, 117 February 2003, p. 37.

Section 5: Reform of the broker industry

5.1 Need for reform

This report has analysed in detail the current state of the Australian finance broker industry. While there has been a growing consumer demand for broker services, the report has identified a range of structural problems within the industry, which mean that consumers are at a risk of being financially disadvantaged, either through increased repayments on home loans, high brokerage fees or, in extreme cases, through loss of the family home.

CCLC (NSW) considers that the problems experienced by consumers in their dealings with brokers are likely to continue, or, in some areas, even worsen given the following factors:

- gaps in the way in which existing legislation regulates the conduct of brokers, both at a state and Commonwealth level;
- the capacity of brokers to manipulate loan applications in order to present consumers as meeting the acceptance criteria of banks and credit unions;
- the prospect of interest rate increases in the foreseeable future, and consequent increases in repayments. Caseworkers have identified as a problem consumers being placed in loans where they are unable to afford the repayments, or can only do so with difficulty. Increases in interest rates make it likely that an unknown percentage of consumers will have difficulty in meeting increased repayments, to the extent that they may have to sell their family home;
- continuing high rates of growth in the industry with no entry requirements for new players. As noted in Section 1.1, one current estimate is that there are 50 new entrants into the industry each week;
- minimal incentives for brokers to invest in training and compliance, given the absence of uniform legislation, and, for some brokers, a potential loss of market share to brokers who engage in unethical yet successful marketing strategies.

The structural nature of the problems means that there is a need for reform, and that ultimately this can only be effective through government intervention. One common objection to enhanced regulation, that it has the potential to limit consumer-friendly innovation in the marketplace, is less of an issue with finance brokers, given that they provide a service of delivering rather than developing

products. While undoubtedly the introduction of regulation will necessarily impose costs and demand additional resources from both government and industry, it also has the potential to save both consumers and industry money through better standards of conduct and, therefore, a decreased incidence of both defaults on credit contracts and mortgage fraud. The report also notes that a number of industry players are calling for regulation, despite an awareness of the potential additional expenses involved.

5.2 Interim measures

It is acknowledged that any process of achieving legislative reform will inevitably be complex and protracted. In the short term, there is an urgent need for some interim measures to protect consumers and improve standards of conduct in the broker industry. These steps include:

- increased and visible enforcement action by regulatory agencies;
- the introduction of improved codes of conduct by industry bodies, such as the MIAA and the FBAA, together with greater monitoring and enforcement of their obligations;
- improved access to industry-based dispute resolution procedures such as the Mortgage Industry Ombudsman Scheme, and ASIC approval (pursuant to Policy Statement 139) of the operation of such schemes, in order to provide greater transparency in the operation and decision-making practices of these schemes; and
- State and Territory governments encouraging a greater degree of supervision of brokers by lenders by giving consideration to expanding the circumstances in which a lender will be liable for the conduct of a broker, at least where the broker and the lender have an ongoing relationship and the broker regularly refers consumers to that particular lender. This could be done by creating a rebuttable presumption that the broker is the agent of the credit provider in these circumstances, at least in matters relating to the establishment of the loan.

5.3 Scope of any reform

CCLC (NSW) considers that any reform of the broker industry should identify the desired outcomes from such changes and then determine the most effective way of achieving those outcomes. It notes that any such reform will need to initially determine two issues:

1. the range of intermediaries; and
2. the range of transactions to be regulated.

As noted in Section 1.2 of this report, there are major differences in the way in which brokers operate, from those providing independent advice on a range of credit products to those who are little more than conduits for an individual lender. CCLC (NSW) considers that all these intermediaries should be regulated.

Another consequence of this variation in methods of operation is that it can be unclear, both in law and to the consumer, who the intermediary is acting for. The circumstances of each particular case determine whether or not the broker will be considered to have been acting as the agent of the borrower or the credit provider. Ultimately this uncertainty is not beneficial to any party. The role of the broker, as a credit intermediary, should be clarified in a way that is consistent and practical; some options for achieving this outcome are discussed below.

CCLC (NSW) considers that the range of broker transactions to be regulated should not be restricted to instances where the credit is used for personal, domestic or household use. There should be at least some coverage of transactions involving credit for small businesses (particularly where the borrower is an individual rather than a company) and credit for investment purposes (particularly where the funds are used to purchase investment properties). Irrespective of the scope of coverage, the method used to determine whether or not a particular transaction is regulated should depend on objective criteria and not be susceptible to manipulation by brokers (as is currently the case with the business purposes declaration model in the UCCC).

5.4 Objectives of reform

Inevitably, the wide variation in the size, services offered and business model of brokers across the marketplace will necessitate careful consideration in the design of the regulatory regime. Nevertheless, the minimum consumer protection objectives of any reform should include the following matters:

1 *Improved disclosure, including:*

(a) effective disclosure of costs to be borne directly and indirectly by the borrower/consumer (including disclosure of costs as a dollar figure rather than a percentage);

(b) effective upfront disclosure by brokers of the range of lenders and products actually accessible through their service, and those regularly recommended by the broker; (c) effective disclosure by brokers in a service agreement (including disclosure of the type of credit requested, all fees, any conflicts of interest, commissions and other financial benefits, range of products and credit providers

reviewed by the broker, and any time limits within which credit must be obtained); and

(d) reliable information about the credit product recommended, including information about the terms and conditions, interest rate, fees and charges, and penalties for early repayment.

2 Improved standards of advice and conduct, including:

(a) clarification of the role of brokers, and the circumstances in which they are providing advice and where they are deemed to be agents of the lender;

(b) where brokers are providing advice, then they are required to have a reasonable basis for recommending a credit product, and advising consumers of this in writing;

(c) where brokers are acting as agents of the credit provider, this should be clearly disclosed to the consumer together with a warning about the need to make their own inquiries about the competitiveness and suitability of the loan; and

(d) reliable and prompt service (eg arranging finance so that settlements of property purchases can take place on time).

3 Preventing unfair practices, including:

(a) exclusion from the marketplace of incompetent brokers, or those adopting unfair or dishonest practices;

(b) prevention of unconscionable exploitation of consumers' lack of information/comprehension of the marketplace and the role of various players;

(c) prevention of advertisements offering "instant loan approval" to financially vulnerable consumers (such as pensioners, bankrupts and people with a poor credit history);

(d) prevention of unconscionable exploitation of consumers' financial difficulties for profit;

(e) brokers being prevented from avoiding consumer protection legislation by falsely or incorrectly documenting a loan as being for business purposes;

(f) capping of fees and commissions; and

(g) elimination of sales activity disguised as independent advice.

4 *Improved redress/accountability, including:*

(a) in appropriate cases, credit providers to be responsible for poor or misleading information about their products and services by brokers;

(b) in appropriate cases, credit providers to be responsible for poor lending decisions and unjust contracts resulting from actions by brokers;

(c) effective and accessible redress mechanisms (as in other financial services industries) with brokers required to hold professional indemnity insurance;

(d) in appropriate cases, redress to include damages and adjustment of loan commitments; and

(e) certainty about the responsibilities and liabilities of brokers.

5.5 Models for reform of the broker industry—overview

There are three possible basic models for reforming the broker industry:

1 national coverage through uniform State/Territory legislation;

2 Commonwealth legislation (either by extension of the Corporations Act or dedicated broker legislation); and

3 enhanced self-regulation.

Implicit in this selection of models is that reform of the industry will only be effective where it takes place on a national basis. The alternative, of individual jurisdictions adopting different levels of regulation, is deeply flawed. Its weaknesses can be seen in the current level of complaints about brokers to government agencies, Legal Aid, and community legal centres. It also has the disadvantage of extra costs for industry in having to adopt different documentation and practices to meet the requirements in each jurisdiction.

5.6 Uniform State/Territory legislation

There are two broad options as to how reforms by way of uniform State/Territory legislation could be introduced: by way of amendment of the UCCC, or by broker-specific legislation. However, even if the latter option is chosen, it is likely that there will need to be at least some reforms to the UCCC, to address issues arising from the tripartite nature of the broker-consumer-credit provider relationship. These reforms include:

- amending the Code to clarify that a person who submits a loan application on behalf of a borrower in return for a commission paid by the credit

provider (whether or not they are also paid by the borrower) is the agent of the broker for the purposes of that transaction;

- changing the method used to determine which credit transactions are regulated by the Code by abandoning the use of business purposes declarations and using an alternative model, such as the retail client definition currently applied under the *Corporations Act 2001*, or to at least include all housing finance whether or not that finance is for a primary residence or an investment property;
- prohibiting brokers from charging fees to the borrower (whether in cash or at settlement) where the broker is also paid a commission by the credit provider, and to otherwise limit or cap such fees according to a formula prescribed in the legislation. This would reduce the unconscionable exploitation of borrowers in financial difficulty without the need for protracted litigation about whether any particular action is unconscionable or fee excessive in all the circumstances; and
- compelling both brokers and credit providers to become members of an approved ADR scheme (with this being facilitated through an arrangement whereby the States gave ASIC the power to oversee this aspect in order to encourage a consistent approach across ADR schemes).[76]

The above reforms would address some of the extremes of behaviour in the industry, provide certainty for consumers, and ensure that credit providers do not use third party intermediaries to protect or insulate themselves from poor lending practices.

However, any legislative reform would need to go further and also address the range of limitations that currently exist in relation to State and Territory regulation of brokers, as detailed in Section 2.3 of this report. To be effective, any uniform State/Territory legislation would need to address these problems by, for example, including requirements that:

- before recommending that the borrower refinance an existing liability, the broker provides their client with a written recommendation outlining the advantages and disadvantages of refinancing;

[76] Recommendation 26 of the Final Report of the Financial System Inquiry (March 1997) was that "The States and Territories should facilitate the creation of a nationally uniform dispute resolution scheme for finance companies." No coherent steps have been taken to implement this recommendation in the six years since the release of the report, and it may be timely for the States and Territories to revisit this recommendation in the context of considering whether it should also extend to brokers.

- provide for detailed disclosure by the broker of the fees and commissions they will receive, the circumstances in which they are payable, and the amounts payable if finance is not obtained, or the borrower rejects any finance offer arranged by the broker;
- provide for detailed disclosure by the broker of the fees and commissions they pay to third parties for referring the consumer to them;
- prohibit brokers using caveats over the borrower's property to secure their fees; and
- ensure that practical mechanisms are in place for resolving the liability of the consumer to the credit provider (or other third parties), in disputes involving the conduct of brokers.

Assuming, however, that these limitations are otherwise addressed in any reforms, regulation of brokers through uniform State/Territory legislation would have the following advantages:

- there would be uniform rules across all jurisdictions;
- both the provision of credit and credit broking would be dealt with under the same jurisdiction. This means that the legislatures would be able to develop a homogenous response to this particular industry, rather than seeking to apply to brokers a model adapted for other intermediaries. It would also be possible to define with clarity and detail the different responsibilities of brokers and lenders (which may not be as straightforward in legislation focusing solely on brokers), and to address the different types of broker service offered (from quasi-agent of the lender to fully independent adviser); and
- in at least some jurisdictions, consumers would have access to existing informal tribunals for low cost resolution of disputes involving brokers. There would also be an existing higher level of contact between credit consumers and fair trading agencies in terms of complaint handling.

The disadvantages of regulation of finance brokers through uniform legislation would include:

- State and Territory governments have historically not been responsible for encouraging or mandating the establishment of ADR schemes, or for their continued supervision, and may be reluctant to introduce a requirement for brokers to be members of such a scheme;

- as evidenced by the development of the UCCC, there are likely to be long delays while uniformity of approach is being negotiated;
- if licensing is the preferred option, it is unclear whether all jurisdictions would agree to introduce a licensing regime for finance brokers (given that credit providers do not need to be licensed or registered in four States or the Northern Territory). The steps taken by Western Australian and New South Wales to revise legislation regulating brokers suggest that a coordinated approach with other States is unlikely, at least in the short-term; and
- there are a range of practical difficulties associated with licensing if it is introduced, for example, the risk of inconsistent criteria in different jurisdictions; the need for brokers to obtain licences in each jurisdiction in which they operate; and historically, the states have taken the approach of registration rather than licensing (ie not requiring participants to meet competency or other minimum entry requirements in order to practice).

5.7 Commonwealth legislation–Extension of the Corporations Act

One possible model for Commonwealth legislation is extending the existing regime under the *Corporations Act 2001* (Corporations Act) to brokers. In general terms, the Corporations Act establishes the following regulatory regime for intermediaries in financial services industries (such as insurance brokers and financial planners):

- the intermediary must be authorised to provide advice by the holder of an Australian financial services licence. The licensee is responsible for ongoing training and supervision of its representatives;
- the intermediary must only make product recommendations that are appropriate, following consideration of the consumer's personal circumstances and the product recommended;
- intermediaries are required to meet detailed disclosure requirements, including providing clients with a Financial Services Guide (setting out a range of matters including providing consumers with a summary of the types of products or advice they provide and their usual method of remuneration). They must also provide a Statement of Advice when recommending a product. The Statement must specify the financial and other benefits that would be received as a result of the recommendation that might reasonably be expected to have influenced the advice, in order to alert the consumer to any conflicts of interest. Downstream commissions or "spotters fees" must also be disclosed. Where the recommended product

would replace an existing product, the Statement must specify the costs and consequences of changing products; and

- intermediaries must have in place detailed internal complaints handling mechanisms (meeting prescribed benchmarks) and they must be members of an alternative dispute resolution (ADR) scheme.

The advantages of national regulation of finance brokers consistent with the Corporations Act are:

- uniform rules across all jurisdictions with a single body responsible for licensing brokers, resulting in consistent application of standards (eg recognition of training and educational qualifications);
- greater accountability of brokers to consumers through the requirement that they become members of an ADR scheme, which would create pressure on brokers to improve their business standards, and to respond promptly and sensibly to complaints;
- intermediaries in financial services industries who also provide finance broker services would have adopted methods of operation that already meet their obligations under the Corporations Act (resulting in reduced compliance costs); and
- transactions would be regulated according to whether or not the consumer is a retail client (as defined in s761G of the Corporations Act). This definition would capture a broader range of transactions than those regulated under the UCCC. The application of the definition would depend on a number of objective criteria, and therefore would not be susceptible to manipulation by brokers or credit providers.

The disadvantages of such a model are:

- finance brokers and credit providers would be regulated under different jurisdictions, unless the States and the Commonwealth can reach agreement for the transfer of responsibility for credit generally (including therefore the provision of credit) to the Commonwealth.[77] If agreement cannot be reached for the transfer of credit, then the advice by the broker in relation to a credit product would be regulated by the Commonwealth, but the product itself would be subject to State and Territory regulation. This has the potential for a number of problems, including conflicting and inconsistent disclosure regimes, and difficulties for the consumer in

[77] It is noted that Recommendation 6 of the Final Report of the Financial System Inquiry (March 1997) was that, after the UCCC had been in operation for two years "the UCCC should be subject to a comprehensive and independent review to consider what improvements are necessary and whether a transfer to the Commonwealth would be appropriate." No such review has yet taken place, despite the UCCC having been in operation for over two years.

seeking redress (as they may not be able to have a dispute involving both the broker and the lender heard in one forum);

- very significant transition costs would result for credit providers if the UCCC was to be made redundant, and they were required to comply with different obligations under a Commonwealth regime;
- an intensive commitment from the Commonwealth is necessary to establish a licensing scheme that meets the consumer protection objectives. There is a risk that if inadequate resources are provided, a licensing scheme could be established which did not improve industry standards or exclude brokers engaging in unfair practices, but the existence of the scheme would inhibit further reform;
- there is a risk of a proliferation of ADR schemes involving disputes about brokers and credit, raising questions about consistency in decision-making and the possibility of a dispute having to be taken to two different schemes (one in relation to the broker, and one in relation to the credit provider);
- the regulation of finance brokers would compete with the other responsibilities of ASIC;
- consumers would find it difficult to obtain relief through the Federal Court unless they were able to arrange legal representation; and
- the adequacy of this model is as yet untested, in terms of consumer protection outcomes (given the time span for the application of the legislation).

5.8 Commonwealth legislation—Dedicated broker legislation

An alternative model is for the Commonwealth to introduce legislation specifically regulating finance brokers. Such legislation would acknowledge that the problems experienced by consumers in their dealings with brokers need to be addressed through a more interventionist model, which directly regulates some of the more problematic aspects of the broker-client relationship, by, for example, directly addressing some of the high risk practices identified in this report.

Such legislation would require written contracts, prescribe a detailed disclosure regime, and prohibit fees being paid in advance of credit being secured. It could also prevent or restrict the use of interest only loans, and introduce a cap on fees. It could also address issues arising from the tripartite relationship between brokers, consumers and lenders, to ensure that consumers in dispute with a lender due to the conduct of a broker are in no worse position legally than if they had dealt with the lender directly. One method of achieving this outcome could be by clearly

distinguishing between the role of the broker in comparing and arranging finance, and its role in completing and facilitating in the processing of the loan application, with the legislation providing the broker is the agent of the lender for the latter purpose only. The legislation could also provide for the development of a Code addressing matters such as mandatory entry requirements, and marketing and advertising conduct.

The advantages of this model would be:

- uniform rules across all jurisdictions with a single body responsible for licensing brokers, resulting in consistent application of standards (eg recognition of training and educational qualifications);
- transactions would be regulated according to whether or not the consumer is a retail client (as defined in s761G of the *Corporations Act 2001*). This definition would capture a broader range of transactions than those regulated under the UCCC. The application of the definition would depend on a number of objective criteria, and therefore would not be susceptible to manipulation by brokers or credit providers;
- where the lender is a member of an ADR scheme, consumers in dispute with both their broker and the credit provider would be able to have all aspects of their complaint heard by that scheme, avoiding further proliferation in the number of ADR schemes;
- brokers could be required to become members of an ADR scheme for complaints concerning matters solely relevant to the broker-consumer relationship (such as a failure to arrange finance, or a dispute over fees and charges). Should there be two ADR schemes (one for brokers and the other for credit providers) there would need to be practical arrangements between the two to ensure that consumers were not confused by any splits in their capacity to determine complaints; and
- credit providers would be forced to play a greater role in the supervision of brokers.

The disadvantages of this model (in addition to those previously discussed under the Corporations Act model) include:

- the Commonwealth may not require credit providers to become members of an ADR scheme. Where the credit provider is not a member of such a scheme consumers will experience practical difficulties in resolving all aspects of their complaint to an ADR scheme that cannot determine the liability of the credit provider;
- the risk that shared supervision of a broker (between all credit providers to whom it submits finance applications) will not in practice result in

enhanced levels of monitoring by credit providers. Brokers will have the capacity to abandon lenders who adopt too strict a compliance regime, or will be able to argue that they should only have to meet the least stringent level of supervision; and

- a major commitment of Commonwealth resources in establishing a new Act.

5.9 Enhanced self-regulation

CCLC (NSW) acknowledges that, in appropriate cases, self-regulation can have significant benefits over other methods of regulation, including greater flexibility, reduced costs and industry ownership and commitment to reforms. However, it is of the firm opinion that the current structure of the broker industry militates against effective self-regulation for reasons previously discussed in this report, including:

- the large number of players, including a significant percentage of small brokers who are those most prone to adopting systematically unfair practices;
- significant differences in the method of operation of industry players (leading to lack of common interests among these players);
- the lack of a single strong industry body able to impose improved standards on its members (the two main industry bodies, the FBAA and the MIAA, are currently unable to discipline or make accountable recalcitrant members); and
- the absence of any sufficiently strong history or tradition among brokers of adherence to codes of practice, and accountability through membership of an ADR scheme, and consequent unwillingness by some brokers to accept these voluntarily.

In calling for government regulation, CCLC (NSW) is at the same time aware of the important function that self-regulation can play. It acknowledges that industry bodies are able to perform a role complementing that of government regulation by undertaking activities such as developing and monitoring the implementation of codes of practice (fleshing out legislative requirements and addressing issues of what constitutes best practice), providing and promoting ongoing education to members, and assisting in the development and supervision of ADR schemes, thereby encouraging acceptance of their decisions by members. However, given the current structure and nature of the broker industry, CCLC (NSW) is of the firm opinion that self-regulation can only perform that complementary role following the introduction of robust national legislation. As noted in various places in this report, this view is shared by a significant number of major players as noted

throughout this report. For example, Tony Crossley, Chief Executive of Mortgage Choice, Australia's largest mortgage broker, has said:

> *"We will continue to lobby state and federal governments to introduce consistent national regulation, either under Commonwealth legislation or by cooperative state legislation, and encourage other major mortgage brokers to join in the campaign. We believe that any self-regulation of the industry will be perceived by consumers and observers to be for the benefit of the industry participants rather than the consumers of the industry's services."*[78]

[78] Quoted in "Lenders act to lift broker standards", *Australian Banking and Finance,* 15 October 2002, p. 17.

Appendix A: Case studies

In addition to the responses in the "Caseworker Survey" (see Appendix C), CCLC (NSW) received over 125 case studies about transactions involving brokers. Some of the case studies were provided by caseworkers who did not respond to the "Caseworker Survey". A number of the case studies have been included at relevant places throughout this report, and a selection of case studies are also included in this Appendix.

The case studies have not been independently verified for the purpose of this report. They most often represent the events as reported by the client and as reflected in the documents available. In some instances, the allegations have been tested and to varying degrees proved within the process of resolving the complaint involved, but that is not universally the case. Nevertheless, the case studies are an important source of information on consumers' experiences, the concrete ways in which problems with brokered transactions can play out, and the very real hardship that can be caused to individuals. It should also be noted that it is not possible to generalise from the individual case studies to the industry as a whole.

The case studies listed in this Appendix detail adverse experiences of consumers in their dealings with brokers. The experiences are divided into three broad categories of complaint. These categories are, however, necessarily arbitrary and some of the cases overlap different areas. The categories are:

1. fees and charges;
2. the quality of advice and service by brokers; and
3. the use of unfair tactics by brokers.

Although the majority of the broker case studies provided were negative (which is not surprising given the recipients of the survey), some eight to ten positive examples were also provided. Most of these indicated that the broker concerned had been helpful, efficient, suggested the most appropriate or competitive loan product, and generally appeared to act in the borrower's best interest. A number of caseworkers/consumers also commented that the broker had been informative about the loan products available without pushing the consumer towards a particular lender or product. A couple of examples noted that the broker revealed the commission they would receive from different credit providers and in one case, the broker advised the potential borrowers against over-committing themselves. These case studies have not been included in the report.

A.1 Fees and charges

Case study 1

Mr and Mrs Z were $120,000 in debt and had received a judgment against them in favour of their creditors. They then received unsolicited mail from a finance broker, which suggested they could use the broker's services to consolidate and refinance their debts. Mrs Z responded to the broker's letter and was faxed a loan application, which she filled in. Because the loan application had been incorrectly completed the broker sent it back asking the couple to fill it in correctly. The Zs decided not to use this broker to arrange finance, and did not send the correctly completed application back to the broker. A month later, the broker rang the Zs asking them where the application was. Mr Z responded by saying that he and his wife no longer needed his services. The broker still sent Mr and Mrs Z another application in the mail, which they threw away. This, they thought, had ended the matter. A few months later, though, Mr and Mrs Z received a letter of demand from the broker for $5000 worth of brokerage fees, even though he had not, of course, been requested to arrange finance on their behalf, and had been unable to do so without a correctly completed application form. Mr and Mrs Z have since offered to pay the broker $500 in complete settlement of the outstanding debt. The broker rejected this offer.

Case study 2

Mrs Q had judgment entered against her for unpaid land rates, and had a number of other debts. She then received unsolicited brochures from a finance broker offering to help her find a loan. Mrs Q contacted the broker about the service and was sent information and a loan application form, which she filled in and sent back. Mrs Q was told that the broker would not start searching for a loan on her behalf until her property had been valued, and was not given any information about the fees that would be charged for this service. When the valuation had been completed, the broker told Mrs Q that she would probably receive a loan of no more than $30,000. Unable to pay her debts with this amount, Mrs Q informed the broker that she needed a loan for more than $30,000. The broker said that he could not assist her in finding a loan, although he said that she should contact him "in the future if she needed anything". He did not mention any outstanding fees at this stage. Mrs Q did not have any further contact with the broker until a few months later when she received a letter of demand from the broker for brokerage fees of $2200.

Case study 3

Ms A saw a finance broker, after seeing an advertisement that suggested he specialised in consolidating debts for consumers with an adverse credit history.

The broker told Ms A that there was an upfront fee of $600. Ms A told him that she could not afford $600. The broker told that her that she should arrange to pay the fee by applying for a credit card, and then arranging for a cash advance of $600.

Ms A applied for and received a credit card. She obtained a cash advance of only $500, which she gave to the broker. However, she was unable to pay the outstanding $100 in cash, given her other debts. The finance broker refused to make any loan inquiries on Ms A’s behalf. In addition to her previous debts, she now finds herself liable for the $500 as well as interest on that amount.

Case study 4

Ms P approached a finance broker for assistance in getting her a loan for $8000. The broker told her that he charged an upfront fee of $800, and that when this was paid, she “would have the loan in 48 hours”. Ms P deposited $800 into the broker’s bank account. Since then, she has not heard anything from the broker, who has refused to talk to her over the phone or contact her.

Case study 5

Mr K approached a finance broker to organise a loan for the purchase of a house. He asked the broker how much she would charge to arrange the finance. The broker told him that the lender would pay her costs, and that arranging the finance would be straightforward, given Mr K’s financial position. Relying on this advice, Mr K exchanged contracts for the purchase of a home. The broker later told Mr K that she would not arrange finance unless Mr K paid her $1400. Mr K was worried that he would not be able to complete the purchase of his house in time any other way. He therefore signed an agreement with the finance broker to pay her $1400 for her services. The loan contract stated that the broker also received a commission from the lender.

Case study 6

Mr P went to see a mortgage broker to arrange a home loan on his behalf. The mortgage broker told him that he would charge a fee of $7500 for his services. Mr P suggested that this was an expensive fee, but the broker assured him he would be able to find Mr P “the cheapest home loan around”. The broker then asked Mr P to sign an agreement, and turned the agreement to the page where he had to sign. Mr P did not read the agreement. In fact, the agreement stated that the broker would charge a fee of $10,000, and not the $7500 Mr P had verbally agreed to. The broker arranged finance and deducted the fee of $10,000 at settlement. Mr P then complained to the broker, who said that he would refund the difference of $2500.

Since then, the broker has failed to refund this amount to Mr P, and has refused to speak to him.

Case study 7

Ms Q decided to refinance her existing home loan, and needed a loan of $150,000. She contacted a private lender who referred her to its solicitor. At all times, she dealt directly with the solicitor, who acted on behalf of the credit provider whom she was to refinance with. When she went to collect the loan proceeds from the solicitor, she was surprised to see that the cheque was for $129,000 only. She asked the solicitor where the balance of $21,000 had gone. He told her that fees had been taken out to pay stamp duty and legal and broker fees. At no stage throughout the transaction had Ms Q ever instructed a finance broker to act on her behalf, and it is not clear how this was arranged.

Case study 8

Ms Z had a block of land and wanted to build a house. She consulted a broker in order to arrange a loan to facilitate this. The broker told her that they charged a 1% commission on the principal amount borrowed, with $300 payable as a non-refundable deposit. Ms Z signed a broker agreement and paid the deposit. She decided to cancel the agreement four days later, forfeiting her $300 deposit. This was before the broker had given her any loan applications to complete. Ms Z then arranged finance through other sources. Some eight months later, Ms Z received a letter from the first broker stating that he had arranged a loan for her, and demanding payment of fees of $2080 from her.

Case study 9

Mr A approached a broker about refinancing his existing home loan, in response to an advertisement saying that this broker could save you money on your home loan. The broker arranged for Mr A to visit his office and sign a number of documents, including a letter of appointment and an application for finance. However, when Mr A was completing the finance application, he noticed that the purpose of the funds was described as being for “Business/Investment Purposes”.

Mr A realised this statement was incorrect. He asked the broker why the application had been completed in this way, and did not receive a satisfactory response. As a result, he decided not to use that broker any more. Shortly afterwards, he received a letter of demand for a broker fee of over $5,000. He ignored the letter. About two weeks later the broker served Mr A with Court proceedings for the amount of its fee.

A.2 Quality of advice and service

Case study 1

Mr D wanted to help his sister, who had a bad credit rating and needed to pay off a mounting credit card debt. Mr D went to see a finance broker who advertised as being able to help people in that position. The broker told Mr D that if he paid $250, the broker would be able to find a loan for his sister. When Mr D paid the money, the broker suggested to him that his sister should change her name, and apply for some store cards in her own name, in order to build up a new good credit rating. She would then be "guaranteed to get a loan". Mr D's sister relied on the broker's advice and agreed to change her name. However, she was still unable to obtain a loan. With her debts mounting, Mr D's sister eventually filed for bankruptcy (in *both* names).

Case study 2

Ms E had a number of debts, including credit cards and a car loan. She decided to consolidate these debts and sought advice from a finance broker who had been recommended to her. The broker agreed to obtain a loan for her, which would pay out all her existing liabilities. To secure this loan, the broker obtained from Ms E details of all her possessions. He also asked her boyfriend to guarantee the loan in his own name, and that of his business.

The broker subsequently arranged finance through a lease agreement. Under the lease agreement, the lender (a finance company) purported to have purchased the motor vehicle and Ms E's possessions from her beforehand, before leasing them back to her, something that was clearly false and was known by the broker and the finance company to be false. The finance broker also arranged for Ms E to sign a declaration stating that the credit was for business purposes, when the broker knew the credit was being used to pay out existing debts (which were not for business purposes). Ms E was given no explanation as to the significance of the declaration, which was to exclude the lease transaction from regulation under the Uniform Consumer Credit Code. As the transaction was unregulated by the UCCC, the interest rate was not disclosed; in fact, the interest rate was 40%.

The vehicle was subsequently repossessed by the finance company, in part because of the high repayments due to the 40% interest rate charged under the lease. The vehicle was repossessed in circumstances which would not have been permitted had the transaction been properly documented as credit regulated by the UCCC.

Case study 3

Mr and Mrs X rang a finance broker firm and arranged for a broker to visit them at home. After discussing their financial circumstances, the broker (Broker A) told

Mr and Mrs X that she could arrange to consolidate their debts into a single loan, with an interest rate of about 9%. She also told them that no fees or charges would be payable if the loan did not go ahead. Mr and Mrs X signed a letter of appointment, authorising Broker A to arrange a $125,000 loan on their behalf, secured over their house.

In fact, contrary to their discussions, the letter of appointment stated that the loan was to have an interest rate of no more than 9.95% per annum, and that a brokerage fee of $2200 was payable. It also stated that the term of the loan was to be 12 months only. This was inconsistent with Mr and Mrs X's instructions, as they did not want to have to refinance again after only 12 months.

Mr and Mrs X signed a loan application for a fixed "interest only" facility for $125,000 over one year at 8.45% per annum. Broker A told Mr and Mrs X that approval for the loan would be obtained "within a few days". Mr and Mrs X then heard nothing further about the progress of their loan application from either the broker or the lender. Over a six-week period they attempted to contact Broker A by leaving numerous messages at her office and on her home phone. After six weeks had elapsed, Mr and Mrs X had still not heard from the broker, and assumed that their loan application had been rejected.

Approximately three months after the initial meeting with Broker A, Mr and Mrs X received in the mail a loan agreement from the lender for a loan of $125,000. The interest rate was in fact 10.25% per annum—0.30% higher than the maximum interest rate provided for in the letter of appointment. Mr and Mrs X had not been contacted by the broker to advise them that the loan had been approved.

Mr X then rang the broker firm. He was unable to speak to Broker A and told another broker (Broker B) that they would not be proceeding with the loan as the interest rate was higher than they had expected. Mr X also complained of poor service and the unprofessional dealings the Xs had had with Broker A. Broker B offered to reduce the $2200 brokerage fee by $500 in light of Mr X's complaints. Mr X rejected this offer. Mr and Mrs X subsequently received a number of demands from the broker firm (and their solicitors) to pay the outstanding brokerage fee. The broker's solicitors then commenced proceedings against Mr and Mrs X in the Magistrate's Court. These were settled with Mr and Mrs X agreeing to pay $750 only.

Case study 4

Mrs M is an aged pensioner. As her only income is the pension, she was struggling to meet even her basic living requirements. She is poorly educated and has difficulty reading and writing. She owned her own home in country Victoria, a property valued at $40,000. Mrs M decided to consolidate her debts, primarily a

debt owed to Legal Aid (incurred for divorce and custody proceedings). Legal Aid was not demanding payments from Mrs M, but she felt she should pay off the debt. Mrs M found an advertisement for a finance broker in a newspaper. The advertisement stated “no credit checks” and “loans up to 90% of valuation”. Mrs M rang the broker and gave some initial details over the phone. She then attended an appointment at the broker’s office with a friend.

The finance broker advised at this meeting that he could arrange a loan for $24,000 for her, although it would have to be secured with a mortgage over Mrs M’s property. The broker provided her with a loan document and mortgage. Due to her literacy problems, which would have been evident to the broker, she was unable to understand them. Her friend suggested they take them to a solicitor, but the finance broker told her she could not do so, and that if she wanted the loan she would have to sign immediately. Mrs M asked how long the loan was for, but an evasive answer was given. The broker did not explain that the loan was “interest only” in nature, and that the principal had to be repaid in 12 months. The interest rate on the loan was 13% and the contract provided for the broker to receive a procuration fee of $1500 (or 6.25% of the amount of the loan).

Mrs M felt she had no choice except to sign the documents. She was able to meet the monthly repayments, although with some difficulty. When the term of the loan expired, Mrs M was unable to repay the capital sum of $24,000. She sought legal assistance and was advised to sell her home as otherwise she risked losing her outstanding equity in the property in legal action that was likely to be unsuccessful.

Case study 5

Mrs S, a pensioner, was in serious financial difficulties. She was in danger of having her car seized by the sheriff and did not have the money required to pay the relevant judgment debt. She was put in touch with a finance broker, who obtained finance for her through a firm of solicitors with a substantial first-mortgage practice. The law firm arranged a loan for her, not only to pay the immediate debt sought by the sheriff but also other debts she owed. The loan was secured by first mortgage over her home. The law firm insisted Mrs S seek independent legal advice before signing the contract and recommended she see a solicitor practising in rooms adjacent to theirs. Mrs S did see the second solicitor; however, his advice did not address the question of whether or not she could afford the repayments or whether the loan was financially prudent, and was limited to ensuring that she understood her home was security for the debt, and the consequences of defaulting on the loan.

In fact, the loan was an “interest only” loan for a period of one year. Because Mrs S is a pensioner, she has no hope of repaying the principal sum unless she sells her

house. Mrs S is faced with the prospect of refinancing (at additional cost to her), or selling her home.

Case study 6

Mrs A is a pensioner in her 60s who owns her own home. She saw an advertisement in the newspaper by a broker offering to arrange finance. The advertisement was targeted at pensioners and low-income earners. Mrs A visited the finance broker and requested a loan for $10,000. The broker said that "by law" he could only arrange a loan for her for $20,000. He said that he would arrange for the additional $10,000 to be invested on her behalf. Mrs A agreed. The broker then invested the $10,000, although he did not give Mrs A any details about the precise nature of the investment. Of the remaining $10,000, Mrs A received only $7500, with the balance going to legal fees and the broker's fees.

The loan arranged by the broker for Mrs A was in fact of an "interest only" nature secured by first mortgage over her home. At the end of the contract period of two years, Mrs A would be required to repay the total amount borrowed. There was never any prospect that Mrs A could have paid this amount without selling her house or refinancing. Six months later, Mrs A decided to borrow a further $5000 for a holiday. She went to the same broker. He told her that he could arrange a loan but it would have to be for $6500. He did not tell her what his fees would be or that he would deduct them from the loan proceeds. She asked him to arrange a loan for $6500. The broker deducted fees of $1500, so that Mrs A only received $5000.

Within twelve months of the original loan, the broker advised Mrs A that there was a problem with the investment, and that it had "gone to the wall". Mrs A said that she was going to complain. The broker then assured Mrs A that she should be able to receive $10,000 from the sale of assets associated with the investment. In fact, she has received no money from the investment and is unable to repay the principal on the two loans the broker obtained for her.

Case study 7

Ms G needed $11,000 to start up a business. She was unable to raise the funds herself, and asked her two sisters to help her obtain finance. It seems that Ms G exercises considerable influence over her sisters. Ms G arranged for her sisters to see a broker. He arranged finance with an interest only loan for $11,000, with a term of three years. The loan was secured over property jointly owned by the two sisters.

Ms G was unable to meet the repayments under the loan, even though they only covered interest rather than principal and interest. When the loan fell into default,

Ms G arranged for her sisters to return to the finance broker to arrange a refinance of the debt. The broker obtained finance through a firm of solicitors operating a substantial first mortgage practice. The second loan was for approximately $26,000, the increase being partly due to additional fees, unpaid interest and default charges. It was also an interest only loan. The broker did not discuss with the sisters alternatives to refinancing, or the disadvantages and risks of refinancing, given that Ms G had been unable to meet the smaller repayments due under the first loan.

Ms G's business venture subsequently failed, and her two sisters have no chance of repaying the principal when the term of the loan expires.

Case study 8

Mr B was (and still is) unemployed, living on a pension and has no substantial assets other than his house, which is worth just over $50,000. He approached a finance broker to see if he could arrange a loan for $3000, as he felt that he should be able to afford the modest repayments on a loan of this amount. However, the broker told Mr B that he would not arrange a loan for him that was any less than $10,000. After some discussions, Mr B very reluctantly agreed to borrow this amount. The broker then arranged a loan with interest at 12% per annum. The loan contract stipulated that, for each month in default, the debtor would be charged between $100 and $600. The broker did not advise Mr B of the amount of the default fees before arranging to execute the loan. Nor did he properly assess whether Mr B could meet the repayments under the loan.

Mr B soon was in arrears and attempted to resolve the matter with the lender's solicitor. About nine months after the loan was taken out, the lender's solicitor finally decided to call in the loan and issued a writ of possession. Solicitors for Mr B obtained a stay, and it was agreed that Mr B would sell his house himself and pay out the lender.

Case study 9

Ms O and her partner arranged for a broker to visit them at home to discuss options for refinancing her home loan. The broker advised Ms O that he would be able to find them a cheaper loan, and, as a result, Ms O and her partner signed a broker agreement that day. They did not read it before signing it, and the broker did not explain it to them.

The broker subsequently contacted Ms O and sent her documents to sign to enter into a new loan to refinance her home loan. However, when Ms O examined the agreement, she decided not to go ahead with it as it was not cheaper and she believed she would not be able to afford the higher repayments. She is now being

pursued for a $6000 brokerage fee referred to in the broker agreement, even though the finance arranged by the broker did not meet her needs.

Case study 10

Miss L wanted to purchase an investment property. The real estate agent handling the sale of the property referred her to a broker. The broker guaranteed to Miss L that he would get her a loan with an interest rate of 4.99%, fixed for one year. Miss L signed an offer to enter into a loan contract with a fixed interest rate of 4.99%. However, for unknown reasons, the lender declined to accept her offer. Miss L was then informed by the broker that he could not get her the loan he guaranteed he could. Miss L had already signed an agreement to purchase the property, and the time to complete the conveyance was fast running out. The broker then advised Miss L to sign a loan contract with the same credit provider, but with a variable interest rate. Miss L agreed to do this but, after signing up for this loan, the interest rate has gone up four times in one year. Tired of this, Miss L decided to investigate refinancing with another credit provider. She decided against refinancing when she learnt that her existing lender would charge her a penalty of $1900 for early termination of the loan contract.

Case study 11

Ms J had a standard variable interest rate home loan with an outstanding balance of $114,000. Ms J was cold called by a telemarketer offering to talk to her about how she could save money on her mortgage. Ms J was interested in increasing her loan to buy a computer (to work from home) and agreed to a visit.

The person who visited Ms J only discussed finance with one particular lender, and did not disclose that he was a broker. He led Ms J to believe he acted for that lender, and that she would only have to pay the lender’s application and loan fees. The broker gave Ms J a series of documents to sign. These included a broker agreement (which was not explained to her) and an application for a loan of $120,000. In fact, the loan was to be provided through a line of credit. This type of finance was completely inappropriate and unnecessary for Ms J, while the interest rate was more expensive than on her existing loan.

When the loan settled, Ms J paid around $4000 in fees, including nearly $3000 to the broker, as well as the lender’s application fees and solicitors costs. This meant there were insufficient additional funds available for her to buy a computer.

Case study 12

Mr U was cold called by a mortgage broker and agreed for the broker to visit him at home to discuss refinancing options. Mr U told the broker that he was concerned about whether he would be able to refinance, given that he only worked

on a casual basis. The broker assured him that this would not be a problem. Mr U then signed a broker agreement entitling the broker to $3000 if she was successful in finding Mr U a loan.

The broker subsequently forwarded a loan agreement to Mr U. However, when Mr U examined the loan he found that it was too expensive for him, due to the costs associated with the loan, including monthly account keeping fees and a considerable application fee. Mr U would also have to pay the lender's costs of arranging mortgage insurance. The broker also quoted the wrong interest rate on the credit card that was part of the loan package. As a result, Mr U decided not to go ahead with the loan. The broker has now demanded payment of its $3000 brokerage fee.

Case study 13

Mr M is a 66-year-old pensioner with limited literacy skills. His only asset is the family home. He lives in it with his son, who is unemployed. His son contacted a broker, who advised him that he could not organise a loan unless Mr M's house was used as security. The broker and the son then arranged for Mr M to execute documents for a loan for $60,000. The loan was on an interest only basis, for a period of two years. The default rate, if payments were not made on time, was over 16%. Mr M is the only party to the loan.

The broker never met Mr M or spoke to him. The son collected the documents and arranged for his father to sign them. It is doubtful that Mr M properly understood the nature of the documents she signed.

After three months, the son had spent the proceeds of the first loan. He approached the broker again, as he and Mr M were unable to meet the repayments. The broker arranged for a second mortgage of $30,000, again through an interest only loan. The broker did not suggest any alternatives to the second loan, which might prevent Mr M going further into debt and losing additional equity in his home. The broker charged an upfront fee and received commissions from the lender for both loans.

Case study 14

Mr L is a client of an accountant who also practises as a broker. The broker recommended to Mr L that he should accumulate wealth by using a line of credit, both for living expenses and to purchase an investment property. He then prepared a plan showing how Mr L could use the line of credit to purchase three properties over a five-year period. The broker then organised the purchase of the property and finance for Mr L, including refinancing his existing home loan. The broker charged Mr L a fee of $12,000 for arranging the plan and the finance. He also

received a commission from the bank, a commission from the real estate agent from the purchase of the first property by Mr L, and a commission from the insurance company for the home and contents cover for that property. These commissions were not disclosed to Mr L.

Mr L has had difficulty in using the line of credit, in part because his expenses are greater than assessed by the broker. He is able to cover the loan for the first property, but has no prospect of purchasing two additional properties in the foreseeable future.

Case study 15

Mr S is an old-age pensioner. His only income is $225 a week from the pension. He has evident cognitive difficulties. His only asset is the family home, worth about $110,000. He asked his local real estate agent for a valuation. During their conversation, Mr S mentioned that he needed about $1000 for minor repairs to his car, which he could not afford.

The next day, a finance broker appeared at Mr S's door, and offered to arrange finance for him. The broker said that he could arrange a loan for as much as $30,000. Mr S agreed. The broker arranged an interest only loan, for a period of two years. He charged Mr S a fee of over $1000, deducted from the loan proceeds. The loan was documented as being for business purposes, thereby avoiding the operation of the UCCC. Before the two-year period of the loan expired, Mr S had used the proceeds of the loan for living expenses, repairs to the car and the home, and bills. He is now unable to meet even the modest monthly repayments.

Case study 16

A broker advised Ms W that it would be able to find finance to cover 100% of the price of a property being purchased, and the costs associated with the purchase. It would appear this statement was based, at best, on an optimistic assessment of Ms W's circumstances, as the broker had not obtained even "in principle" approval from a lender.

Ms W relied on the statement by the broker to sign contracts to purchase a property where she did not have funds to cover the deposit. The broker arranged for the deposit (10% of the purchase price) to be secured by Ms W signing documents for a deposit bond. These documents were not explained properly to Ms W, and in fact she understood they were part of the process of applying for finance. In fact, the broker was only able to arrange finance for Ms W for 90% of the purchase price. Ms W was only advised of this shortly before settlement and, in the short period of time available to her, was unable to make alternative arrangements to meet the shortfall. The provider of the deposit bond paid the

deposit (over $25,000) to the vendor, and has demanded payment of this sum from Ms W.

A.3 Unfair tactics

Case study 1

Mr and Ms J had experienced difficulties in obtaining a loan from a mainstream lender. They contacted a broker who had placed a newspaper advertisement offering loans with “no credit checks”. They paid an initial fee of $200 to the broker to arrange a home loan. The broker did not provide them with a written broker agreement, in breach of the requirements of the *Consumer Credit (Victoria) Act 1995*. Before the broker had been able to arrange a loan, Mr and Ms J changed their mind about going through with the transaction, as they considered they would be unable to afford the repayments under a home loan.

The broker then demanded fees of $2000 from Mr and Ms J, who approached the Consumer Credit Legal Service (CCLS) for assistance. CCLS wrote to the broker stating that no fees were payable as he had failed to provide them with a written agreement. The broker wrote back stating that the reason he did not provide Mr and Ms J with any documents was because they told him they wanted to purchase a property as an investment, as they were unable to afford finance for a residential property. Mr and Ms J advised CCLS that they had told the broker the finance was only for a home that they would live in themselves. CCLS was able to get the broker to drop his claim for the $2000 brokerage fee, and to refund the $200 fee paid to the broker by the Mr and Ms J.

Case study 2

Mr and Mrs F were contacted by a representative of a broker firm, who said that he could arrange a budget plan for them, designed to cut thousands of dollars and many years off their mortgage. Mr and Mrs F agreed for the broker to visit them at home. They stipulated to the representative, however, that they wanted a “no obligation” discussion. The representative spent three hours at their home, providing them with calculations showing how they could save several years in repayments. He then announced that he could go no further unless Mr and Mrs F agreed to pay a deposit. Mr and Mrs F then signed an agreement committing them to paying $4000 for a plan specifying the amount they could save in repayments, and how this could be achieved. They were then provided with a cancellation notice under the door-to-door sales provisions of the *Fair Trading Act (Victoria)*; the notice was not completed correctly.

After considering the matter, Mr and Mrs F attempted to cancel the agreement within the five-day period allowed by the Fair Trading Act for contracts signed at

home. The broker firm told them that the five-day period had in fact expired, as it included the weekend. Mr and Mrs F argued the point with the broker firm, and the representative eventually conceded that five days meant five business days and so the weekend should not be counted. However, the representative then told Mr and Mrs F that they would still be liable for reasonable expenses so far, and that these were over $2000.

Mr and Mrs F contacted CCLS for advice, and a solicitor wrote to the brokers. Initially, the broker firm refused to acknowledge any failure to comply with the Fair Trading Act and insisted on being paid $1000. However, CCLS was subsequently able to get the firm to agree to release Mr and Mrs F from any further obligation to pay money.

Case study 3

Ms P's then husband was arranging to purchase a car on finance from a dealer. Ms P was present at the time, but owned her own car and was not a party to the purchase. The dealer said he could broker the car loan through a finance company. The dealer told Ms P her details were required on the application for finance, as it was standard practice to include a spouse's details where the borrower was not an Australian citizen. Ms P was then asked to sign the contract. She agreed to do this. However, she subsequently questioned the dealer about why she had to sign. When she examined the document, she learnt that she had been nominated as a co-borrower. She told the dealer that the transaction had to be redone, leaving her out altogether. The dealer agreed to destroy the contract and to get Mr P to sign a new one. Ms P then left the dealership.

Mr P later separated from Ms P and left the country. He left some money with Ms P to make repayments on the car loan. Once this had been used up, the finance company contacted Ms P seeking further repayments. It was only at this time that Ms P discovered that the original loan documents, with her as a co-borrower to the loan, had been submitted to the lender. The finance company refused to release Ms P from her loan obligations and threatened enforcement action if she defaulted in repayments.

CCLS tried unsuccessfully to negotiate Ms P's release from the contract. CCLS then issued a Tribunal application seeking to have the contract set aside as unjust under s70 of the UCCC. After receiving this application, the finance company agreed to release her from all further obligations.

Case study 4

Ms Y received an unsolicited call from a finance broker, who said that he could "save her money" on her home loan. Ms Y and her husband were interested, and

arranged for the broker to visit their home on a weekday evening. The broker arrived at 8 pm, and explained that he would need to get an idea of their financial position and goals, and then discuss the specific home loan product he endorsed and how it would help them, given their financial position.

Ms Y and her husband were genuinely interested in hearing about the product. By 11 pm, the broker had not finished his presentation. Ms Y and her husband explained that they were too tired to concentrate and that they would not sign any contracts that night, although they would be happy if the broker came back another time to continue their discussion. Ms Y asked the broker to leave, but he refused, saying, “You promised me a cup of coffee”. The broker continued to pressure Ms Y and her husband to sign a contract that evening, and said that it would be unlikely he could visit again, as he was too busy.

After many pointed requests to leave, the broker eventually left Ms Y’s home at 12.15 am. He refused to leave any documentation or contracts for Ms Y and her husband to review. At no time during the meeting did he describe the interest rate, or the terms and conditions of the loan. He was even reluctant to leave a business card. The next day, Ms Y made an official complaint about the broker’s conduct to the broker’s head office. However, the office was unsympathetic, and said only that their staff were very enthusiastic about making sure their clients received “a good deal”.

Case study 5

Mr and Mrs Y went to a finance broker in order to secure a $20,000 personal loan on Mr Y’s behalf. Mr Y spoke very little English and so Mrs Y acted as a translator. The finance broker told Mr Y it would cost him $500 for the personal loan to be arranged, which Mr Y paid. The broker then discovered that Mr Y’s credit report had incorrectly listed one of Mr Y’s personal details. Mr Y was told it would cost him $350 for the broker to correct the inaccurate details. In fact, the credit reporting agency does not charge consumers for amending their reports, and Mr Y could have done this himself for free.

The broker instructed Mr Y to apply for a number of credit cards, until one application was successful. The broker then told Mr Y to withdraw $1900 from his new credit card account and to give it to the broker to prove he had “savings”. This was meant to assist with Mr Y’s personal loan application. Mr Y was assured that his $1900 would be returned after his personal loan was approved. The broker has failed to arrange a loan for Mr Y and has refused to refund the $1900.

Case study 6

Miss X went through a finance broker to secure a loan for a car. The broker told her that he could arrange a loan with an interest rate of 5.6% and that she would be charged $500 for this service. When it came time to sign the loan offer document, Miss X noticed that the interest rate was not listed in the document. She telephoned the lender to check and was told that the interest rate was in fact 8.2% and not 5.6% as the broker had represented to her. Miss X refused to sign the loan agreement and contacted the broker to complain. The broker assured her that the interest rate was only 5.6%, and said it would only increase to 8.2% “if you don’t pay on time”.

Case study 7

Mrs Z, a recent immigrant who only speaks some English, visited a finance broker to secure a $40,000 personal loan. Over the course of some months, the broker assured her that he was close to arranging a loan for her. However, each time the broker contacted her, he said that he needed more money to arrange the loan.

Over several months, Mrs Z paid a total of $14,150 worth of brokerage fees to the broker. The broker did not arrange a loan for Mrs Z.

Case study 8

Ms J was cold called by a mortgage broker and eventually agreed to the broker visiting her at home to discuss refinancing options. The broker arrived at 8.30 pm. Despite numerous requests, the broker failed to leave her home until 2 am. By this time, Ms J had agreed to pay an initial fee of $295 and to sign a broker agreement. The broker told her that she could withdraw from this agreement so long as the mortgage documents had not been prepared, although she would forfeit the $295 she had paid as a deposit.

Tired, and believing that this was the only way she could get the broker out of her home, Ms J signed the agreement. She did not realise that a clause in the contract stipulated that she would be required to pay $2000 if she did not proceed. Days later, Ms J in fact decided not to proceed with a loan application. She is now being pursued for the $2000 brokerage fee.

Case study 9

Mr P and his partner went to see a finance broker to discuss options for financing a new car. The broker did find Mr P and his partner a loan, but told them there was a shortfall of $2800 for the cost of the car they wanted. The broker then said he would lend Mr P the amount of the shortfall on condition that they purchased their

car from a particular dealer whom he knew. The couple agreed, took the money from the broker and purchased the car.

A few weeks later, Mr P and his partner were told they would need to repay their debt to the broker as soon as possible. Mr P paid $2800 to the broker shortly afterwards and received a receipt. A number of months passed and Mr P and his partner heard nothing further from the broker, until Mr P one day realised that his pay had been garnisheed, with a deduction in favour of the broker. The broker disputes that he was ever repaid the $2800 he lent to Mr P, even though Mr P has the receipt. The broker also claims that he arranged for Court proceedings to be served on Mr P, which Mr P never received.

Case study 10

A broker previously worked for a particular lender. He then left the lender and began contacting some of its clients, telling them that he had left because "that lender is stealing your money" and offering to help them refinance. Mr H was one of the clients approached by the broker. Mr H had recently been retrenched, and had income from a part-time job only. Mr H had purchased an investment unit off the plan sometime previously. The unit was nearly completed, with settlement approaching.

The broker told Mr H that he could arrange for him to refinance his existing loan, and get finance for the purchase price of the investment unit. The broker arranged for false documents to accompany Mr H's loan application, including doctored bank statements, and a false reference from an employer, suggesting that Mr H was employed in sales, and earning over $80,000 in commission annually. The loan application was approved.

Case study 11

Mr and Mrs S approached a broker to arrange finance to purchase a house. A friend had recommended the broker. He told them that there would be no difficulties in him organising finance for them. Mr and Mrs S then signed a contract for the purchase of a property. The contract gave them three weeks to arrange finance or cancel without penalty. Before the three-week period expired, they contacted the broker asking him to provide confirmation that the loan had been approved. The broker then faxed to the couple a document purporting to be an "Approval in Principle" from a mortgage originator. In fact, it appears that the broker forged this document, as the mortgage originator denies receiving a loan application from Mr and Mrs S until sometime later. About a week before settlement, Mr and Mrs S saw the broker in his office. He reassured them that the finance would be ready in time, and that he would contact them shortly when the loan documents were ready to sign. He asked Mr and Mrs S to pay $400 for the

lender's application fee. The lender denies that the broker ever forwarded this fee to it.

When Mr and Mrs S did not hear again from the broker, they contacted the lender directly, the day before settlement. The lender told them that it had previously advised the broker that in fact funds would not be available for settlement, and that the broker had said he would contact the borrower's solicitor to negotiate an extension with the vendor. Mr and Mrs S immediately contacted their solicitor, who negotiated an extension with the vendor on condition that they pay the full deposit of $32,000, and cover the cost of the vendor's bridging finance.

The broker contacted Mr and Mrs S shortly afterwards. He told them that although the lender had said that it would take a further two weeks to arrange the finance, he would "move mountains" to make it happen in a week. A few days later, he phoned Mr and Mrs S and told them everything was progressing well, and that there would be no problem settling in time with the revised schedule. He said that he had a small financial problem, and asked Mr and Mrs S to assist him by paying his commission of $5000 that day. They were told that due to the urgency of the situation, they should pay it directly into his personal account in cash so he could draw on it immediately. Mr and Mrs S paid the money, as they were worried that otherwise the broker would not arrange the loan in time.

Mr and Mrs S did not hear from the broker again, and so they again contacted the lender directly. The lender told them that finance could not be arranged in time for the revised schedule. Mr and Mrs S and their solicitor then arranged alternative finance. The broker has refused to refund payments made to him by Mr and Mrs S, or to compensate them for the extra expenses they incurred.

Case study 12

Mr B is a single father with a young child, working four days a week. He was living in his own (mortgaged) home, and was interested in buying an investment property as a way of becoming more financially secure. Mr B approached a broker for advice, initially to determine whether or not he could borrow money to purchase an investment property, and, if so, how much. The broker informed him that he would be able to borrow over $300,000, with the precise figure depending on the rental income received from the investment property. Relying on this advice, Mr B found a property for about $250,000.

The broker then lodged an application for finance for Mr B with a bank, which was approved. However, when Mr B began budgeting to meet the repayments, he realised he could not afford them. He contacted the bank and the broker, and discovered that the broker had misrepresented his financial situation on the

application form to the bank, by suggesting that he would be getting additional rental income from the property in which he and his child were living.

Mr B was advised that if he did not proceed with the purchase of the investment property, he would lose his deposit. He therefore has had to move out of his home and live with his parents. Despite this, he still finds it difficult to meet repayments on both loans and is considering selling one of the properties.

Case study 13

Ms C was having financial difficulty and could not meet her mortgage payments in relation to her home loan. She asked a solicitor to assist her and received a referral to a mortgage broker. She asked for around $180,000 to pay out her mortgage and some other accumulated debts. The mortgage broker warned her that she was a bad credit risk and that he would have to work particularly hard to assist her.

After a number of phone calls and payment of various amounts requested in cash, Ms C was informed that a lender had been found. The catch, however, was that she had to borrow $250,000 minimum and she would need to come up with more income to meet the lending criteria. After some discussion with the broker she stated her income, which was actually social security, as $20,000 and nominated a job she had done casually for a few days as her permanent job. This amount still failed to meet the lending criteria, and Ms C decided to ask her son to become a co-borrower.

By the time the loan was approved Ms C had received legal notices in relation to her current mortgage and the bank was threatening imminent foreclosure. She signed the paperwork in the solicitor's office. Only then did she realise it was a two-year interest-only loan, and a very expensive one at that. She decided she had no choice but to proceed – she had already paid more money than she could afford to the broker and she was desperate to save her house. The loan went ahead and she paid out her original mortgage.

After several months of trying to meet the repayments on the loan, Ms C again fell into default. She sought assistance from a caseworker. Upon examination of the documents it became apparent that upon settlement the broker had been paid close to $5000, in addition to the amounts already paid directly by Ms C, and the lender had received an "application fee" of a similar size. She has also signed a business purposes declaration, taking the loan outside the jurisdiction of the UCCC.

Appendix B: The "Broker Survey"

To get an indication of the practices and approaches to some key issues by brokers, CCLC (NSW) conducted a written survey of brokers. The "Finance and Mortgage Broker Survey" (the "Broker Survey") was conducted between 1 February 2002 and 31 July 2002. As discussed below, the survey was limited in scope and methods of distribution, which resulted in some categories of brokers being over-represented. However, nearly all of the brokers who responded were members of one or both of the two main industry bodies—the Finance Brokers Association of Australia (FBAA) and/or the Mortgage Industry Association of Australasia (MIAA). The survey therefore provides a snapshot of some of the structures, business models and methods currently employed—at least in the mainstream industry.

B.1 Methodology

CCLC (NSW) developed a questionnaire for the survey in consultation with various industry, caseworker and ASIC representatives. Questions in the survey covered matters such as the type of business, details of the panel of lenders used, and relationships with consumers.

Copies of the "Broker Survey" were distributed nationally by the CCLC (NSW) to 155 brokers randomly selected from the *Yellow Pages*. The FBAA and the Professional Lenders Association Network of Australia (PLAN) also distributed nationally a combined total of 950 copies of the survey to their members. As well as assisting in the distribution of the survey, industry also assisted in project-related publicity.

Respondents were informed in both the attached cover letter and the survey itself that their survey responses would be treated as strictly confidential and for research purposes only. Brokers were not required to identify themselves or their business anywhere in their responses.

Accompanying the survey was an explanation of the project and a direction to brokers that they should complete the survey only if they brokered loans for personal, domestic or household use. Brokers were also instructed that if they brokered commercial loans as well as personal and/or home loans, they should complete the survey. Respondents were given approximately one month to complete and return the survey, although all returned completed surveys were

accepted and included in the results. The project was also actively promoted online[79] and through various media outlets.

A total of 166 broker-completed surveys were returned to CCLC (NSW). The following is an analysis of those 166 responses. In some cases, brokers were required to provide only one response to a question, although usually the nature of the questions was such that a number of different responses could be selected.

B.2 Business details

Broker business types

The vast majority of broker respondents indicated that they operated as private companies. The remainder of the respondents operated as sole proprietors or in partnerships, with a handful indicating that they had an alternative structure, such as a public company or a franchisor. The distribution of broker business types is listed in Table B.1.

Table B.1 Distribution of broker business types

Operate as	Total	Percentage
Private company	117	70%
Sole proprietor	27	16%
Partnership	13	8%
Public company	4	2%
Other*	3	2%
Franchisee	1	1%
Franchisor	1	1%
TOTAL	**166**	

* Other includes licensee, family trust and trust.

[79] For example, at www.choice.com.au and www.fido.asic.gov.au

Location of brokers

The majority of broker respondents had a main office located in either Queensland, New South Wales or Western Australia (see Table B.2). It should be noted in this context that a large number of surveys were distributed by the FBAA, whose members are mostly located in Queensland.

Table B.2 Location of respondents' main office

Main office in	Total	Percentage
Queensland	54	33%
New South Wales	36	22%
Western Australia	33	20%
Victoria	22	13%
South Australia	9	5%
Australian Capital Territory	4	2%
Northern Territory	4	2%
Tasmania	4	2%

Range of operation

While the majority of respondents limit their activities to the State in which their main office is located, 36% of respondents indicated that they operate in more than one State or Territory. Only 10% approached national coverage, operating in six or more States or Territories (see Table B.3).

Table B.3 Number of States/Territories in which broker operates

Number of States/ Territories broker operates in	Total	Percentage
1	106	64%
2	19	11%
3	11	7%
4	8	5%

Number of States/ Territories broker operates in	Total	Percentage
5	5	3%
6	5	3%
7	3	2%
8	8	5%
Not specified	1	1%

Operational life

The majority of broker respondents indicated that they have been operating between two and five years (see Table B.4). Overall, 56% of respondents have been operating for five years or less, indicating a large proportion of new entrants into the industry in the last five years. Given the evidence of growth cited elsewhere in this report, it is likely that this is predominantly due to the growth of the industry rather than a high turnover of participants.

Table B.4 Operational life of broker respondents

Number of years operating	Total	Percentage
< 2 years	28	17%
2–5 years	64	39%
5–10 year	43	26%
10+ years	30	18%
Not specified	1	1%

Staffing levels

The majority of respondents were relatively small organisations employing only two additional staff members—62% of respondents employed three people or less, while only 10% employed 26 or more staff (see Table B.5).

Table B.5 Number of broker staff employed

Number of staff employed	Total	Percentage
None (self-employed)	19	11%
1–3	84	51%
4–10	38	23%
11–25	9	5%
26–100	6	4%
> 100	4	2%
Not specified	6	4%

B.3 Services provided

Types of loans sought by broker clients

Virtually all the broker respondents indicated that their clients asked them to arrange regulated home loans and unregulated (investment) loans. Nearly a third of respondents (31%) indicated that their clients sought personal loans.

The other main types of finance that clients requested were commercial and industrial property loans and chattel and equipment loans, as detailed in Table B.6.

Table B.6 Types of loans sought by broker clients

Types of loans sought	Total	Percentage
Regulated home loans	158	95%
Unregulated (investment) home loans	154	93%
Commercial and industrial property loans	97	58%
Chattel and equipment loans	76	46%
Personal loans	51	31%
Other*	12	7%

* Other includes private mortgages, investment and/or insurance advice.

Broker services provided

The majority of broker respondents indicated that they performed tasks traditionally associated with brokers, including assisting their clients with the completion of paperwork; comparing credit products; advising clients of the terms and conditions of recommended credit products; and negotiating with credit providers (see Table B.7).

However, the results of the survey are interesting in that 11% of broker respondents indicated that they did not compare credit products; 11% of respondents indicated that they did not advise clients of the terms and conditions of recommended credit products; and 15% of respondents indicated that they did not negotiate with credit providers. It would appear that a significant percentage of brokers acted as mere conduits between lenders and borrowers and did not actively assist their clients to obtain the best possible loan.

Twenty two per cent of respondents advised that they sold insurance and other financial products, thereby requiring them to hold an Australian Financial Services Licence in accordance with the requirements of the *Corporations Act 2001*.

Twenty seven per cent of respondents also indicated that they managed loans after they were approved. While no particular conclusions can be drawn from this fact alone, it does raise some questions about what financial remuneration is received for loan management, and whether this affects or limits the loan products on offer by that particular broker.

Table B.7 Broker services provided

Service provided	Total	Percentage
Assist with the completion of paperwork	161	97%
Compare credit products	148	89%
Advise clients of terms/ conditions of recommended credit products	147	89%
Negotiate with credit providers	141	85%
Arrange valuations	85	51%
Manage loans once approved	45	27%

Service provided	Total	Percentage
Sell insurance and/or other financial products	36	22%
Other	6	3%

Credit providers and the panel of lenders

Broker respondents reported having an average of 21 credit providers on their panel of lenders. This is slightly lower than Market Intelligence Strategy Centre data, which puts the average number of lenders at 24.[80]

The broker survey data for this question ranged from a low of three credit providers on a broker's panel of lenders, to a high of 60. Twenty per cent of respondents reported having ten or less credit providers on their panel (see Table B.8). While it may not be possible to precisely address the issue of what constitutes an appropriate number of credit providers, a panel of ten lenders or less is generally too low to ensure consumers can access the most competitive loan.

The survey did not address whether some brokers (irrespective of the number of credit providers on their lending panel) consistently favour one lender over others, and, if so, whether this is because that lender pays higher commissions. This remains an important issue for consumers, particularly if the higher rate of commissions is recouped through higher interest rates.

Table B.8 Number of credit providers on brokers' panel of lenders

Number of credit providers	Total	Percentage
1–5	12	7%
6–10	22	13%
11–20	54	33%
21–40	63	38%
40+	7	4%
Not specified	8	5%

[80] Market Intelligence Strategy Centre, Mortgage Broking Data Pooling Facility, March 2002 Quarter Collection

Types of credit providers

Unsurprisingly, the major banks (the National Australia Bank, the Commonwealth Bank of Australia, ANZ and Westpac) and second-tier/regional banks (such as St George and Citibank) featured on the panel of lenders for most, though not all, brokers.

Additionally, 23% of brokers indicated that they have private investors on their panel of lenders. Traditionally, these lenders charge a higher rate of interest than mainstream lenders, and provide interest only loans, where repayments only meet the interest charged on the loan, with the capital to be repaid after a short period (such as one or two years). These types of loans are therefore generally only appropriate for consumers who are experiencing short-term cash flow problems. The survey did not, however, examine whether the loans provided by private investors met these characteristics.

A small number of respondents (3%) also indicated that there were financial links between their business and the credit provider(s) on their panel of lenders. It should be noted that Mortgage Choice, Australia's largest broker organisation, has a number of credit providers on their panel of lenders who are also Mortgage Choice shareholders.

Table B.9 lists the types of credit providers on the brokers' panel of lenders.

Table B.9 Types of credit providers on brokers' panel of lenders

Credit provider types	Total	Percentage
Second-tier/regional banks	156	94%
Major banks	154	93%
Finance companies	102	61%
Building societies	96	58%
Credit unions	74	45%
Private investors	38	23%
Non-conforming/ sub-prime lenders	14	8%
Mortgage originators/ managers	10	6%

Credit provider types	Total	Percentage
Securitised lenders	2	1%
Solicitors	2	1%
Aggregators	2	1%
Fund managers	1	1%

Customer demand

Question 11 of the broker survey asked respondents to indicate approximately how many customers approached them in the 2000–1 financial year for regulated home loans and/or personal loans. Question 12 asked brokers about the average amount their customers sought to borrow for regulated home loans and/or personal loans. Unfortunately, it was not possible to determine whether a customer approach translated into a loan in either of these questions. In fact, while a number of respondents indicated that customers approached them for personal loans, some also indicated that these customers were either turned away or referred elsewhere because the broker focused on home loans only.

For home loans, the survey results indicate that, on average, broker respondents were approached by 1127 customers seeking a loan of an average amount of $173,592. Most brokers, though, were approached by 100 customers who sought a regulated home loan of $164,500.[81] This figure is slightly higher than Australian Bureau of Statistics data in May 2002, which puts the national average home loan size (owner occupied) at $158,400.[82] The number of customers who approached brokers for regulated home loans ranged from 0 to 110,000.

For personal loans, on average, broker respondents were approached by 442 customers seeking an average loan of $22,215. Most brokers, though, were approached by 10 customers seeking a personal loan of $10,000. The number of customers who approached brokers for personal loans ranged from 0 to 24,000.

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[81] The reason there is such a discrepancy between the mean (1127) and the median (100) figures is because of one respondent who indicated that it was approached by 110,000 customers for regulated home loans.

[82] Australian Bureau of Statistics, Table 7, "Housing finance commitments, by type of borrower and loan", Original(a) in *5609.0, Housing Finance for Owner Occupation, Australia*, at: www.abs.gov.au/ausstats/abs@.nsf/lookupresponses/4a2f9de75f0248e0ca25688d001aa150?opendocument

Customer–broker relationship

Respondents were asked how they first established contact with their clients; 22% of brokers reported that they sent representatives to customers' homes, 17% telephoned potential customers and 14% sent representatives to a customer's workplace. A significant percentage of respondents therefore approach clients by way of a "cold call".

Table B.10 How contact is first established between brokers/customers

How contact with customers is first established*	Total	Percentage**
Customer calls broker	149	90%
Customer attends broker's office	67	40%
Referred by third party***	41	25%
Broker sends representative to customer's home	36	22%
Customer sends broker letter/email/fax	35	21%
Broker calls customers	29	17%
Broker sends representative to customer's workplace	23	14%
Broker sends customer letter/email/fax	19	11%
Referred by other customers	9	5%

* Respondents could select more than one method.

** The percentage is expressed as a percentage of the total brokers responding to the survey (166).

*** This includes accountants, solicitors, real estate agents, financial planners, builders, developers and other brokers.

Loan applications

Having made contact with their client, brokers indicated that there is a range of ways their clients apply for loans (see Table B.11). A significant proportion of respondents arrange to deal with their clients in either the customer's home or workplace. Thirty per cent of respondents arrange, at least some of the time, for loan applications to be completed by post or facsimile. In these circumstances, it seems likely that the consumer would receive no explanation of the terms of the loan from the broker, or, at the least, no adequate explanation.

Table B.11 How broker customers apply for a loan

How customers apply for a loan	Total	Percentage
By having the broker attend their home	124	75%
By attending the broker's office	116	70%
By having the broker attend their workplace	70	42%
By phone at either the customer's work or home	59	36%
By post/facsimile	49	30%
By email	16	10%
Via the internet	15	9%

The broker agreement

Fifty four per cent of broker respondents indicated that they have a written broker agreement describing the terms and conditions of the relationship between the broker and their client. However, 42% of respondents indicated that they do not have such an agreement. The remaining 4% of brokers did not answer the question.

Of those brokers who reported having a written agreement with their client, 92% indicated that this agreement included information about broker fees/commissions, 73% indicated that this included information about the amount and type of loan being arranged, and 51% indicated that this included information about the interest rate for the loan.

This suggests that there is a poor level of written disclosure by brokers about fees and commissions (with just under 50% of respondents including information about fees and commissions in their documented agreement with the consumer), which is consistent with the problems identified in Section 1.5 of this report. Similarly, a majority of broker respondents did not record in writing with the client information about the type and/or amount of the loan being sought, or details of the maximum interest rate the client would be prepared to pay on any broker-arranged loan. At the minimum, this leaves open the possibility of misunderstandings between the broker and the client as to their needs.

Length of the broker–customer arrangement

Question 17 of the survey was designed to find out how long brokers expected clients to wait for them to find a loan on their behalf. Unfortunately, the wording of the question was ambiguous, and almost 20% of brokers did not understand the question, or did not answer it. Of those brokers who did answer the question, 17% indicated that the length of the broker–customer relationship was two months or less (see Table B.12).

Table B.12 Duration of broker–customer relationship

Duration of appointment	Total	Percentage
< 1 day	3	2%
2–10 days	2	2%
10 days–2 months	16	13%
2–12 months	12	10%
12+ months	16	13%
Ongoing	43	35%
Life of the loan	12	10%
Through to settlement	20	16%
TOTAL	**124**	

B.4 Broker remuneration

Fees charged by brokers for their services

Questions 18, 19 and 20 in the survey referred only to *fees charged by the broker to the customer for the broking service*. These are sometimes known as commissions, although this term is more often used to describe payments to brokers from credit providers.

Forty three per cent of broker respondents (or 72 brokers) indicated that they do charge their customers a fee for their service. Fifty seven per cent of respondents did not answer the question. However the structure of the survey means it can be assumed that these respondents do not charge clients a fee for their service. Presumably these brokers are reliant solely on commissions from credit providers for remuneration.

Only three respondents indicated that they do not receive a commission from credit providers. These brokers all charged an upfront fee to their clients, with each broker charging a different amount: up to $600; $250; and 0.6 x 91% of the loan (which equates to $898 on a loan of $164,500).

Type of fees charged

Seventy two broker respondents advised that they charged their customer a fee for service. As shown in Table B.13, the most common fee was an application fee, although some brokers also charged a termination fee and an ongoing service fee.

Table B.13 Type of fees charged

Type of fee	Total	Percentage
Application fee	44	61%
Other fee	26	36%
Termination fee	9	13%
Ongoing service fee	6	8%
Not specified	1	1%

Fixed vs variable fees

Of those respondents who indicated that they do charge customers a fee for their service, 24% charged a fixed fee and 76% charged a variable fee. In relation to

those brokers who charged their customers a variable fee, the reasons given for the variation are set out in Table B.14. The large number of brokers who charge variable fees has potential implications for ensuring adequate and effective disclosure of such fees.

Table B.14 Reasons given for variable fees

Reason	Total	Percentage
Depends on loan amount	38*	53%
No reason given	8	11%
Depends on loan type (home, personal)	7	10%
Depends on amount of work	6	8%
Depends on whether lender pays commission	6	8%
Depends on negotiation with client	4	6%
Depends on what other services are being provided	1	1%

* In one case, the smaller the loan, the greater the fee.

Informing customers about fees

Of the 72 broker respondents who indicated that they do charge customers a fee for their services, 86% indicated that they informed customers about these fees orally (though this was not necessarily the exclusive means of communicating about fees, as brokers were able to give multiple answers to this question). However, 16 broker respondents indicated that they *only* informed customers orally about their fees. This leaves open the possibility of misunderstanding or confusion about the nature and extent of fees and the circumstances in which they will be charged.

Other methods of fee disclosure were through the inclusion of this information in the broker agreement (71%), in a separate document or schedule (56%), or in the credit provider's loan document or a tax invoice. 18% of respondents only disclosed commissions orally and through the documents provided by the credit provider.

Without further clarification, it is not possible to determine at what stage of the transaction brokers inform clients about their fees. It is also not possible to determine whether brokers disclosed to their client the amount of the brokerage fee, and when such a fee would be incurred.

Commissions from credit providers

Question 21 asked respondents whether they receive commissions from credit providers. Ninety seven per cent of the broker respondents indicated that they receive a commission or benefit from credit providers. Forty per cent of these respondents (or 64 brokers) indicated that they also charge their clients a fee for their service (see Section B.3). Six respondents advised that they charge clients a fee only when they do not receive a commission from the credit provider.

Size of commissions

Typically, brokers receive both an upfront commission from credit providers upon introducing a loan customer to them and a trailing commission calculated on the outstanding loan balance, and payable either monthly or yearly.

Questions 22 and 23 in the survey asked respondents to identify the maximum and minimum upfront and/or trailing commission they receive from credit providers. Some respondents provided dollar figure responses to these questions, while others provided a percentage of the amount financed.

Upfront commissions

The average[83] *maximum fixed percentage* commission received by broker respondents was 0.9% of the loan amount, though most[84] brokers received 0.7%.[85] On a $164,500 brokered home loan, this equates to commissions of $1480.50 and $1151.50 respectively. The largest fixed percentage upfront commission received was 4% of the loan amount (with this respondent also charging customers a $165 application fee).

The average *maximum fixed dollar* commission received by brokers was $2397.50, with commissions ranging from $385 to $6000.

The average *minimum fixed percentage* commission received by brokers was 0.5% of the loan amount (n = 112), though most brokers received 0.45%. On a $164,500 brokered home loan, this amounts to $822.50 and $740.25, respectively. The

[83] The term "average" refers to the mean and will continue to do so in this section.
[84] The term "most" refers to the median and will continue to do so in this section.
[85] A number of respondents advised that they either did not receive such a commission, specified that the commission varied, or did not answer the question.

smallest fixed percentage upfront commission received was 0.2% of the loan amount.

The average *minimum fixed dollar* commission received by brokers was $258.68, with commissions ranging from $50 to $550.Accordingly, commissions charged on a percentage of loan basis varied from 0.2% to 4% of the loan amount, which equates to $329 and $6580 respectively, on a $164,500 loan.

Trailing commissions

The average *maximum fixed percentage* trailing commission received by brokers was 0.5% of the loan amount, though most brokers received 0.3%. On a $164,500 brokered home loan, this amounts to an ongoing trail that starts at $822.50 and $493.50 per year, respectively.[86] The largest fixed percentage trailing commission received was 1.7% of the outstanding loan amount, with this respondent also charging customers an application fee of 1.1% of the loan amount for home loans and 10% of the loan amount for personal loans.

The average *maximum fixed dollar* trailing commission received by brokers was $586 per annum, with payments ranging from $48 to $1610.

Using the median maximum commission of 0.3% per annum, a broker who arranged a $164,500 loan with an interest rate of 7% per annum for a term of 25 years would receive a total of $7715 in trailing commissions from the credit provider.

The average *minimum fixed percentage* trailing commission received by brokers was 0.44% of the loan amount, though most brokers received 0.2%. On a $164,500 brokered home loan, this amounts to an ongoing trail that starts at $723.80 and $329 per year, respectively. The smallest fixed percentage trailing commission was 0.01% of the outstanding loan amount.

The average *minimum fixed dollar* trailing commission received by brokers was $81.33 per annum, with payments ranging from $36 to $148.

Trailing commissions charged on a percentage of loan basis therefore ranged between 0.01% and 1.7% of the outstanding loan amount. This equates to payments of $16.54 and $2796.50 respectively in the first year of a loan for $164,500.

[86] The figures for this and subsequent amounts of trailing commission may vary slightly according to the precise calculation used to determine the commission payable.

Informing customers about commissions

Ninety one per cent of brokers indicated that they inform their customers about the commissions or benefits they receive from credit providers. However, 5% of respondents did not inform their customers about such commissions or benefits, while 4% did not answer the question.

As shown in Table B.15, a majority of brokers indicated that they informed customers about credit provider commissions orally, with 31 of these brokers advising that they *only* informed customers about such commissions orally.

It should be noted that respondents were not asked at what point in the transaction they informed their clients about the commissions they receive from credit providers, nor were they asked whether they informed their clients about the *amount* and *type* of the commission to be received.

Table B.15 How brokers inform customers about commissions

How information is provided	Total	Percentage
Orally	88	58%
Loan offer document/loan contract	43	28%
Separate document	42	28%
Broker agreement	40	26%
Loan application form	37	25%

B.5 Attracting customers

Third party referrals

Responses to the survey indicated that a referral by a third party was the most common way brokers promoted their services (65% of respondents) (see Table B.16). Third parties included solicitors, real estate agents and accountants. Forty five per cent of respondents indicated that they offer financial or other incentives to people who refer customers to them; 53% do not, and the remaining 2% of respondents did not answer the question.

Twenty one per cent of respondents indicated that they used “cold calling” of consumers as a marketing strategy.

Table B.16 Promotion of broker services

How services are promoted	Total	Percentage
Through solicitors and other service providers*	108	65%
Phone directories	70	42%
Calling potential customers	35	21%
Word of mouth	35	21%
Internet	26	16%
Radio	16	10%
Television	13	8%
Pamphlet drops	12	7%
National newspaper	9	5%
Billboards	9	5%
Promotional material to existing client base	9	5%
Ethnic media	5	3%
Sponsorship	3	2%
Public transport	2	1%
Cinema	2	1%
Death referral	1	1%
Local newspaper	1	1%

* This also includes accountants, real estate agents, collection agencies, financial planners, car dealers, building contractors and introducers.

Customer target groups

The survey asked brokers to identify groups to whom they targeted their services (see Table B.17). Thirty nine per cent of respondents indicated that their advertising and other service promotion targets people seeking a more competitive loan. However, 61% of respondents did not select this option, despite being able to

give multiple responses to the question, which by inference suggests that groups were selected for targeting for other reasons.

Self-employed/contract workers and people pushed for time were popular target groups for brokers. Twenty eight respondents indicated that they targeted one or more of the following categories: people who have been refused credit in the past; people in financial difficulty; people with a poor credit record; and people who are low income earners or social security recipients. These groups could be described as vulnerable groups, since they often find it very difficult to obtain finance and may resort to "fringe lenders" and/or relatively high cost credit to obtain a loan.

Eleven respondents indicated that they target people of particular age groups, and four respondents indicated that they target recent immigrants.

Table B.17 Customer groups targeted by brokers

Target market	Total	Percentage
People seeking a more competitive loan	64	39%
Self-employed/ contract workers	39	24%
People pushed for time	32	19%
People who have been refused credit in the past	21	13%
People experiencing financial difficulty	15	10%
People with a poor credit record (eg bankrupts)	14	8%
People of a specific age group (eg students, seniors)	11	7%
(First) home buyers	6	4%
All markets	5	3%
People from particular cultural/language groups	4	2%
Recent immigrants	4	2%

Target market	Total	Percentage
Part-time workers	4	2%
Business people/investors	4	2%
Low income earners/ social security recipients	2	1%
Companies	2	1%
Significant home equity holders	2	1%
Other*	5	3%

* This includes existing clients, medical fraternity, medium/high income earners, overseas borrowers and non-conforming borrowers with a good credit rating.

B.6 Complaints procedures

Formal complaint handling

Fifty one per cent of broker respondents indicated that they had a formal internal dispute resolution (IDR) procedure for handling customer complaints. Forty seven per cent of brokers had no formal procedure for dealing with complaints, although 5% of these made comments such as that they "have never experienced a complaint", "get few complaints" or use "basic common sense" to resolve complaints. Two per cent of respondents did not answer the question.

The survey did not investigate the extent to which those brokers with an IDR procedure in place would meet the benchmarks required of Australian Financial Services Licence holders under the *Corporations Act 2001*.

Dispute resolution schemes

The survey asked brokers to advise whether or not they were members of an alternative dispute resolution (ADR) scheme. The responses provided by some brokers indicated confusion about the nature of such schemes, as 25 brokers responded by indicating that they were members of industry associations. It is disturbing that so many respondents were unfamiliar with the nature and role of ADR schemes.

Overall, the survey results indicate that only 62 respondents were members of an ADR scheme, and that a majority of brokers were not members of any such scheme (see Table B.18).

Table B.18 Broker membership of industry dispute resolution schemes

Scheme	Total	Percentage
Mortgage Industry Ombudsman Scheme	43	26%
Mortgage Industry Association of Australasia*	15	9%
Finance Brokers Association of Australia**	10	6%
Australian Banking Industry Ombudsman Scheme	3	2%
Professional Lenders Association of Australia***	2	1%
Financial Industry Complaints Service	1	1%
Australian Finance Group***	1	1%
TOTAL	**75**	

* While this is an industry association, MIAA does have a Mortgage Industry Ombudsman Scheme (MIOS) attached to it, so that those respondents who are members of the MIAA will also be participants in MIOS.

** This is an industry association (not an ADR scheme).

*** This is an aggregator (not an ADR scheme).

B.7 Insurance

Ninety eight per cent of respondents indicated that they have professional indemnity insurance. Only one respondent indicated they do not have such insurance. Two respondents did not answer the question.

B.8 Industry associations/networks

Membership

A majority of respondents are members of the Finance Brokers Association of Australia (FBAA) and/or the Mortgage Industry Association of Australasia (MIAA), as shown in Table B.19. It should be noted that the FBAA and the Professional Lenders Association Network (PLAN) distributed a large number of surveys to their members. Further, a condition of PLAN membership is that brokers *must* also be members of the MIAA. Accordingly, the method of distribution of the survey was likely to have resulted in a level of membership of industry associations significantly higher than the national average.

Table B.19 Broker membership of industry associations/networks

Industry association/ network	Total	Percentage
Finance Brokers Association of Australia	85	51%
Mortgage Industry Association of Australasia	85	51%
Professional Lenders Association Network (PLAN)	36	22%
Other*	8	5%
Australian Finance Group	7	4%
Preferred Broker Network	2	1%
Australian Finance Conference	2	1%
Australian Lease Brokers Association	2	1%
Institute of Financial Services	2	1%

* This includes the Australian Institute of Banking and Finance, Australian Institute of Company Directors, Association of Financial Advisors, Financial Planners Association, and the Real Estate Institute (NT).

Professional codes of practice

The majority of respondents indicated that they belonged to the FBAA or the MIAA, or were members of a mortgage aggregator, the Professional Lenders

Association Network of Australia (PLAN). However, the survey responses indicated a low level of recognition within these respondents of the existence of codes of practice adopted by these bodies (see Table B.20).

Eighty five brokers indicated that they are members of FBAA, but only 32 of these stated that they were subject to the FBAA Code of Ethics (even though being an FBAA member necessitates agreeing to abide by the code). Similarly, while 85 brokers confirmed that they are members of the MIAA, only 37 of these indicated that they participate in the MIAA Code of Practice. Again, while 36 brokers stated that they were PLAN members, only 19 of these indicated that they subscribed to the PLAN code of ethics.

Five respondents indicated that the code of practice they belong to had a legislative basis (namely, “finance broker legislation”, “privacy legislation” or the UCCC). Two respondents indicated that they belong to the Banking Code of Practice. One respondent indicated that they belong to the “finance and mortgage industry” code of practice, while another indicated that they belong to their own code of practice. Another respondent indicated that they belong to a code of practice, but were unsure which one.

Table B.20 Brokers’ participation in an industry professional code

Code of practice	Total	Percentage
Mortgage Industry Association of Australasia	37	25%
Finance Brokers Association of Australia	32	22%
Professional Lenders Association Network (PLAN)	19	13%
Other*	7	5%
Financial Planning Association of Australia	3	2%

* This includes Asset Finance Association of Australia, ASIC Auditor, Australian Finance Group, Australian Institute of Banking and Finance, Australian Institute of Company Directors, Australian Institute of Management, Financiers Association of Australia and the Preferred Broker Network. These responses may be referring to codes of practice adopted by these bodies (which are not necessarily broker-specific).

Additional broker comments

Question 35 gave brokers the option of adding any additional information about their business or the broker market generally. Brokers were also invited to expand on their earlier answers. Altogether, 51 brokers (31% of respondents) provided additional comments. Of these, 17 were supportive of additional regulation of the industry, and 13 believed that there should be minimum qualifications for entry. One respondent opposed regulation of brokers. Table B.21 lists some additional broker comments.

Table B.21 Additional broker comments

Comments	Total	Percentage
Additional comments about own business and skills	21	41%
Additional broker regulation is required	17	33%
Brokers should have minimum professional qualifications	13	25%
Brokers should be members of a recognised industry association	5	10%
Brokers need to be ethical	2	4%
Industry standards should be set	2	4%
Dissatisfaction with aggregators	2	4%
Credit providers should not have an interest in broker organisations	1	2%
There should be regulation for private lenders	1	2%
Brokers should *not* have to disclose the commissions they receive	1	2%
Brokers should *not* be regulated	1	2%

Appendix C: The "Caseworker Survey"

In recent years, caseworkers dealing with low income consumers have increasingly drawn attention to problems their clients have arising from, or associated with, the use of brokers in arranging finance. In order to capture the range of problems, CCLC (NSW) conducted a survey of the experiences of caseworkers. The surveys were completed from 1 February 2002 to 31 July 2002.

Inevitably, many of the responses from caseworkers involve some subjectivity and were based on their individual experiences and expertise, rather than a consistent pattern of statistical collection by them. Respondents to the "Caseworker Survey" generally only deal with people who are in financial difficulty (financial counselling services), or who have a civil legal dispute and meet certain income and asset limits (Legal Aid and community legal services). Clients of these services therefore experience problems by definition. The prevalence of such problems noted by caseworkers cannot therefore necessarily be equated to the prevalence of those problems in the industry overall. Nevertheless, the survey provides a useful insight into the range and frequency of the problems arising for consumers from the use of brokers, and the ways in which caseworkers endeavour to resolve those problems.

C.1 Methodology

The "Caseworker Survey"

The "Caseworker Survey" was developed in consultation with caseworkers and ASIC representatives. CCLC (NSW) distributed copies of the survey to 193 financial counselling organisations, community legal centres, financial counsellors and solicitors Australia wide.

The project was also promoted in newsletters received by financial counsellors in New South Wales, Queensland, South Australia, Victoria and Western Australia. The Financial Counsellors Association in New South Wales, South Australia and Western Australia distributed copies of the survey to their members. Information about the project was also distributed to 23 Aboriginal and Torres Strait Islander organisations Australia wide. Further project promotion took place online and through various media outlets.

Respondents were informed that the survey responses would be treated as strictly confidential and for research purposes only. An explanation of the project was attached to the survey. As well as completing the survey, caseworkers were asked

to forward copies of broker contracts, advertisements and relevant case studies. A "Consent to Use Information" form was attached to the survey for caseworkers to pass on to clients who agreed to the use of their broker experiences in the final report.

A total of 85 caseworkers completed the "Caseworker Survey".[87] These caseworkers, either individually or through their agency, saw approximately 40,000 clients in the year preceding the survey. It should also be noted that clients approach these services with a range of problems, the majority of which are not relevant to this project.

Table C.1 shows the State/Territory breakdown of survey respondents.

Table C.1 State/Territory breakdown of survey respondents

State/Territory	Surveys received
Australian Capital Territory	2
New South Wales	20
Northern Territory	2
Queensland	14
South Australia	3
Tasmania	5
Victoria	11
Western Australia	28
TOTAL	**85**

Overall, 53 responses were received from financial counsellors, 17 from solicitors (including 9 from Legal Aid solicitors), and 15 from other community organisations (including community legal centres and welfare bodies).

Caseworkers who completed the surveys were asked whether they had clients who experienced problems with brokers in the 2000 calendar year or 2000–1 financial year; how many of these problems had arisen; and whether the number of these problems had increased, decreased or stayed the same when compared to two years ago. Caseworkers were also asked to indicate the extent to which certain types of problems with brokers had arisen in either their own casework experience

[87] Forty-three caseworkers indicated that they were responding on behalf of their agency's casework, 32 on behalf of their own casework and nine caseworkers did not address this question.

or that of their agency. A four-step scale was provided for a response: “Never”, “Rarely”, “Sometimes” and “Often”.

In some of the tables of results below, the number of respondents who answered a particular question is given in parentheses.[88] The percentage of respondents listed as giving a particular response to a question (eg “Never”) is the percentage of those respondents *who answered that question*, and not the percentage of total respondents.

There were significant discrepancies in the number of broker complaints experienced by different caseworkers and agencies, ranging from nil to 200. However, all caseworker responses are given the same weight regardless of the number of relevant cases such caseworkers dealt with. The answers provided by respondents reporting the largest number of problems have been reported separately where relevant.

Departments of fair trading

Requests for information were also sent to each department of fair trading (or its equivalent) Australia wide. Information was requested in relation to:

- the number of complaints about finance/mortgage brokers that were received in 2001 and 2002;
- the types of practices that complainants are/were concerned about;
- any recent enforcement action taken against finance/mortgage brokers; and
- the number (actual or estimated) of finance brokers operating in the relevant State or Territory.

Responses were received from each State and Territory department.

C.2 Incidence of broker problems

The “Caseworker Survey”

Forty four per cent (n = 37) of respondents indicated that they have identified or come across concerns, problems or complaints in relation to finance and/or mortgage brokers. Fifty five per cent (n = 47) had not identified nor come across any such problems. One caseworker did not answer the question. Solicitors and coordinators of financial counselling/community legal centres identified the *most* broker problems. Financial counsellors came across the *least* number of broker problems (see Table C.2).

[88] For example, (n = 17) where n = the number of respondents who answered that particular question.

Table C.2 Number of broker problems identified per job description

Job description	Problem		If YES, number of problems
	YES	NO	
Solicitor/community legal centre coordinator (n = 32)	19	13	49
Financial counsellor (n = 53)	18	35	60

It should be noted, however, that a great majority of those caseworkers who did *not* identify or come across any problems with brokers do *not* generally make inquiries as to whether a broker was involved in the particular problem their clients present to them. Some of these respondents, particularly financial counselors, indicated that their main concern is with their client's immediate financial difficulties, rather than how or whether these difficulties resulted because of the involvement of a broker.

It is no coincidence, then, that those caseworkers who *did* identify or come across problems with brokers (namely solicitors and community legal centre coordinators) generally *do* make inquiries about the presence or absence of a broker in the problems their clients present to them.

The 36 caseworkers whose clients had experienced difficulties with brokers reported dealing with a total of 556 problems nationwide in the last year.[89] When compared to their experiences of a similar period two years before the survey, 43% of these respondents indicated that the number of problems with brokers had increased, and 46% stated that the level of problems had stayed the same. Eleven per cent of respondents indicated that the number of problems their clients had experienced with brokers had decreased.

Seven caseworkers or agencies identified 25 or more broker problems. In some cases the responses from these respondents have been discussed separately below.

Departments of fair trading

A total of 486 complaints were received by State and Territory fair trading departments (although it should be noted that the period assessed varied in each

[89] Some caseworkers reported figures in the last calendar year (2001), while others referred to the last financial year (2000-01).

jurisdiction). Table C.3 lists the incidence of broker problems experienced by departments of fair trading.

Table C.3 Incidence of broker problems experienced by departments of fair trading

State/Territory	Number of complaints	Period for complaints
ACT	54*	Jan 2001–May 2002
New South Wales	52	Jan 2001–Mar 2002
Northern Territory	31	2001 only
Queensland	78	Jan 2001–30 Jun 2002
South Australia	3	Jan 2001–25 Mar 2002
Tasmania	Nil	Jan 2001–4 Apr 2002
Victoria	149	Jan 2001–26 Feb 2002
Western Australia	119	Jan 2001–5 April 2002
TOTAL	**486**	

* This includes complaints against brokers *and* credit providers (although the ACT Office of Fair Trading indicated that the “majority of these complaints were about the conduct of finance brokers”).

In their responses, some departments identified the types of problems most frequently coming to their attention. These problems involved:

- problems arising from advertisements offering easy credit to people in financial difficulty (NSW and NT);
- consumers paying excessive and poorly disclosed brokerage fees (NSW and NT);
- loans being incorrectly documented as being for business purposes (NSW);
- brokers requiring upfront payment of fees, and refusing to provide refunds when they were unable to arrange finance (Qld); and
- misrepresentations about the transaction by the broker (Qld and Vic).

C.3 Reasons clients give for using brokers

While the reasons clients give for using brokers often vary (see Table C.4), the majority of caseworkers indicated that clients use brokers because they:

- have been refused credit elsewhere;
- believe that a broker can secure a better deal;
- have responded to persuasive advertising; or
- were referred to a broker by a third party.

Table C.4 Why clients use brokers

Reason	Never	Rarely	Sometimes	Often
Refused credit elsewhere (n = 42)	14%	19%	41%	26%
Believe that broker can secure a better deal (n = 42)	12%	24%	41%	24%
Responded to persuasive advertising (n = 39)	15%	13%	44%	28%
Previous experience using a broker (n = 37)	43%	49%	5%	3%
No time/desire to compare available products (n = 39)	28%	38%	23%	10%
Responded to unsolicited call/visit (n = 39)	33%	21%	33%	13%
Referred by third party (eg solicitor, real estate agent, accountant) (n = 40)	20%	20%	45%	15%

Other reasons why individual clients used brokers were because their English-speaking relatives took them to see a broker (n = 1), because of gambling debts (n = 1), or because they were on government pensions and needed money (n = 1).

C.4 Client experiences with brokers

Misrepresentations and/or lack of information

The biggest concerns caseworkers identified as occurring either "Sometimes" or "Often" were in relation to broker misrepresentations and/or lack of information about:

- the fees, repayments and other conditions of the broker-arranged loan (81%);
- the broker–credit provider relationship (81%); and/or
- the fees that brokers charge clients, and/or the circumstances in which fees will be charged (79%).

In fact, some 73% of caseworkers indicated that they "Often" came across broker misrepresentations and/or lack of information about the amount of fees that brokers charge or the circumstances in which clients will be liable to pay those fees. Other areas of concern to emerge from the data were in relation to broker misrepresentations; lack of information about the service the broker provides; and lack of advice about the likelihood of the broker obtaining credit for them. Table C.5 lists the nature of the problems involving misrepresentations or lack of information.

The seven caseworkers who identified 25 or more broker problems *all* indicated that broker misrepresentations and/or lack of information about either the service the broker provides and the size of the fees that are imposed by the broker, or the circumstances in which fees will be charged were problems that occurred "Often".

Table C.5 Nature of problems

Misrepresentation/ lack of information	Never	Rarely	Sometimes	Often
About the service the broker provides (n = 35)	17%	6%	31%	46%
About the chance of credit being provided (n = 32)	16%	16%	40%	28%

Misrepresentation/ lack of information	Never	Rarely	Sometimes	Often
About the size of the fees that are charged by the broker and/or when they will be charged (n = 33)	12%	9%	6%	73%
About the fees, repayments and other conditions of the loan found by the broker (n = 33)	6%	12%	36%	46%
About the broker–credit provider relationship (n = 33)	6%	12%	36%	46%
About the duration of the brokers' appointment (n = 32)	47%	19%	6%	28%

Aggressive marketing

A significant percentage of caseworkers identified problems with aggressive broker marketing as occurring either "Sometimes" or "Often" (see Table C.6). The most common type of conduct was brokers applying unfair pressure to clients to sign broker agreements immediately to avoid "missing out". Forty one percent of caseworkers responding to this question also reported that either extended visits by brokers or refusal to leave the family home occurred "Sometimes" or "Often".

Table C.6 Aggressive conduct by brokers

Broker behaviour	Never	Rarely	Sometimes	Often
Unsolicited calls/visits (n = 32)	41%	19%	25%	16%
Extended visits/refusal to leave (n = 32)	38%	22%	28%	13%
Unfair pressure to sign a broker agreement immediately to avoid missing out (n = 32)	25%	13%	28%	33%

Problems with fees and charges

Brokers charging excessively high undisclosed fees and/or failing to refund fees in appropriate circumstances were both identified as concerns that arose either “Sometimes” or “Often” by a majority of caseworker respondents (see Table C.7). In fact, almost half of respondents indicated that this was a problem they “Often” came across.

The seven caseworkers who identified 25 or more broker problems all indicated that both types of problems occurred either “Sometimes” or “Often”.

Table C.7 Client experiences with fees and charges

Broker behaviour	Never	Rarely	Sometimes	Often
Charging excessively high/undisclosed fees (n = 35)	9%	9%	37%	46%
Failing to refund fees in appropriate circumstances* (n = 34)	29%	6%	21%	44%

* (eg in breach of the agreement or where the services are not provided)

Inappropriate loans

Caseworkers reported a high incidence of dealing with clients who had experienced problems involving the broker obtaining inappropriate finance (see Table C.8). Of most concern is that 81% of respondents indicated that a problem arising “Sometimes” or “Often” was brokers knowingly arranging finance that a client cannot afford without suffering substantial hardship.

The majority of caseworkers responding to this question also identified as problems that occurred either “Sometimes” or “Often”:

- brokers arranging loans that are uncompetitive or have high interest rates;
- broking loans based on asset lending; and
- brokers arranging inappropriate loans.

Table C.8 Client experiences with inappropriate loans

Broker behaviour	Never	Rarely	Sometimes	Often
Knowingly arranging finance that a client cannot afford without suffering substantial hardship (n = 36)	8%	11%	31%	50%
Knowingly broking loans based on asset lending (n = 35)	14%	17%	34%	34%
Broking loans that are significantly more/less than was sought (n = 33)	25%	31%	31%	13%
Arranging loans that are uncompetitive or have high interest rates (n = 34)	9%	15%	47%	29%
Broking inappropriate loan type* (n = 33)	33%	15%	33%	19%

* (eg arranging a business loan where the purpose of the loan is for personal use)

Provision of false information to lenders

Fifty four per cent of caseworker respondents indicated that they either "Sometimes" or "Often" came across situations with clients where brokers have encouraged or been complicit in the consumer providing out of date/incorrect information to credit providers (see Table C.9). Examples of such conduct included:

- suggesting that the client give "different" answers on the application form to the response initially given to the broker;
- assisting the client to obtain one form of credit (such as a credit card) to establish a deposit or savings record in order to obtain a more substantial advance from another credit provider; and
- asking the borrower to sign blank application forms, without giving the borrower the opportunity to verify the accuracy of the information provided to the lender by the broker.

Table C.9 Incidence of broker involvement in provision of false information to lenders

Broker behaviour	Never	Rarely	Sometimes	Often
Knowingly providing out of date/incorrect information to credit providers (n = 36)	29%	17%	31%	23%
Encouraging/being complicit in the consumer providing out of date/incorrect information to credit providers (n = 34)	30%	21%	24%	24%

C.5 Dealing with complaints

Methods of dispute resolution used by caseworkers

Of those respondents who did identify problems with brokers (n = 36), 78% had tried to resolve such problems. The majority of these caseworkers sought to do so by directly negotiating with the credit provider, the broker themselves and/or by taking the matter up with the relevant consumer affairs agency. Table C.10 lists the methods of dispute resolution caseworkers used.

Table C.10 Methods of dispute resolution used by caseworkers

Forum	Never	Rarely	Sometimes	Often
Direct negotiation with broker (n = 28)	14%	21%	29%	35%
Direct negotiation with credit provider (n = 28)	21%	11%	46%	21%
Industry association (n = 26)	58%	19%	23%	Nil
Industry dispute resolution scheme (n = 26)	35%	31%	31%	4%
Consumer affairs agency* (n = 27)	33%	4%	56%	7%

Forum	Never	Rarely	Sometimes	Often
Other (n = 3)**	Nil	33%	66%	Nil

* This includes departments of fair trading, the ACCC and ASIC.

** This includes the Courts, the Public Interest Law Clearing House and the Real Estate Supervisory Board (WA).

Effectiveness of dispute resolution methods

Caseworkers had most success in resolving complaints when they negotiated directly with the broker and/or the credit provider (see Table C.11). The majority of respondents indicated that they achieved little success when using industry associations. Consumer affairs agencies and industry dispute resolution schemes were also characterised as being unlikely to produce successful resolutions to the broker problems caseworkers sought to resolve.

Table C.11 Effectiveness of dispute resolution methods used by caseworkers

Forum	Never	Rarely	Sometimes	Often
Direct negotiation with broker (n = 27)	26%	30%	33%	11%
Direct negotiation with credit provider (n = 29)	28%	17%	41%	14%
Industry association (n = 22)	64%	14%	23%	Nil
Industry dispute resolution scheme (n = 22)	36%	32%	23%	9%
Consumer affairs agency* (n = 23)	35%	35%	22%	9%
Other (n = 3)**	Nil	Nil	100%	Nil

* This includes departments of fair trading, the ACCC and ASIC.

** This includes the Courts, the Public Interest Law Clearing House and the Real Estate Supervisory Board (WA).

C.6 Other practices of brokers

In addition to answering the specific questions detailed above, survey respondents were given the opportunity to make additional comments under a variety of headings, relating to other practices of brokers. Thirty-six respondents chose to make additional comments. Their responses are summarised in Tables C.12–C.19.

It should be noted that the 36 respondents did not necessarily respond to each specific issue. In addition, respondents could provide a number of different comments on a particular issue, so that the number of comments is, in most instances, greater than the number of respondents.

Advertising practices

The majority of caseworkers who made additional comments under this heading expressed concern with broker advertising targeting the financially desperate and/or containing misleading/deceptive information (see Table C.12).

Table C.12 Caseworker responses on advertising practices

Comments	Total
Targeting financially desperate consumers	10
Misleading/deceptive	8
Inadequate details in advertisements	4
Haven’t seen a problem	2
Appropriate advertising	1
RESPONDENTS WHO COMMENTED	**25**

Broker selling practices

Problems caseworkers identified with broker selling practices chiefly involved:

- misleading/deceptive broker behaviour;
- brokers giving little information or options to consumers; and
- brokers using high-pressure sales tactics (see Table C.13).

Table C.13 Caseworker responses on broker selling practices

Comments	Total
Misleading/deceptive	10
Little information/options given to consumers	7
High pressure sales tactics	6
Have own interests as primary objective	5
Haven't seen a problem	4
Appropriate	2
RESPONDENTS WHO COMMENTED	**29**

Disclosure of broker fees and charges

By far and away the biggest problem identified by caseworkers with broker fees and charges was that there was little or no disclosure about such charges and when they were likely to be incurred by the consumer. Non-meaningful disclosure was also identified as a problem by a number of caseworkers (see Table C.14).

Table C.14 Caseworker responses on disclosure of broker fees and charges

Comments	Total
Little or no disclosure	25
Non-meaningful disclosure*	6
Haven't seen problem	2
Adequate disclosure	1
RESPONDENTS WHO COMMENTED	**29**

* This includes oral/written disclosure not understood by the consumer.

Disclosure of other terms and conditions in the broker agreement

Little or no disclosure and/or non-meaningful disclosure by brokers of other terms and conditions in the broker agreement was identified by a number of caseworkers as a concern (see Table C.15).

Table C.15 Caseworker responses on disclosure in the broker agreement

Comments	Total
Little or no disclosure	16
Non-meaningful disclosure*	6
Haven't seen problem	5
Unclear disclosure	4
Appropriate disclosure	2
RESPONDENTS WHO COMMENTED	**27**

* This includes oral/written disclosure not understood by the consumer.

Broker disclosure of credit provider's terms and conditions

Caseworkers also identified as a problem the failure of brokers to provide any, or any meaningful, disclosure or explanation of the terms and conditions on which finance was provided (see Table C.16). Problems ranged from brokers explaining or disclosing contract terms in a way that was not easily understood by the client to active concealment by the broker of the terms and conditions. One caseworker observed that some credit providers rely entirely on the broker to explain the terms on which finance is provided, but refuse to take any responsibility for the accuracy of any such explanation.

Table C.16 Caseworker responses on disclosure of terms of credit contract

Comments	Total
Little or no disclosure	18
Non-meaningful disclosure*	8
Haven't seen problem	4
Misleading disclosure	1
Appropriate disclosure	1
RESPONDENTS WHO COMMENTED	**26**

* This covers an oral/written disclosure not understood by the consumer.

Broker representations as to likelihood of loan approval

Misleading and/or deceptive broker comments as to the likelihood of a customer securing a loan were identified as a problem by caseworkers (see Table C.17). A number of caseworkers also identified problems with a lack of broker concern about their clients' ability to repay the arranged loan.

Table C.17 Caseworker responses on broker representations as to likelihood of loan approval

Comments	Total
Misleading/deceptive	15
Haven't seen a problem	7
No concern about consumers' ability to repay loan	6
Appropriate conduct	1
RESPONDENTS WHO COMMENTED	**23**

Explanation of broker–credit provider relationship

The majority of caseworker responses indicated a problem with brokers providing little or no explanation of their relationship with credit providers (see Table C.18). In some cases, the explanation of this relationship given by brokers was described by caseworkers as misleading and/or deceptive.

Table C.18 Caseworker responses on explanation of broker–credit provider relationship

Comments	Total
Little or no explanation given	18
Haven't seen a problem	5
Misleading/deceptive information given	4
Not sure what information is given	2
Appropriate disclosure	2
RESPONDENTS WHO COMMENTED	**26**

Dealing with customer complaints

The majority of caseworkers who responded to this question identified problems with the way brokers dealt with customer complaints (see Table C.19). Some caseworkers specifically indicated that some brokers adopt delaying or obstructionist tactics when dealing with complaints to discourage complainants or to hamper any further action anticipated by the customer.

A small number of caseworkers also highlighted concerns about the ineffectiveness of broker dispute resolution schemes.

Table C.19 Caseworker responses on dealing with customer complaints

Comments	Total
Inadequate means of dealing with complaints	19
Use of delaying tactics when dealing with complaints	5
Unsure of adequacy or have not handled any complaints with broker directly	2
Ineffective broker dispute resolution schemes	2
Critical of absence of dispute resolution schemes	2
Complaints have been resolved effectively	1
RESPONDENTS WHO COMMENTED	**23**

Additional comments

Caseworkers were also able to make comments on other matters not covered in the survey (see Table C.20). No particular theme emerged from these additional comments. Some of the more frequent comments related to caseworker perceptions that broker regulation is currently ineffective and that little or no enforcement action is taken by government consumer affairs agencies. Problems with brokers who operate out of car yards and brokers who make multiple loan inquiries on behalf of borrowers (which then appear on the borrower's credit report) were also raised by a number of caseworkers.

Table C.20 Summary of additional comments by caseworkers

Comments	Total
Broker regulation ineffective	5
Little/no enforcement action taken by government	4
Problems with brokers who operate out of car yards	4
Problem of multiple inquiries on credit reports (see discussion below)	4
Brokers pressuring client’s family members to co-borrow	3
Consumers asked to sign blank finance applications	2
Lenders failing to take responsibility for brokers	2
Problems with solicitors acting as lenders as well	2
Takes an empowered client to report broker problem in first place	2
Little consumer/broker knowledge about broker regulation	1
Door-to-door salespeople problems	1
Problems with debt collectors referring clients to brokers	1
High fees for service being provided	1
Brokers going into liquidation (causing problems for clients)	1
Problems with clients giving broker full authorisation to act on their behalf	1
Credit providers in different jurisdiction to place of contract*	1
RESPONDENTS WHO COMMENTED	**24**

* This means that the borrower cannot easily dispute claim.

C.7 Case study data

In addition to the "Caseworker Survey", CCLC (NSW) received over 125 case studies about transactions involving brokers. A selection of these case studies have been included in Appendix A.

The case studies catalogue negative broker experiences, ranging from situations where the borrower was directed into a non-competitive loan to complex scams involving multiple players and allegations of fraud and other criminal activity. The most common complaints are covered in descending order of frequency.

Difficulty for consumers in terminating the broker contract

In these cases, consumers tried to terminate their contract with the broker because either the finance offered was clearly inappropriate or it did not meet their stated specifications; no loan was provided within a reasonable time-frame; or the time-frame represented by the broker, or the consumer simply changed their mind within a day or two of their first interview.

In all cases, the consumer was either:

- unable to obtain a refund of the brokerage fee;
- experienced great difficulty in obtaining a refund of the brokerage fee; and/or
- was pursued, through letters from solicitors, Court action or otherwise, for the brokerage fee. While the size of the brokerage fee in such case studies varied, most often consumers had outlaid (or were being pursued for) between $2000 and $3000.

Charging excessive fees

In one case, a client was charged a brokerage fee equivalent to 35% of the arranged loan amount (ie a $14,150 brokerage fee on a $40,000 loan). Problems such as these were often coupled with complaints about brokers arranging uncompetitive or inappropriate loans.

Arranging inappropriate loans

In some cases, consumers had tried to terminate the contract because they realised the proposed credit did not meet their needs. In other cases, consumers felt they had no option but to accept the inappropriate offer because of pending settlement on a purchase of a property.

Not arranging a loan, or not within a reasonable time

Sometimes consumers had tried to terminate the brokerage contract because of inordinate delays, and instead sought to arrange finance themselves. In other cases, consumers had suffered substantial loss because of their failure to settle a purchase in accordance with a contract of sale. In these cases, it was not uncommon for the broker, aware of the settlement date, to falsely reassure the consumer by misrepresenting to them that a loan had already been approved.

Other complaints

Other common complaints to emerge from the case studies included complaints about brokers who:

- fail to disclose brokerage fees and/or misrepresentations about such fees;
- fail to explain the terms and conditions of a prospective loan (such as unusual penalty fees or the fact that the loan was of an "interest only" nature or a line of credit facility);
- encourage consumers to misrepresent their financial circumstances, their employment status or the purpose of the loan in order to obtain finance;
- cold call potential customers;
- fail to return customers' phone calls or to answer their inquiries;
- visit (potential) customers at home and stay for extended periods;
- pressure potential customers into signing brokerage contracts;
- make misleading statements about the interest payable on prospective loans;
- fail to disclose their relationship with the credit provider; and/or
- fail to disclose and/or make misleading statements about the broker contract and/or the likelihood of finance being approved.

C.8 Summary of results

The majority of caseworker respondents who identified broker problems indicated that:

- the number of complaints received about brokers has increased when compared to two years ago;
- caseworker clients tend to use brokers because they have responded to persuasive advertising, have been refused credit elsewhere, believe that a broker can secure a better deal or were referred to a broker by a third party;

- caseworkers sometimes/often came across broker misrepresentations and/or lack of information about:
  - (a) the fees, repayments and other conditions of the broker-arranged loan;
  - (b) the broker–credit provider relationship;
  - (c) the size of brokerage fees and/or when they will be charged; and/or
  - (d) the chance of credit being approved;
- caseworkers sometimes/often came across brokers applying unfair pressure to clients to sign a brokerage agreement immediately to avoid missing out on a loan;
- caseworkers sometimes/often came across brokers who charge excessively high/undisclosed fees and/or failed to refund fees in appropriate circumstances;
- caseworkers sometimes/often came across brokers who:
  - (a) knowingly arrange finance that a client cannot afford without suffering substantial hardship;
  - (b) knowingly broker loans based on asset lending;
  - (c) arrange loans that are uncompetitive or have a high interest rate;
  - (d) broker inappropriate loan types; and/or
  - (e) knowingly provide out-of-date or incorrect information to credit providers; and/or
- caseworkers sought to resolve broker complaints by directly negotiating with the credit provider, the broker and/or with the relevant consumer affairs agency. Such complaints were most often resolved when directly negotiating with the credit provider, though there was a perception among respondents that brokers had inadequate means of dealing with customer complaints.

Acronyms

ABIO	Australian Banking Industry Ombudsman
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institutions (ie banks, credit unions and building societies)
ADR	Alternative dispute resolution
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
CCLC (NSW)	Consumer Credit Legal Centre (NSW) Incorporated
FBAA	Finance Brokers Association of Australia
MIAA	Mortgage Industry Association of Australasia
UCCC	Uniform Consumer Credit Code