Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019

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Law and Bills Digest Section

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House: House of Representatives
Portfolio: Treasury
Commencement: Sections 1–3 on Royal Assent; Schedules 2 and 3 on the day after Royal Assent; and Schedule 1 on 5 April 2021.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through the Australian Parliament website.

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.

All hyperlinks in this Bills Digest are correct as at February 2020.
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Purpose of the Bill
The purpose of the Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019 (the Bill) is to:

• implement recommendations 4.7 and 4.2 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne)¹ and

• amend the National Consumer Credit Protection Act 2009 (Consumer Credit Act) and the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 (TCP Act) to require mortgage brokers to act in the best interests of consumers and address conflicted remuneration for mortgage brokers.

Structure of the Bill
The Bill comprises three Schedules:

• Schedule 1 amends the Australian Securities and Investments Commission Act 2001 (ASIC Act) and the Insurance Contracts Act 1984 to extend the protection from unfair contract terms to certain insurance contracts

• Schedule 2 amends the ASIC Act and the Corporations Act 2001 so that the consumer protection provisions of the ASIC Act apply to funeral expenses policies and

• Schedule 3 amends the Consumer Credit Act and the TCP Act in relation to mortgage brokers.

Structure of this Bills Digest
As the matters covered by each of the Schedules are independent of each other, the relevant background, stakeholder comments (where available) and analysis of the provisions are set out under each Schedule number.

Committee consideration

Standing Committee for the Selection of Bills
At its meeting of 5 December 2019, the Standing Committee for the Selection of Bills (Selection of Bills Committee) determined that the Bill not be referred to Committee for inquiry and report.²

Senate Standing Committee for the Scrutiny of Bills
The Standing Committee for the Scrutiny of Bills (Scrutiny of Bills Committee) commented on the use of delegated legislation in Schedule 3 to the Bill.³ The comments are canvassed under the heading ‘Mortgage brokers’ in this Bills Digest.

Statement of Compatibility with Human Rights
As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible.⁴

4. The Statement of Compatibility with Human Rights can be found at pages 41–43 of the Explanatory Memorandum to the Bill.
Parliamentary Joint Committee on Human Rights

At the time of writing this Bills Digest the Parliamentary Joint Committee on Human Rights (Human Rights Committee) had not commented on the Bill.

Unfair contract terms

The Hayne RC identified a number of issues in relation to insurance including issues relating to the use of, and reliance upon, potentially unfair contract terms (UCT).\(^5\)

**Recommendation 4.7 – Application of unfair contract terms provisions to insurance contracts**

The unfair contract terms provisions now set out in the ASIC Act should apply to insurance contracts regulated by the Insurance Contracts Act.

The provisions should be amended to provide a definition of the ‘main subject matter’ of an insurance contract as the terms of the contract that describe what is being insured. The duty of utmost good faith contained in section 13 of the Insurance Contracts Act should operate independently of the unfair contract terms provisions.\(^6\)

Unfair contract terms regime

Background

In 2008, the Productivity Commission undertook a review of Australia’s Consumer Policy Framework which included amongst other things, the use of unfair contract terms and their effect on consumers.\(^7\) According to the Productivity Commission:

Unfair contract terms are those that disadvantage one party but that are not reasonably necessary to protect the legitimate interests of the other. Examples of such ‘unfair’ terms include reserving the right to vary the contract at any time for any reason, or removing liability for interruptions in supply, which may have the effect of inefficiently shifting risk from suppliers to consumers ...

The biggest concerns arise for standard-form contracts—typically used in the supply of a broad range of services including air travel, telecommunications, energy, consumer credit, car hire, holiday packages, home improvements and software sales. Such non-negotiated contracts have advantages for consumers—in particular, in competitive markets, lower business costs will be passed on to consumers as lower prices. But, by their nature, these contract terms are offered on a ‘take-it-or-leave-it’ basis, are often complex and apparently mostly not read. The concern is that businesses sometimes use unfair terms against consumers and the public interest generally.\(^8\)

Subsequently, the Government enacted the Australian Consumer Law (which is located in Schedule 2 to the Competition and Consumer Act 2010 (CCA)) to establish the unfair contracts regime.\(^9\) The ASIC Act contains unfair contract provisions which are in broadly equivalent terms except that they apply to a financial product or to a contract for the supply, or possible supply, of services that are financial services.\(^10\) Initially the unfair contract terms regime applied only to

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6. Ibid., p. 32.
8. Ibid., vol. 2, p. 149.
10. Australian Securities and Investments Commission Act 2001, (ASIC Act), section 12BF.
business-to-consumer contracts. Later amendments extended the unfair contract terms regime to small business contracts.\(^\text{11}\)

**How the unfair contract terms regime operates**

A term of a consumer contract is void if the term is *unfair*\(^{12}\) and the contract is a *standard form* contract.\(^{13}\)

The existing unfair contract term protections operate as follows:

- an *unfair* term is one which would cause a significant imbalance in the parties’ rights and obligations arising under the contract, is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term and would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on\(^{14}\)
- in deciding whether a contract is unfair a court must take into account the *transparency* of the term—that is, whether it is expressed in reasonably plain language, is legible, is presented clearly and is readily available to any party affected by the term\(^{15}\)
- the exceptions to the unfair contract term provisions are terms that:
  - define the main subject matter of the contract
  - set the *upfront price* payable under the contract or
  - are required, or expressly permitted, by a law of the Commonwealth, a state or a territory.\(^{16}\)

The *upfront price* payable is the amount that is provided for the supply or sale under the contract. It is disclosed at, or before, the contract is entered into. It does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event.\(^{17}\)

If a party to a proceeding alleges that a contract is a standard form contract, it is presumed to be a standard form contract unless another party to the proceeding proves otherwise.\(^{18}\) The relevant Acts list a number of matters which a court may take into account in determining whether a contract is a standard form contract.\(^{19}\)

**Insurance contract exception**

While the unfair contract terms regime applies to most financial products and services, it does not currently apply to insurance contracts regulated under the *Insurance Contracts Act*. This is because the *Insurance Contracts Act* states that a contract of insurance is not capable of being made the subject of relief under any other Act.\(^{20}\)

**Rationale for the exception**

Both parties to an insurance contract must act with utmost good faith or *uberrima fides* towards each other.\(^{21}\) Part II of the *Insurance Contracts Act* contains provisions about the duty of utmost

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12. *ASIC Act*, section 12BH and CCA, Schedule 2, clause 25 list examples of terms that may be unfair.
14. *ASIC Act*, subsection 12BG(1); CCA, Schedule 2, subclause 24(1).
15. *ASIC Act*, subsection 12BG(3); CCA, Schedule 2, subclause 24(3).
16. *ASIC Act*, subsection 12BI(1); CCA, Schedule 2, subclause 26(1).
17. *ASIC Act*, subsection 12BI(2); CCA, Schedule 2, subclause 26(2).
18. *ASIC Act*, subsection 12BK(1); CCA, Schedule 2, subclause 27(1).
19. *ASIC Act*, subsection 12BK(2); CCA, Schedule 2, subclause 27(2).
21. ‘*Utmost good faith*’ means the obligation of the promisee to communicate to the promisor every fact and circumstance which might influence the promisor’s decision whether or not to enter into the contract. Where only one of two parties knows the
good faith. According to the High Court, in relation to the insurer, the touchstone of the duty of utmost good faith is ‘to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured’.22

Under the duty of utmost good faith, each party must voluntarily disclose to the other, during pre-contractual negotiations, any fact of which he or she is aware and which he or she knows, or ought to have known, would be material to those negotiations. That duty continues up until the time that the insurance contract is formed.23 Where there is a breach of this duty of disclosure, an insurer may, depending on the terms of the insurance contract, elect to avoid the contract ab initio24 or refuse to pay a claim.

According to the Australia Law Reform Commission report which was the catalyst for the enactment of the Insurance Contracts Act the requirement of both parties to act with utmost good faith ‘should provide sufficient inducement to insurers and their advisers to be careful in drafting their policies and to act fairly in relying on their strict terms’.25

However, the Consumer Action Law Centre considers that the duty of utmost good faith is not achieving its stated aims because:

- it does not hold the insurer to account for policy terms which are harsh, oppressive, unconscionable, unjust, unfair or inequitable
- it does not require an insurer to draft policy clauses ‘fairly’
- it does not prevent an insurer from selling an insurance policy which is unsuitable, or which the customer does not understand and
- people are overwhelmingly unaware of it and, if they are aware of it, it is very unlikely to assist them in common disputes.26

The Consumer Law Committee of the Law Council of Australia echoed this sentiment stating that the duty of utmost good faith has ‘not succeeded as an adequate consumer protection against unfair contract terms’ and expressed the view that ‘the insurance sector should not have received an exemption from the 2010 UCT reforms’.27

Examples of terms in insurance contracts which may be ‘unfair’
The type of terms that are problematic include:

- for home building insurance:

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23. A fact is considered to be material if it would have affected the mind of a prudent insurer in determining whether to accept the insurance, on what terms and at what premium. The test of materiality was stated by Samuels J in Mayne Nickless Ltd v Pegler (1974) 1 NSWLR 228 at p. 239 and cited in Russell Young Abalone Pty Ltd v Traders Prudent Insurance Company Ltd [1991] TASSC 94 at paragraph 15.
24. That is, the contract is null and void from the beginning.
27. Law Council of Australia, Consumer Law Committee, Submission to Treasury proposals paper, Extending unfair contract terms protections to insurance contracts, 27 August 2018, p. 16.
– terms that provide that the most the insurer will pay in the event of loss or damage to a building is the cost to the insurer for rebuilding or repairing the building (as opposed to the actual cost of the repair, which may be higher for the insured) and
– terms that allow the insurer to require the insured to pay an excess before paying the claim
• for car insurance: terms that require the insured to provide the name, registration and contact details of an uninsured at-fault driver when making a claim
• for consumer credit insurance: terms that prevent an insured from making a disability claim if they were not diagnosed with the disability prior to leaving work and
• for travel insurance: terms that allow a claim to be denied on the basis of a blanket mental health exclusion.28

Previous consideration of the insurance contract exception

The question of whether the Insurance Contracts Act needs to be supplemented in some manner by unfair contract terms provisions—that is, to operate in addition to the requirement of utmost good faith—had been considered prior to the recommendation of the Hayne RC. The considerations included, but are not limited to:

• in March 2017, the final report of the Consumer Affairs Australia and New Zealand (CAANZ) review of the Australian Consumer Law recommended applying unfair contract terms protections to contracts regulated under the Insurance Contracts Act29
• the 2017 Senate Economics Committee inquiry into the general insurance industry30 which recommended that the government ‘introduce the legislative changes required to remove the exemption for general insurers to unfair contract terms laws’31
• the 2018 Parliamentary Joint Committee on Corporations and Financial Services inquiry into the life insurance industry32 which recommended, amongst other things, that ‘section 15 of the Insurance Contracts Act be reformed to enable consumer protections to apply to life insurance contracts’ and that the ‘consumer protections for life insurance be aligned with consumer protections for other financial services and products’33 and
• the Australian Competition and Consumer Commission first interim report in the Northern Australia Insurance inquiry in 201834 which stated that the ‘unfair contract term protections in the Australian Securities and Investments Commission Act should apply to insurance contracts regulated by the Insurance Contracts Act’.35

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30. The terms of reference for the inquiry into Australia’s general insurance industry, submissions to the Senate Committee on Economics and the Committee’s final report are available on the inquiry homepage.
31. Senate Economics References Committee, Australia’s general insurance industry: sapping consumers of the will to compare, Senate, Canberra, August 2017, recommendation 11, p. x.
32. The terms of reference for the inquiry into the life insurance industry, submissions to the Parliamentary Joint Committee on Corporations and Financial Services and the Committee’s final report are available on the inquiry homepage.
34. The terms of reference for the inquiry into Northern Australia insurance, submissions to the Australian Competition and Consumer Commission (ACCC), various updates and interim reports are available on the inquiry homepage.
35. ACCC, Northern Australia insurance inquiry: first interim report, ACCC, Canberra, 2018, recommendation 6, p. x.
**Treasury consultation**

In June 2018, Treasury began consulting on a Proposals Paper to extend unfair contract terms laws to insurance contracts relating to both life and general insurance.\(^{36}\) The paper proposed that section 15 of the Insurance Contracts Act be amended to allow the unfair contract terms laws in the ASIC Act to apply to insurance contracts. This amendment would provide insureds with the same protections as consumers under the Australian Consumer Law.

According to the Australian Securities and Investment Commission (ASIC) extending the protections:

- would give life and general insurance policyholders the same protections that are currently available for other financial products and services and other standard form contracts throughout the economy
- will require insurers to review their standard form contracts and proactively address any terms that could be unfair
- can play an important role in promoting trust and integrity in the insurance sector and
- when appropriately tailored to the specific features of insurance contracts, can help protect consumers and small businesses while still accommodating the legitimate interests of insurers.\(^{37}\)

Treasury received 23 submissions for its consultation on the proposals paper\(^ {38}\) and an equivalent number for its consultation on the subsequent exposure draft of the Bill.\(^ {39}\)

**Government response to the Hayne RC**

On 5 February 2019 the Government announced it would take action in relation to all of the Hayne RC recommendations. This includes extending the unfair contract terms regime to insurance contracts in response to recommendation 4.7 of the Hayne RC.\(^ {40}\)

**Policy position of non-government parties/independents**

At the time of writing this Bills Digest none of the non-government parties or independent Members and Senators had commented on the Bill.

**Position of major interest groups**

**Consumer advocates**

In their submissions to Treasury in response to the proposals paper, consumer advocates such as Choice and the Consumer Action Law Centre strongly supported the notion that the unfair contract protections be extended to insurance contracts. For instance, Choice stated:

> ... insurance is the ideal case study for why a prohibition on UCT should exist. General insurance contracts are often so complex that consumers need an additional layer of protection against harmful terms. Contracts extend over pages of information, few people read or understand them, and they

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36. The Treasury, *Extending unfair contract terms protections to insurance contracts*, op. cit.
38. The Treasury, *Extending unfair contract terms protections to insurance contracts*, op. cit.
contain complex terms which most people are unlikely to understand. As a consequence, consumers suffer detriment by having claims denied due to the mismatch between what they thought the policy covered and what was actually covered. Allowing insurance contracts to include provisions that are unfair leaves consumers open to exploitation. 41

**Insurers**

Generally speaking, insurers took a different view—arguing that the reform is unnecessary because the *Insurance Contracts Act* contains sufficient protections. According to Suncorp:

> ... it is essential [the reform] does not adversely impact the availability of affordable and accessible insurance products for our customers and the broader community. We want to ensure the reforms are workable, do not impose an unreasonable compliance burden, and do not result in the limitation of choice for consumers. 42

Similarly, the Insurance Council of Australia is concerned that the Bill ‘would operate more severely, and create far more uncertainty, than the general UCT regime ... does for other sectors of the economy’. 43

Specific comments by stakeholders in relation to the amendments contained in Schedule 1 to the Bill are canvassed under the heading ‘Key issues and provisions’ below.

**Financial implications**

According to the Explanatory Memorandum the measures in Schedule 1 ‘have no financial impact’. 44

In relation to compliance costs for insurers, ‘it is estimated that there will be upfront costs of under $4 million in the first year to implement the reform with no ongoing costs’. 45

**Key issues and provisions**

**Amending the Insurance Contracts Act**

Currently subsection 15(1) of the *Insurance Contracts Act* provides that a contract of insurance is not capable of being made the subject of relief under any other Act of the Commonwealth, a state or a territory. Subsection 15(2) makes it clear that the ‘relief’ referred to in subsection 15(1) is by way of judicial review of a contract on the ground that it is harsh, oppressive, unconscionable, unjust, unfair or inequitable or relief for insureds from the consequences in law of making a misrepresentation.

**Item 9** of Schedule 1 to the Bill amends subsection 15(2) so that relief under the *ASIC Act* under the unfair contract terms provisions is available.

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41. Choice, Submission to Treasury proposals paper, Extending unfair contract terms protections to insurance contracts, 23 August 2018, p. 1; Consumer Action Law Centre, Submission to Treasury proposals paper, Extending unfair contract terms protections to insurance contracts, 24 August 2018, p. 1.
42. Suncorp, Submission to Treasury proposals paper, Extending unfair contract terms protections to insurance contracts, 24 August 2018, p. 1.
45. Ibid.
Amending the ASIC Act

Application to insurance contracts

Items 2–5 of Schedule 1 to the Bill amend Subdivision BA of Division 2 of Part 2 of the ASIC Act which is about unfair contract terms. Currently section 12BF(1) operates so that a term of a consumer contract or small business contract is void if:

- the term is unfair
- the contract is a standard form contract and
- the contract is a financial product or a contract for the supply, or possible supply, of services that are financial services.

The contract continues to bind the parties if it is capable of operating without the unfair term. Item 2 of Schedule 1 to the Bill adds a note after section 12BF to make clear that the section applies to insurance contracts under the Insurance Contracts Act.

Terms that are unaffected

Currently subsection 12BI(1) of the ASIC Act provides that a term of a contract will not be an unfair term (in the context of section 12BF) if:

- it defines the main subject matter of the contract
- sets the upfront price payable under the contract or
- is a term required, or expressly permitted, by a law of the Commonwealth or a state or territory.

Key issue—main subject matter

Item 4 of Schedule 1 to the Bill inserts proposed subsection 12BI(4) into the ASIC Act so that the main subject matter of a contract is a description of what is being insured. This is consistent with the recommendation of the Hayne RC that the definition of the main subject matter of a contract should be drafted narrowly, as the purpose of extending the UCT regime to insurance contracts would be undermined if a broader definition were adopted.

According to the Insurance Council of Australia:

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46. ASIC Act, subsection 12BF(3) provides that a consumer contract is a contract at least one of the parties to which is an individual whose acquisition of what is supplied under the contract is wholly or predominantly an acquisition for personal, domestic or household use or consumption.

47. ASIC Act, subsection 12BF(4) provides that a contract is a small business contract if: (a) at the time the contract is entered into, at least one party to the contract is a business that employs fewer than 20 persons and (b) either (i) the upfront price payable under the contract does not exceed $300,000 or the contract has a duration of more than 12 months and the upfront price payable under the contract does not exceed $1,000,000.

48. ASIC Act, subsection 12BF(2).

49. A contract of insurance offers protection against the consequences arising from the occurrence of an event specified in the contract (the risk). In effect, therefore, a contract of insurance insures the interests of the insured in the subject matter of the insurance. See, for instance: Costellain v Preston (1883) 11 QBD 380, per Bowen LJ at p 397. The subject matter of the insurance may be a physical item such as a house or a car; it may be a chose in action (which is a contractual or proprietary right enforceable by action) such as a debt, contractual right or licence; it may be a potential legal liability such as one road-user's potential liability to other road-users for damage or injury caused by the former's negligence; or, as in the case of life, accident or sickness insurance it may be a person. Source: CCH Limited, Australian & New Zealand insurance commentary at ¶I-410.

With this narrow definition, the terms of an insurance contract setting out the risks covered would be reviewable, and the insurer would be required to justify why they are necessary to protect their legitimate interests … the terms describing the risk an insurer covers (which is used as a basis for determining the premiums charged by insurers) goes to the commercial bargain at the heart of the contract and are necessary to protect the interests of the insurer. Being required to justify the specified cover in the insurance policy is more onerous than what is required in other sectors. For example, a cleaning service is not required under the existing UCT regime to justify terms setting out areas that it will and will not clean. The failure to exclude from review terms in insurance contracts relating to the risks an insurer will and will not cover causes significant uncertainty. The scope of application of the proposed UCT regime in the draft Bill and impact of the uncertainty created by this scope on insurers will be significant, and will be passed on to consumers.  

Key issue—upfront price payable

Item 3 of Schedule 1 to the Bill amends section 12BI so that a term of an insurance contract will not be unfair (within the terms of section 12BF) if the term is a transparent term that:

- is disclosed at or before the time the contract is entered into and
- sets an amount of excess or deductible under the contract.  

The question of whether the amount of an excess or deductible should come within the unfair contract terms regime was strongly contested. In particular, the Financial Rights Legal Centre provided a number of examples of car insurance policies in its submission to Treasury’s proposals paper. The Financial Rights Legal Centre sought to demonstrate that car insurance policies often contain ‘complex and confusing excesses’.  

The rationale for the examples was:

Firstly the excess payable is not usually one single excess. The excess payable is regularly made up of multiple, complex excesses at different rates, so that it is not clear what the quantum of excess actually is upfront.

Secondly, the “basic excess” may be highlighted upfront but additional excesses are rarely if ever highlighted. This emphasising of the “basic excess” over all applicable and potential excesses is misleading. There is very little transparency with additional excesses, largely invisible to consumers. A customer must search for them and know to click on a number of links and know to read further documents to find out the full information and potential excess quantum.

Thirdly, the circumstances in which an excess is payable are not straightforward and are structured in complicated ways so that it is not clear upfront when an excess will be paid. To understand the way the excesses work, the customer must go digging in the Product Disclosure Statement (or other documents).

However, according to Suncorp ‘[t]erms that describe different excess options provide customers with choice, and therefore should not be reviewable’.  

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51. Insurance Council of Australia, Submission to Treasury exposure draft, Extending unfair contract terms protections to insurance contracts, op. cit., pp. 1–2.
52. ASIC Act, proposed paragraph 12BI(1)(d) inserted by Item 3 of Schedule 1 to the Bill.
54. Ibid., p. 29.
55. Suncorp, Submission to Treasury exposure draft, Extending unfair contract terms protections to insurance contracts, op. cit., p. 5.
Excluded policies
Currently section 12BL of the ASIC Act lists those matters which are not covered by Subdivision BA of Division 2 of Part 2 and so are not subject to the unfair contract terms provisions. Item 5 of Schedule 1 to the Bill inserts proposed subsection 12BL(1A) into the ASIC Act to also exclude a contract of insurance for medical indemnity cover (as described in section 5 of the Medical Indemnity (Prudential Supervision and Product Standards) Act 2003) for a medical practitioner or registered health professional to which that Act applies.

Third party beneficiaries
Item 6 of Schedule 1 to the Bill amends the ASIC Act to insert proposed paragraphs 12GND(1)(c) and 12GND(2)(c) in equivalent terms so that a court may declare a term of a consumer contract or a small business contract respectively to be unfair on an application by a person who is a third party beneficiary under the contract.

Application
Items 7 and 10 of Schedule 1 to the Bill insert application provisions which operate so that the amendments apply only in relation to a contract of insurance entered into, renewed or varied on or after 5 April 2021.

Funeral expenses facilities
The interim report of the Hayne RC identified a number of issues with funeral insurance—in particular the sale of funeral insurance products to Aboriginal and Torres Strait Islander people.

Recommendation 4.2 – Removing the exemptions for funeral expenses policies
The law should be amended to:

- remove the exclusion of funeral expenses policies from the definition of ‘financial product’
- put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.

Nature of funeral insurance
There are two kinds of funeral insurance: funeral life insurance and funeral expenses insurance.

- A consumer buying funeral life insurance nominates a benefit amount (typically between $5,000 and $20,000) payable, on the death of the nominated life, to a person nominated by the policy holder. The recipient may apply the benefit as the recipient thinks fit. By contrast, funeral expenses insurance will

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56. Medical Indemnity (Prudential Supervision and Product Standards) Act, section 4 defines a medical practitioner as an individual registered or licensed as a medical practitioner under a state or territory law that provides for the registration or licensing of medical practitioners.

57. Medical Indemnity (Prudential Supervision and Product Standards) Act, section 4 provides that an individual is a registered health professional if they practise a health care related vocation; and they are registered under a state or territory law to practise that vocation.


pay funeral costs up to a nominated limit. Often the funeral expenses will be less (sometimes much less) than the nominated limit of cover.  

Both funeral life policies and funeral expenses policies are life policies under the Life Insurance Act 1995 and contracts of life insurance under the Insurance Contracts Act.

Importantly, the consumer protection provisions in the Corporations Act 2001 do not currently apply to funeral expenses policies. This means that issuers of funeral expenses insurance are not required to comply with the general obligations of financial services licensees to ‘do all things necessary to ensure that the financial services they provide are provided efficiently, honestly and fairly’. 

**Background to the recommendation**

In its submission to the Hayne RC, ASIC stated that its work suggests that funeral expenses policies are especially prone to poor selling practices.

The Hayne RC took evidence about both types of funeral insurance. The final report states:

… statistics gathered by ASIC as at 30 June 2014 suggest that funeral insurance policies sold directly to consumers are of little value. Those statistics indicate that at that time, there were about 430,000 policies covering about 740,000 insured lives. In the 2014 financial year, more than 12,500 claims were accepted by insurers. The amount paid out in claims was about one-third of the value of premiums collected over the same period. In the preceding year, the proportion was one-fifth.

**Policy position of non-government parties**

**Greens**

It is expected that the Australian Greens (the Greens) will support this aspect of the Bill. Senator Rachel Siewert acknowledged that during the Royal Commission there was ‘sickening evidence of companies targeting regional and remote areas for funeral insurance’ and has urged the Government to:

… act quickly to remove the exclusion of funeral expenses policies from the definition of ‘financial product’, so that they are properly regulated and put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.

**Position of major interest groups**

At the time of writing this Bills Digest, stakeholders had not commented on this element of the Bill.

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64. R Siewert (Australian Greens Senator for Western Australia), Industry that has preyed on vulnerable people must pay up, media release, 5 February 2019.
Financial implications

According to the Explanatory Memorandum the measure in Schedule 2 of the Bill has ‘no financial impact’ on the Government. Further, the measure ‘will result in low increases to compliance costs’.

Key issues and provisions

Amending the Corporations Act

Chapter 7 of the Corporations Act is about financial services and markets. The objects of Chapter 7 are, amongst other things, to promote:

- confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services
- fairness, honesty and professionalism by those who provide financial services and
- fair, orderly and transparent markets for financial products.

Defining what is not a financial product

Section 761A defines the term funeral benefit as a benefit that consists of the provision of funeral, burial or cremation services, with or without the supply of goods connected with such services. A funeral benefit is not a financial product.

In addition, paragraph 765A(1)(y) of the Corporations Act provides that a facility, interest or other thing declared by regulations for the purposes of the subsection is not a financial product. Currently, section 7.1.07D of the Corporations Regulations 2001 defines a funeral expenses policy as a scheme or arrangement for the provision of a benefit consisting of the payment of money, payable only on the death of a person, for the sole purpose of meeting the whole or part of the expenses of, and incidental to the person’s funeral and burial or cremation. The Regulation makes clear that a funeral expenses policy is not a financial product.

That being the case, providers of funeral expenses policies:

- do not have to obtain an Australian financial services licence
- are not bound by the general conduct obligations contained in section 912A of the Corporations Act and
- are not restrained by the anti-hawking provisions in sections 992A and 992AA of the Corporations Act.

Repealing the Regulation

The Treasury Laws Amendment (Financial Services Improved Consumer Protection) (Funeral Expenses Facilities) Regulations 2019 repeals section 7.1.07D of the Corporations Regulations with effect from 1 April 2020.
What the Bill does
As the definition of funeral expenses policy will be repealed when section 7.1.07D of the Corporations Regulations is repealed, item 3 of Schedule 2 to the Bill inserts an updated version of the definition of the term funeral expenses facility into section 761A. The term means a scheme or arrangement for the provision of benefits consisting of the payment of money, on the death of a person, for the purpose of meeting the whole or a part of the expenses of and incidental to the funeral, burial or cremation of the person.

For clarity, item 4 of Schedule 2 to the Bill inserts proposed section 765B into the Corporations Act to specify that a funeral expenses facility is not a funeral benefit. 69

Amending the ASIC Act
Similarly item 1 of Schedule 2 to the Bill inserts proposed subsection 12BAA(10) into the ASIC Act to provide that a funeral expenses facility is not a funeral benefit for the purposes of that Act.

Operation of the amendments
The amendments to the Corporations Act essentially remove the exemption currently existing which operates so that providers of funeral expenses policies are not required to comply with certain obligations in Chapter 7.

Currently paragraph 12BAA(8)(o) of the ASIC Act provides that funeral benefits are not financial products. This means that they are not subject to the consumer protection provisions in Division 2 of Part 2 of that Act. The amendment to the ASIC Act distinguishes the difference between a funeral expenses facility and a funeral benefit and makes clear that they are not the same.

Mortgage brokers

About mortgage brokers and aggregators
Mortgage brokers act as an intermediary by matching borrowers to lenders (and their loan products), assisting and advising borrowers on the loan application process and negotiating interest rates on home loans. Mortgage brokers engage in credit activities. That being the case, mortgage brokers are regulated by ASIC under the Consumer Credit Act and must either hold an Australian credit licence (ACL) or be an authorised credit representative of a mortgage aggregator (or any other entity) that holds an ACL. 70

Mortgage aggregators act between mortgage brokers and lenders by providing mortgage brokers with access to the lenders on its aggregator’s ‘panel’. Aggregators have contractual arrangements with lenders which allow brokers operating under the aggregator to arrange loans from those lenders. Mortgage aggregators engage in credit activities by acting as an intermediary and must hold an ACL. 71

69. Item 2 in Schedule 2 to the Bill inserts a note in equivalent terms at the end of the definitions in section 761A of the Corporations Act.
70. Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Some features of the Australian mortgage broking industry, Background paper 2, 2018, p. 5.
How mortgage brokers are paid

Mortgage brokers and mortgage aggregators generally do not charge borrowers directly for their services. Instead, most brokers’ income is derived from commissions:

- the first form of commission paid by lenders is an upfront commission. This is generally a once-off payment after settlement and based on a proportion of the settled amount, drawn amount or the approved limit.\(^{72}\)
- the second form of commission paid by lenders is a trail commission. This is a regularly recurring commission based on a proportion of the current or average loan balance.\(^{73}\)

In 2017, ASIC published the results of its review of the mortgage broking market. The review was undertaken to determine the effect of extant remuneration structures on the quality of consumer outcomes.\(^{74}\) According to that report:

In 2015, based on data we received from aggregators, the average rate of upfront commission and annual rate of trail commission paid by lenders to aggregators was 0.62% and 0.18%, respectively. On a $500,000 home loan, this equates to an upfront payment of $3,100 and a trail payment of $75 per month (or $900 in the first year of the home loan).

The average rate of upfront commission and annual rate of trail commission passed on by aggregators to broker businesses was 0.54% and 0.14%, respectively. On a $500,000 home loan, this equates to an upfront payment to the broker business of $2,700 and a trail payment of $58 per month (or $700 in the first year of the home loan).\(^{75}\)

Risks of mis-selling

In 2017, Stephen Sedgwick AO undertook an independent review of product sales commissions and product based payments in retail banking in Australia. The review was commissioned by the Australian Bankers’ Association.\(^{76}\) The final report of the review (the Sedgwick Review) noted several factors which pointed to significant risks of mis-selling arising from the existing arrangements to remunerate mortgage brokers.\(^{77}\) These include, but are not limited to:

- that banks seeking to increase market share through a sales campaign often improve both the terms and conditions they offer the borrower and the commission they pay the mortgage broker
- that some banks believe they need to offer volume based incentives to mortgage brokers over and above the upfront and trail commissions to remain competitive
- many banks believe they need to offer significant ‘soft dollar’ payments to mortgage brokers\(^{78}\)
- data presented show that mortgages arranged through the broker channel are likely to be larger, paid off more slowly, and more likely to be interest-only loans than those provided to equivalent customers who dealt directly with bank staff and

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\(^{72}\) Ibid., p. 241.
\(^{73}\) Ibid.
\(^{74}\) Ibid.
\(^{75}\) Ibid., p. 76.
\(^{76}\) Australian Banking Association, Review into retail banking remuneration begins, media release, 11 July 2016.
\(^{78}\) ASIC states that the main types of ‘soft dollar’ benefits are loyalty programs (much like an airline frequent flyer program); and travel and hospitality-related benefits. See: ASIC, Review of mortgage broker remuneration, op. cit., p. 12.
• a few banks had changed (or were intending to change) trail commission arrangements because some customers draw down a larger loan amount than they need, with the surplus being deposited in an offset account or a loan account (that is as a redraw amount). 79

Who does a mortgage broker work for? According to the Hayne RC an intermediary is ‘paid only by the lender’. 80

... in most cases, even if an intending borrower believes or expects the intermediary to be acting in the interests of the borrower, the intermediary owes no general duty to the borrower to seek out the best and most appropriate deal for the borrower ... 81 [emphasis added]

**Recommendation 1.2 – Best interests duty**
The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision. 82

**Recommendation 1.3 – Mortgage broker remuneration**
The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending. Changes in brokers’ remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers. 83

**Government response**
In February 2019, the Government issued its formal response to the recommendations of the Hayne RC. 84 In relation to recommendation 1.2, it stated:

The Government agrees to introduce a best interests duty for mortgage brokers to act in the best interests of borrowers ... The Government also agrees that a breach of the best interests duty should be subject to a civil penalty. The Government agrees, following the implementation of the best interests duty, to further align the regulatory frameworks for mortgage brokers and financial advisers. This also responds to the Productivity Commission’s report *Competition in the Australian Financial System*, which also recommended imposing a best interests duty on mortgage brokers ... 85 [emphasis added]

In relation to recommendation 1.3, it stated:

The Government agrees to address conflicted remuneration for mortgage brokers ... From 1 July 2020, the Government will prohibit for new loans the payment of trail commissions from lenders to mortgage brokers and aggregators. From that date, the Government will also require that the value of upfront commissions be linked to the amount drawn-down by borrowers and not the loan amount, and ban

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81. Ibid., pp. 57–58.
83. Ibid., p. 80.
85. Ibid., p. 6.
campaign and volume-based commissions and payments. The Government will additionally limit to two years the period over which commissions can be clawed back from aggregators and brokers and prohibit the cost of clawbacks being passed on to consumers.\footnote{Ibid., p. 7.}

**Policy position of non-government parties/independents**

At the time of writing this Bills Digest no comments had been made in relation to the Bill by members of non-government parties or independents.

**Position of major interest groups**

The Property Council of Australia expressed concern about the proposed ban on conflicted remuneration stating:

\begin{quote}
The proposed alignment of the regulatory framework for mortgage brokers with that of financial advisers may impact on the future structure of the industry and access to finance.\text{" The property industry will need to be consulted on the transitional arrangements, particularly given the current uncertain state of the residential property cycle. It is important not to break the economy as policy makers set about fixing the banks. The abolition of trail commissions and the proposed shift in future to a ‘borrower pays’ model for broker commissions will need to be very carefully managed.\footnote{Ibid., p. 7.}

Following the Government’s announcement that it had accepted the Hayne RC’s recommendation to ban trail commissions, the Australian Finance Group called on the local industry to back a campaign against a blanket ban on broker commissions paid by lenders.\footnote{G Tauriello, ‘Brokers vow to oppose reforms’, The Advertiser, 9 February 2019, p. 28.}

It has since been reported that ‘brokers and consumer groups support the new duty in principle, but are at loggerheads over how broadly the duty should extend, and the size of penalties for breaching it’.\footnote{C Yeates, ‘Stoush heats up on mortgage brokers’ best interest duty’, The Age, 7 October 2019, p. 28.}

**Financial implications**

According to the Explanatory Memorandum the measures in Schedule 3 have ‘no financial impact’.\footnote{Explanatory Memorandum, Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019, p. 4.}

However, it is estimated that the measures will have the following compliance costs:

- recommendation 1.2 (mortgage broker best interests duty)—$58.2 million a year for business and $10.2 million a year for individuals/consumers and
- recommendation 1.3 (broker remuneration)—$18.9 million a year for business.\footnote{Ibid., p. 5.}

**Key issues and provisions**

**Operation of the Corporations Act**

The Corporations Act imposes two important obligations on holders of an Australian Financial Licence and their representatives.

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86. Ibid., p. 7.
89. C Yeates, ‘Stoush heats up on mortgage brokers’ best interest duty’, The Age, 7 October 2019, p. 28.
91. Ibid., p. 5.
First, a person who provides personal advice to a retail client must act in the best interests of the client in relation to the advice. They must only give advice if it is reasonable to assume that the advice is appropriate for the client and, if there is a relevant conflict, they must give priority to the interests of the client. However, these provisions do not currently apply to mortgage brokers.

Second, a financial services licensee must not receive conflicted remuneration. Section 963A of the Corporations Act defines conflicted remuneration as any benefit (whether monetary or non-monetary) given to a financial services licensee or a representative of the licensee, who provides financial product advice to persons as retail clients, that, because of the nature of the benefit or the circumstances in which it is given, could have either of two effects:

- it could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients or
- it could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

Schedule 3 to the Bill amends the Consumer Credit Act to:

- require mortgage brokers to act in the best interests of consumers and
- prohibit mortgage brokers and mortgage intermediaries accepting conflicting remuneration.

**Amendments to the Consumer Credit Act**

For the purposes of the Consumer Credit Act a licensee is a mortgage broker if all of the following are satisfied:

- the licensee carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property
- the licensee does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts and
- in carrying on the business, the licensee provides credit assistance in relation to credit contracts offered by more than one credit provider.

A credit representative of a licensee is a mortgage broker in equivalent circumstances.

A licensee is a mortgage intermediary if all of the following are satisfied:

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92. Corporations Act, subsection 961B(1).
93. Corporations Act, section 961G.
94. Corporations Act, section 961J.
95. The provisions in the Corporations Act about providing financial product advice to retail clients do not apply to giving advice about a residential home loan. Those provisions do not apply because a mortgage that secures obligations under a credit contract (not otherwise expressly included by operation of some particular sections of Chapter 7 of the Corporations Act) is not a ‘financial product’ for the purposes of Chapter 7 of that Act. That being the case, making a recommendation or stating an opinion about a mortgage is not giving ‘financial product advice’. Nor is it considered to be personal advice, even though the broker would be expected to consider the borrower’s objectives, financial situation and needs. It follows that the best interests duty that the Corporations Act imposes on those who provide personal advice to a retail client does not apply to a mortgage broker. Source: Hayne, Final report: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, op. cit., pp. 62–63.
96. Corporations Act, section 963E.
97. National Consumer Credit Protection Act 2009, (Consumer Credit Act), proposed section 158K inserted by item 5 of Schedule 3 to the Bill.
98. Consumer Credit Act, proposed subsection 158(1) inserted by item 4 of Schedule 3 to the Bill.
99. Consumer Credit Act, proposed subsection 158(2).
• the licensee carries on a business of acting as an intermediary in relation to credit contracts secured by mortgages over residential property

• the licensee does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts and

• in carrying on the business, the licensee acts as an intermediary in relation to credit contracts offered by more than one credit provider. ¹⁰⁰

A credit representative of a licensee is a mortgage intermediary in equivalent circumstances. ¹⁰¹

**Best interests obligation**

**Item 5 of Schedule 3 to the Bill inserts proposed Part 3-5A—Mortgage brokers and mortgage intermediaries into the Consumer Credit Act.**

**Credit assistance by a licensee to a consumer**

Proposed sections 158L–158LB of the Consumer Credit Act apply where credit assistance is given to a consumer by a licensee who is a mortgage broker. ¹⁰²

In that case, the licensee must act in the best interests of the consumer in relation to the credit assistance. A failure to do so incurs a maximum civil penalty of 5,000 penalty units. ¹⁰³

Further, if the licensee knows, or reasonably ought to know, that there is a conflict between the interests of the consumer and the interests of the licensee, an associate ¹⁰⁴ or representative of the licensee or an associate of a representative of the licensee, the licensee must give priority to the consumer’s interests when providing the credit assistance. ¹⁰⁵ A failure to do so incurs a maximum civil penalty of 5,000 penalty units.

**Credit assistance by a credit representative to a consumer**

Proposed sections 158LD–158LF of the Consumer Credit Act apply to credit assistance that is provided to a consumer by a credit representative of a licensee—provided that either the credit representative or the licensee is a mortgage broker. ¹⁰⁶

In that case the following rules apply:

• the credit representative must act in the best interests of the consumer in relation to the credit assistance ¹⁰⁷

• the licensee must take reasonable steps to ensure that the credit representative acts in the best interests of the consumer ¹⁰⁸

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100. Consumer Credit Act, proposed subsection 15C(1) inserted by item 4 of Schedule 3 to the Bill.
101. Consumer Credit Act, proposed subsection 15C(2).
102. Consumer Credit Act, proposed subsection 158L(1).
103. Consumer Credit Act, proposed subsection 158LA. The Crimes Act 1914, section 4AA provides that a penalty unit is equivalent to $210. This means the maximum penalty is $1,050,000.
104. Consumer Credit Act, proposed section 15A (inserted by item 4 of Schedule 3 to the Bill) provides that if a person is associated with a credit provider for the purposes of the National Credit Code the person is an associate of the credit provider; and the credit provider is an associate of the person. Otherwise, the person is an associate of another person in the circumstances prescribed by the regulations. The National Credit Code is set out at Schedule 1 to the Consumer Credit Act.
105. Consumer Credit Act, proposed section 158L.
106. Consumer Credit Act, proposed section 158LD.
107. Consumer Credit Act, proposed subsection 158LE(1).
108. Consumer Credit Act, proposed subsection 158LE(2).
• the credit representative must give priority to the consumer’s interests when providing the credit assistance if he or she, knows, or reasonably ought to know, that there is a conflict between the interests of the consumer and the interests of:
  – the licensee
  – an associate of the licensee
  – the credit representative
  – an associate of the credit representative
  – another representative of the licensee or
  – an associate of another representative of the licensee\(^{109}\) and
• the licensee must take reasonable steps to ensure that the credit representative gives priority to the consumer’s interests as above.\(^{110}\)

A maximum civil penalty of 5,000 penalty units applies for a breach of each of those rules.

**Conflicted remuneration**

**Nature of conflicted remuneration**

For the purposes of the Bill *conflicted remuneration* means any benefit, whether monetary or non-monetary that is given to a licensee, or a representative of a licensee where the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the credit assistance provided to consumers. An equivalent definition applies to a benefit that is given to a licensee, or a representative of a licensee, who acts as an intermediary.\(^{111}\)

In addition, regulations may further define the circumstance in which a benefit is, or is not, conflicted remuneration.\(^{112}\)

**Ban on accepting conflicted remuneration**

The Bill prohibits the following persons from accepting conflicted remuneration in circumstances prescribed by the regulations:

• a licensee who is a mortgage broker, or a mortgage intermediary\(^{113}\) and
• a credit representative of a licensee—if the credit representative or the licensee is a mortgage broker or a mortgage intermediary.\(^{114}\)

A breach of the prohibition attracts a maximum civil penalty of 5,000 penalty units.

In addition, a licensee must take reasonable steps to ensure that the credit representative complies with the ban on accepting conflicted remuneration. A failure to comply with that requirement attracts a maximum civil penalty of 5,000 penalty units.\(^{115}\)

**Ban on giving conflicted remuneration**

The Bill bans the giving of conflicted remuneration in circumstances prescribed by the regulations:

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110. *Consumer Credit Act*, proposed subsection 158LF(2).
111. *Consumer Credit Act*, proposed section 158N.
112. *Consumer Credit Act*, proposed section 158NA.
113. *Consumer Credit Act*, proposed section 158NB.
114. *Consumer Credit Act*, proposed subsection 158NC(1).
115. *Consumer Credit Act*, proposed subsection 158NC(2).
• by the employer of a licensee to the licensee—if the licensee is a mortgage broker or a mortgage intermediary\textsuperscript{116}
• by the employer of a representative of a licensee to the representative—if either the licensee or the representative is a mortgage broker or a mortgage intermediary\textsuperscript{117}
• by a credit provider to a licensee—if the licensee is a mortgage broker or a mortgage intermediary\textsuperscript{118}
• by a credit provider to a representative of a licensee—if either the licensee or the representative is a mortgage broker or a mortgage intermediary\textsuperscript{119}
• by a mortgage intermediary to a licensee who is a mortgage broker or a mortgage intermediary\textsuperscript{120}
• by a mortgage intermediary to a representative of a licensee—if either the licensee or the representative is a mortgage broker or a mortgage intermediary.\textsuperscript{121}

In each case a failure to comply with the ban attracts a maximum civil penalty of 5,000 penalty units.

**Scrutiny of Bills Committee**

The Scrutiny of Bills Committee expressed concern that the circumstances in which the proposed bans on conflicted remuneration will apply will be set out in regulations.\textsuperscript{122}

The Committee also noted that the amendments to the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009*, (inserted by item 6 in Schedule 3 to the Bill) would operate so that the regulations could prescribe circumstances in which the whole of Division 4 of new Part 3-5A of the *Consumer Credit Act* (which is about conflicted remuneration) applies, or does not apply, to a benefit given to a licensee. In effect this could mean that the ban on receiving and giving conflicted remuneration could be negated.

The Scrutiny of Bills Committee noted the statement in the Explanatory Memorandum:

> The ability to prescribe by regulation what is and is not conflicted remuneration provides flexibility for the regime to efficiently and effectively respond to changes in industry practice and to ensure that the new regime operates for the benefit of consumers. Regulations also give effect to the ban on conflicted remuneration. This provides flexibility to provide the circumstances in which conflicted remuneration is banned.\textsuperscript{123}

However, the Committee was of the view that ‘the need for flexibility does not, of itself, provide an adequate justification for leaving significant matters to delegation legislation. In this instance, it is unclear why these matters cannot be included on the face of the primary legislation’.\textsuperscript{124}

\textsuperscript{116} *Consumer Credit Act*, proposed subsection 158ND(1).
\textsuperscript{117} *Consumer Credit Act*, proposed subsection 158ND(2).
\textsuperscript{118} *Consumer Credit Act*, proposed subsection 158NE(1).
\textsuperscript{119} *Consumer Credit Act*, proposed subsection 158NE(2).
\textsuperscript{120} *Consumer Credit Act*, proposed subsection 158NF(1).
\textsuperscript{121} *Consumer Credit Act*, proposed subsection 158NF(2).
\textsuperscript{122} Senate Standing Committee for the Scrutiny of Bills, *Scrutiny digest*, 10, 2019, op. cit., p. 6.
Accordingly, the Scrutiny of Bills Committee has requested advice from the Minister. However, at the time of writing this Bills Digest no response from the Minister has been published.

**Anti-avoidance**

The Bill provides that a person must not, either alone or together with one or more other persons, enter into, begin to carry out or carry out a scheme if the sole purpose or a non-incidental purpose of the scheme is to avoiding the application of any provision in new Part 3-5A of the *Consumer Credit Act*. The maximum penalty for a breach of this section is 5,000 penalty units.

**Concluding comments**

The Bill largely puts in place various recommendations of the Hayne RC—with one exception. The broad power to make regulations about what is, or is not *conflicted remuneration* and the circumstances in which conflicted remuneration must not be accepted or given could seriously undermine the intention of recommendation 1.3 of the Hayne RC.

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125. *Consumer Credit Act*, proposed section 158T.