

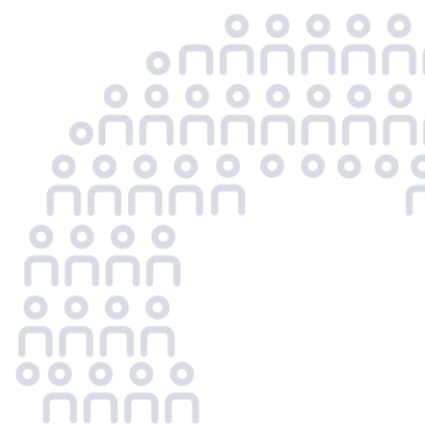


# **BEST INTERESTS DUTY EXPLAINED**

or

## **Doing Your Clients' Bidding**

**January 2021**





## WHAT IS BEST INTERESTS DUTY ALL ABOUT?

Two of the recommendations that resulted from the 2018 Royal Commission into the Banking, Superannuation and Financial Services industry related to mortgage brokers. One stipulated that brokers should be obliged to act in the best interests of consumers and the other that brokers should prioritise consumers' interests over any others when providing credit assistance.

The Federal Government agreed to act on those recommendations and accordingly passed legislation in 2019 that creates a duty for mortgage brokers to act in the best interests of consumers (best interests duty or BID) and requires brokers to prioritise consumers' interests when providing credit assistance (conflict priority rule). These obligations came into effect on 1 January 2021.

The aim of the laws is to improve consumer outcomes, by requiring brokers to act in their clients' best interests and by reducing the potential for conflicts of interests to impact the advice provided to consumers. ***These requirements apply in relation to regulated credit products only.***

ASIC has released Regulatory Guide 273 to provide the industry with guidance on how to meet the obligations. This Paper summarises the content of RG273 and sets out what brokers need to do in order to satisfactorily meet the requirements.

## GENERAL PRINCIPLES

The legislation sets down the obligations noted above. It does not detail specific steps that brokers need to follow to make sure they comply. This is largely because each client scenario is different, so determining what will be in one client's best interests may be very different to making that same determination for another client. So, what conduct satisfies the duty will depend on the individual circumstances of each case. Brokers hold the responsibility to make sure their conduct meets the standards of acting in the best interests of consumers during each dealing with a client.

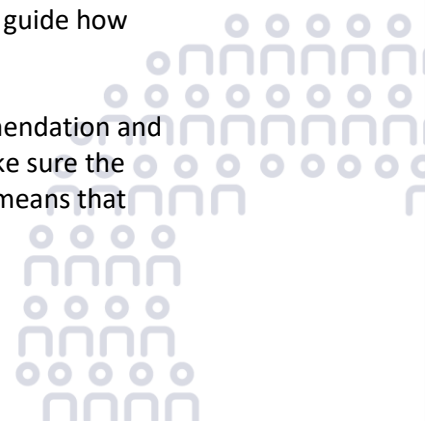
What ASIC has made clear is that it expects brokers to provide appropriate support, guidance and communication to consumers throughout the credit assistance process. The reality is that reputable brokers have provided strong and appropriate support and guidance to their clients for many years, so are well familiar with this approach. ***The main difference now is that what has been traditionally regarded as best practice has been given legal force.***

Additionally, there is now a need to not only act in the client's best interests but also to show by documentary evidence that this has happened i.e. it's not sufficient for brokers to act appropriately – they must be able to show that they did so.

## WHAT GUIDANCE HAS ASIC GIVEN?

While the legislation is not prescriptive, ASIC has made clear that it holds some fundamental expectations in relation to behaviour that brokers will be expected to meet. These will guide how brokers can make sure they satisfy BID. Let's look at these:

- Although the final decision on whether to accept or decline a broker's recommendation and proceed with an application rests with the client, the sole responsibility to make sure the recommendation is in the consumer's best interests sits with the broker. This means that



there will be times that the client's views of their best interests will need to be challenged: it will not be enough to simply go with the client's preferences without at least assessing whether this is in their best interests.

- In most instances, it will not be adequate to present only one option to a client (assuming more than one option exists). Where multiple options do exist, these are to be presented in a manner that are aligned to the client's best interests.
- The evidence that BID has been met will come primarily from the broker's records.

So how does this translate into practical action? The circumstances applying to individual clients are all different, so exactly what a broker needs to do in any given scenario will be largely driven by those circumstances. However, there will be common elements for every scenario:

- Brokers will need to gather information about the client and their situation. This is nothing new – responsible lending requirements have set this standard since 2010.
- Brokers will use the information obtained to assess what credit assistance would be in the client's best interests. Essentially this means making an assessment of whether a credit solution exists for the client and what lenders and products may provide that solution.
- Depending on that assessment, brokers will suggest one or more (where they exist) options to the client and provide information about why the recommended option/s are in the client's best interests.

In simple terms:

1. Find out who the client is, their financial situation, and what they are wanting to do.
2. Decide if a credit solution is feasible and if so, what solutions exist.
3. Present to the client, in clear written detail, solutions that will deliver the best outcomes for the client and recommend the most favourable of these, noting the reason/s for the recommendation.

We'll look at these steps in more detail. But first:

### **ARE THE RESPONSIBLE LENDING STEPS ADEQUATE TO SATISFY BID?**

It's important to understand that BID is a separate standard to responsible lending. Certainly, there are common elements and the process of gathering relevant information to meet both standards will generally be identical. But responsible lending requires making sure the credit product is not unsuitable for the borrower; BID takes this a step further for brokers in that not only must the final loan product be not unsuitable, it must represent the most favourable outcome from those options available to the broker i.e. from those lenders to which the broker is authorised to submit loan applications – the lender panel. Hence, under BID, there is more to do.



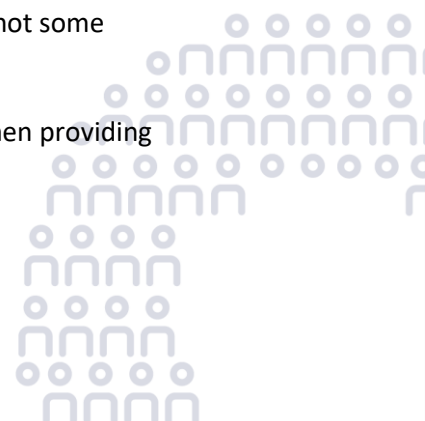
## GATHERING INFORMATION – KEY STEPS

- Understand in depth what the client’s objectives and requirements are. This means going further than just finding out their immediate goals: yes, they want to buy a house, but for how long do they want to retain it? How do they want to repay the loan? Are they worried about the effect of fluctuating interest rates? Are there particular loan features that they value? Do they have lender or product preferences? Are non-financial aspects relevant to the scenario e.g. lender service times?
- The level of enquiry and information gathering may vary, depending on the level of financial capability of the client and/or the complexity of the transaction. The first home buyer and borrower will likely need more detailed enquiries than the experienced borrower purchasing their third investment property. Each case will be different.
- If the client has not provided sufficient information, the broker needs to take steps to gather the information needed to completely and accurately assess the client and what they are looking to do. RG273 makes it clear that where a broker provides incomplete or inaccurate information to a lender in a loan application they are not acting in the client’s best interests.

**End result** – expect to spend more time fully determining, assessing and documenting clients’ borrowing objectives and requirements.

## MAKING AN INDIVIDUAL ASSESSMENT

- There is no prescribed process or set of factors for brokers to consider when conducting the assessment of lenders and products that are in the client’s best interests. Each client’s individual circumstances need to be considered.
- When making the assessment, certain matters are likely to be relevant:
  - ✓ the client’s priorities and preferences for different lenders and/or products, including price, product features and lender service levels;
  - ✓ the client’s needs and objectives – the amount of funding, the loan term and the outcome that is desired;
  - ✓ the client’s personal and financial situation, both current and if these are subject to reasonably foreseeable changes;
  - ✓ the broker’s access (ability to directly submit applications) to lenders and products that will meet the client’s needs, objectives, priorities and preferences;
  - ✓ the broker’s ability and expertise to make an appropriate recommendation that meets the client’s needs, objectives, preferences and priorities.
- The assessment of what product/s are in the client’s best interests is a point-in-time assessment i.e. the best interests at the time the assessment was completed, not some indeterminate future time.
- If the broker’s assessment is that they cannot act in a client’s best interests when providing credit assistance, the broker must not provide credit assistance.



- The cost of a credit product is a factor that brokers should prioritise in their assessment. A failure to consider cost and investigate the lowest cost options available to the client from our panel lenders may suggest non-compliance with BID. Recommendation of a higher priced product needs to be supported by evidence demonstrating why the recommendation is in the client's best interests.
- Cost is not the only factor that is relevant. For some clients, the benefits provided by particular features might outweigh the importance of cost.

**End result – having assessed the client's needs, objectives, priorities and preferences and determined that there are multiple products available from our lender panel that will meet these, the lowest priced product option needs to be recommended i.e. all else being equal, brokers are obliged to recommend the cheapest product. If that product is not recommended, the reason/s why need to be documented.**

ASIC also points out that any promotional offers e.g. cash backs on settlement, need to be considered as part of the cost of the credit product. Similarly, the longer-term effects of a lower interest rate or other features such as offset, need to be balanced against the benefit offered by the promotion. For example, the lender is offering a \$4000 cash back for borrowers who settle a loan under product X by a certain date. The lender's product Y carries a lower interest rate, but no cash back. It may be that the overall cost of the loan to the borrower under product Y is cheaper than product X, even allowing for the \$4000. If that is so, this needs to be pointed out to the borrower and product Y recommended if the borrower's overall objective is to obtain the most cost-effective loan.

## **EDUCATING CLIENTS**

ASIC makes it clear that it expects brokers to educate clients about the availability and eligibility criteria of government (Federal and State) grants and schemes. Brokers may also assist clients assess their eligibility and the benefits of the schemes.

**End result** – brokers need to be fully familiar with all government grants and schemes on offer, who is eligible to apply for these, the eligibility criteria that applies and then educate clients who may be able to apply as to how the grants operate.

## **MULTIPLE FACTORS – WEIGHING THEM UP**

While cost is a key consideration, other features may provide value, depending upon the individual circumstances of the client. The relevance of all factors needs to be considered in light of the customer's circumstances and the nature of the proposed transaction. Where a client has more than one need or objective, the relative importance of each needs to be assessed and any inconsistencies between competing needs or objectives resolved e.g. a client may indicate that they want protection from potential interest rate rises but also the flexibility to make unlimited principal reductions. In this case, it may be necessary to work out which of these is more important to the client, as it may not be possible to satisfy both.

It's important to remember that particular features may provide a greater benefit to some clients than a lower price on the loan product – it's all about priorities. Remember too that circumstances may demonstrate that a desired feature is actually detrimental to a particular consumer e.g. a client

indicates they wish to obtain the lowest possible interest rate which currently is a three-year fixed rate option. However, they also indicate that they intend to sell the security property within two years, thereby incurring a likely substantial break cost. Thus, a fixed rate loan product may not be in the client's best interests, even though it meets their stated prime requirement.

### **WHAT IF THE CLIENT SPECIFICALLY REQUESTS A TYPE OF PRODUCT?**

If the broker considers that a different product or feature to the one initially sought by the client is more appropriate and the broker fails to advise the client of this, the broker is unlikely to have acted in the client's best interests. Essentially, the broker is obliged to make reasonable efforts to explain to the client why the product or features they initially were seeking is not the appropriate solution or may not offer good value. The client must be able to make an informed decision. But, if the client still wishes to proceed with their first preference, that's ok – the broker just needs to show that they did provide the appropriate comparison information and what steps were taken to educate the client about the options.

### **PRESENTING INFORMATION AND RECOMMENDATIONS**

When recommending a product, the information should be presented to the client in a way that clearly spells out how taking the recommended action would achieve their objectives and be in their best interests in comparison to the other available options. ASIC recommends providing a short list of options presented with one being the recommended option. Clients also need to understand why these options have been presented, why some have not been presented and why one has been recommended. If a client is having difficulty in understanding the implications of the various options, the broker needs to help the client understand why a particular loan may or may not be in their best interests.

MoneyQuest has elected to adopt LMG's Game Plan (available through MyCRM), which has been designed to meet these obligations and will facilitate the presentation of options and recommendations to clients. It will generally require 3 options to be presented (assuming at least 3 exist).

### **HOW MANY OPTIONS SHOULD A BROKER HAVE AVAILABLE?**

ASIC notes that it expects brokers to be satisfied that the credit products accessible to them and which they can recommend are sufficient to allow them to act in their clients' best interests. How do they do this?

- ✓ Be aware of what products are available in the market and compare them to what is available to from our lender panel i.e. ask how does my lender panel and accreditations stack up? For example, a broker would need to be aware that some lenders offer reverse mortgage or self managed super fund products – if those lenders are not on the lender panel, or the broker is not accredited with them if they are, the fact that such products are not available through the broker will need to be advised to any client whose interests will be best served by such products.
- ✓ Be accredited with a reasonable representative panel of credit providers. This requires each broker to consider the number of lenders with which they are accredited and whether that group provides sufficient availability of lending options to suit their likely clients' needs. As a



suggestion, any broker not currently accredited with the lender/s that consistently offer the lowest priced product options should consider become accredited with those lenders.

- ✓ If a client is interested in a lender or product to which a broker does not have access, the broker needs to advise the client of this. The broker can actively sell against this other lender, so long as the client understands that the broker does not have access to the other lender and product.
- ✓ If a broker is not satisfied that the lenders and products to which they do have access will allow them to act in the client's best interests, the broker must not provide credit assistance to the client. In such situations, it is appropriate to refer the client to another broker who may be better placed to assist them.
- ✓ In order to facilitate broker decision making in this area and to ensure consistency across the broker network, MoneyQuest requires all Credit Representatives to obtain and maintain accreditations with a minimum of 12 members of the lender panel that provide residential finance products. Of that number, accreditations need to be held and maintained with Commonwealth Bank, ANZ Bank, National Australia Bank, Westpac, Macquarie Bank and MoneyQuest Home Loans.
- ✓ Should a Credit Representative be unable to obtain accreditation with up to 2 of the mandatory 6 lenders, the requirement to be accredited with a minimum of 12 lenders still applies.
- ✓ Should a Credit Representative be unable to obtain accreditation with 3 or more of the mandatory 6 lenders, they will be permitted to continue to act as a Credit Representative only if they meet the following criteria:

They are accredited with a minimum 12 lenders that provide residential finance products;

AND

Have a business partner or employed loans consultant who is accredited with all 6 mandatory lenders, AND

Said business partner or loans consultant works from the same location as the Credit Representative to ensure the Credit Representative can easily refer their clients should BID require recommendation one of the mandatory 6 lenders unavailable to the Credit Representative.

#### **WHAT IF THE CUSTOMER'S CIRCUMSTANCES CHANGE?**

It's important to remember that the BID obligations are point-in-time, so changes that occur after the recommendation has been made are not relevant to whether BID obligations have been met. Nevertheless, if the credit assistance process is subject to delay, brokers should consider whether a fresh assessment is needed or if further enquiries into the client's circumstances are needed, which may lead to a fresh recommendation.

It is also important to remember that BID applies equally when assessing whether a borrower should remain in their current loan. A suggestion for a client to do so should not be made without considering whether this would be in their best interests.

### **DOES BID EXTEND TO OTHER PRODUCTS?**

BID applies to any credit assistance a broker provides. This includes credit assistance on products that are included within a package associated with the mortgage loan. So, for each credit product within a package, the broker needs to:

- Include in their recommendation how the relevant product will meet the client's needs, objectives, priorities and preferences; and
- Explain whether and why suggesting that the client take the package and the products included in it would be in their best interests.

Forming a view on these matters requires brokers to compare a package to other packages available and to stand alone loans without a package.

### **STICK TO THE COMPETENCY AREAS**

If a broker considers that there are material implications that a client should consider, and these go beyond the broker's areas of competence, the broker can act in the client's best interests by ensuring that the credit assistance is:

- Based on advice given to the client by another appropriately qualified person e.g. accountant, financial planner. In such cases, the broker must make it clear to the client that the broker is assuming the advice is appropriate, rather than endorsing it; or
- Limited to matters on which the broker is competent to advise. In such cases, the broker needs to make sure the client understands that they should seek advice from someone with appropriate expertise before following the broker's recommendation.

### **CONFLICT PRIORITY RULE**

Brokers must prioritise consumers' interests if they know, or ought to know, that when providing credit assistance there will be a conflict between the consumer's interests and the interests of:

- The credit licensee;
- The credit representative;
- An associate of the licensee;
- An associate of the credit representative;
- Another representative of the licensee; or
- An associate of another representative of the licensee.

The conflict priority rule means that a broker must not recommend a product that would create extra revenue for the broker, the licensee or another related party, unless doing so would also be in the client's best interests.

Quite simply, if there is a conflict of interest and the broker is unable to prioritise the consumer's interests, the broker must not provide credit assistance. Broker recommendations must be made with the consumer's interests as the primary consideration. If the broker prioritises maximising or receiving



remuneration over the consumer's interests, the broker will breach the conflict priority rule.

## **RECORD KEEPING**

ASIC expects brokers' records to clearly show they have complied with BID obligations. Aside from the relevant NCCP responsible lending records, there will be an additional responsibility to prepare and retain records that provide:

- ✓ Information showing that the broker acted in the best interests of the consumer, including records of efforts made to educate the consumer;
- ✓ The options and recommendation provided to the consumer and a detailed description of the reason/s for the recommendation; and
- ✓ Details of any potential conflict of interest identified and the actions taken to prioritise the consumer's interests over the broker's or a related party.

Again, the enhancements made to Podium facilitate the record keeping requirements being satisfied. Brokers need to be conscious of completing all relevant fields to make sure that the documents produced are as complete and as accurate as possible.

## **IN SUMMARY – BID ON A PLATE FOR BROKERS**

- **Take active and detailed steps to understand every client's credit needs, desired outcomes, preferences and what is really important to them.**
- **All aspects being equal, the lowest priced loan products are the ones that should be presented to clients.**
- **Clients need to be educated if their desired product is not actually appropriate for them.**
- **Clients need to be made aware of their eligibility for any available government grants or concessions.**
- **Assuming 3 loan product options are available, these need to be formally presented in writing to the client, with one option recommended as the most suitable outcome. LMG's Game Plan provides this outcome to us.**
- **Clients' interests must always take priority over the interests of anyone else.**

